

## SYNDICATED LENDING: LAW ENFORCEMENT AND LEGISLATIVE REFINEMENTS\*

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### Abstract

**Subject.** This article focuses on the development of the syndicated lending institution as the respective legal framework emerges.

**Objectives.** The article aims to consider problems of the development of syndicated lending in Russia and describe the main areas for further changes in the legal regulation.

**Methods.** For the study, I used logical and structural analyses, and functional analysis system and legalistic approaches.

**Results.** The article describes the essence, features and legal regulation of syndicated lending, and evaluates enforcement practices based on the new syndicated loan law. It also formulates key issues and identifies further areas for changing the legal regulation of syndicated lending.

**Conclusions.** The development of syndicated lending can significantly support large and medium-sized businesses in terms of job preservation, tax revenue growth, and business competitiveness. The findings can contribute to the theory of syndicated lending in the Russian Federation, and practical activities to suggest possible legislative and regulatory improvements in this area.

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Looking back into the past 2020, there is no doubt that it brought such a new global challenge that every economy around the world, including the Russian one, had to face. Gliding into our life, *the black swan* called COVID-19 made not only revise forecasts for many sectors, but urgently search for effective mechanisms for adapting to the new reality. As key economic indicators were going down, with the stagnating industrial sector and the escalating difficulties in the financial market, the government has to revisit the existing economic development models. As a priority of their new national policy, governments should both support the financing of crucial infrastructure projects and encourage financial institutions to grant credits to the real economy. There should seemingly be refined lending models and new mechanisms in place that would make the *long-term* and *cheap* money more accessible for the Russian business,

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as well as the assistance in refinancing open credit obligations. Such measures are intended to prevent a big wave of corporate bankruptcies, ensure the employment and eliminate the massive downsizing risk. Furthermore, the tax base can be preserved and even increased by supporting active businesses, thus contributing to all the level of budgets in the Russian Federation. Syndicated lending is one of such mechanisms used internationally.

On February 1, 2018, the Russian government passed Federal Law On Syndicated Loan and Amendments to Some Legislative Acts of the Russian Federation, № 486-ФЗ of December 31, 2017 (hereinafter referred to as the Syndicated Loan Law). As the Syndicated Loan Law has been effective for three years already, we can sum up its regulatory effects. Evaluating the enforcement of the Syndicated Law Law, it is important to consider why syndicated loan clauses needed to be introduced into the Russian legislative framework. Comparing the initial ideas and expectations with the enforcement of the Syndicated Loan Law, we can reveal results, pending issues and further directions to follow in amending the legislative regulation of syndicated lending in the Russian Federation.

Although there was no comprehensive regulations of syndicated loans before 2018, similar transactions did virtually take place, developing and drawing upon common principles of the civil law and the banking laws. Furthermore, the English law principles were actively adopted, with the standards of the London Loan Mark Association (LMA) serving as guidelines [1]. However, the fact that Russia missed its own syndicated loan standards somewhat hampered the development of this practice. The 2008 global financial crisis made law-makers set to formulate the national regulations on syndicated lending, as considerable numbers of borrowers subject to the Russian jurisdiction had to restructure their credit obligations due to the above severe crisis. As foreign credit institutions slowed down their activity and borrowers had to restructure their loans through governmental guarantees, the English law was to be adapted to the relationships with the Russian agents solely.

Moreover, in fact there arose some additional legal risks, since the Russian courts were rather unpredictable in interpreting terms of contracts concluded under the English law. To illustrate this, I would refer to difficulties in applying foreign legal concepts, such as parallel debt, joint and several creditors. So, the court ruling required to include rights under the investment contract into the list of the borrower's creditors under the loan contract. The Arbitration Court for the Moscow District disagreed with conclusions the preceding institutions made and appointed a new hearing of the case. As court representatives explained, *conclusions of the court on the non-existence of the loan contract, no evidence of the parallel debt obligation and the term for their enforcement were based on the principles of the Russian Civil Law, while the contract between the parties were governed by the Austrian law*<sup>1</sup>.

As a result, the Russian law-makers actively set to formulate the Russian standards on syndicated lending in 2011. Working on the standards, they still intended to reform the civil laws by including principles which defined a syndicated loan as a type of credit relations with multiple creditors and separate obligations. In 2015, the Association of Regional Banks of Russia released a model syndicated loan contract under the Russian laws [2]. Notably that the Russian standards on syndicated lending were formulated just when there was a considerable drop in syndicated lending in the Russian Federation. The decrease resulted from sanctions and

<sup>1</sup> The Ruling of the Federal Arbitration Court for the Moscow District of November 25, 2011 on Case A40-62359/10-38-293Б. URL: <http://www.consultant.ru/cons/cgi/online.cgi?req=doc&base=AMS&n=151880#09101244667158224> (In Russ.)

restrictions imposed *inter alia* on the foreign capital influx into the Russian market. What is more, the LMA documentation still remained as the main guide on syndicated loans until the Syndicated Loan Law was adopted and came into force.

Hence, it was quite a reasonable and logic step to adopt a special law governing the practice of syndicated lending. As I see it, the law-makers mainly pursued not only to mitigate the overall legal risk and adapt the available international expertise on the issue, but also allow borrowers to increase the amount and term of their loans, reduce costs and time spent on transactions to be made, use mechanisms securing their obligations more effectively. The law draftsmen intended to create a significant factor contributing to the investment climate and giving an impetus to the investing activity.

The Syndicated Loan Law promulgates the legislative definition of a syndicated loan. Previous efforts to interpret the term were found only in documents of the Bank of Russia<sup>2</sup>. As per Article 2 of the Syndicated loan Law, *...under the syndicated loan contract, several creditors (hereinafter referred to as a syndicate of creditors) undertake to concertedly lend or grant a borrower on a free-hold basis monetary funds, with the respective amount and term being agreed in the syndicated loan contract on an individual basis, while the borrower undertakes to repay the monetary funds to the creditors, pay interests on the facility use and other charges, if they are stipulated in the above contract*<sup>3</sup>.

Referring to the legislative definition, we may think that this legal mechanism allows to conclude several diverse contracts as a single document called the *syndicated loan contract* [3]. For instance, a contract combines debtor's borrowing and other obligations to the creditors. Relying upon the syndicated loan contract, creditors acquire mutual rights to claim debts, and obligations subject to the model they choose to govern their relationships. What makes such models different is that who directly transacts with the borrower – a creditor as a representative of the others or all of them. L.A. Popkova defines such models as the syndicated loan model via the lead bank and the syndicated loan model without the led bank [4].

Part 2 and Part 3, Article 2 of the Syndicated Loan Law specifies agents of these relationships. The borrower can be a legal entity or a sole proprietor. In the mean time, would-be creditors are enlisted in a more detailed way. So, creditors can be:

- 1) credit institutions, State Corporation VEB.RF;
- 2) foreign banks, international financial organizations, foreign legal entities, whose jurisdictions permits them to conclude loan contracts;
- 3) non-governmental pension funds, managing companies of investment funds/unit investment trusts/non-governmental pension funds, special depositories of the investment fund/unit investment trust/non-governmental pension fund;
- 4) other Russian legal entities in the cases stipulated by the Syndicated Loan Law.

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<sup>2</sup> On Statutory Standards of Banks: instruction of the Bank of Russia of January 16, 2004 № 110-И (edited as of April 28, 2012) (the document is now null and void). URL: [http://www.consultant.ru/document/cons\\_doc\\_LAW\\_46534/](http://www.consultant.ru/document/cons_doc_LAW_46534/) (In Russ.)

<sup>3</sup> Syndicated Loan Law.

Analyzing the agents with respect to creditors providing syndicated loans, we can note some discrimination of the Russian legal entities as compared to companies from other jurisdictions. Law-makers virtually restricted the Russian companies from being creditors on the analyzable obligations by simply making the scheme accessible for companies operating in the financial market and holding necessary licenses. The above list misses non-credit financial institutions either, though being indispensable actors of the financing market [5]. There is still a hope that the law-makers will let non-credit financial institutions participate in syndicated loan deals by envisaging corresponding clauses in the special laws so that the above institutions could be qualified as *other legal entities in the cases stipulated by the federal law* [6].

However, the Syndicated Loan Law is more liberal to foreign companies, *which under their own laws are empowered to enter into loan contracts*. In this respect, we can agree with A.L. Chelyuskin, the Managing Director of the Presidential Administration, Chair of the Management Board of Bank VTB, stating that *the Russian legal entities were deliberately discriminated as compared to foreign agents of syndicated loan relationships* [7].

The Syndicated Loan Law provides a very brief guidance on the procedure and consequences in case such contracts are repudiated. According to the general rule enshrined in the law, creditors may withdraw from a syndicate. Nevertheless, the syndicated loan contract continues to be effective unless at least two creditors remain parties to it. The law fails to clearly regulate what should be done if the single creditor is left and the above creditor or the borrower are ready to perform their obligations. Concerning this issue, we can agree with the idea of O.P. Kazachenok, who suggests providing for the transformation of a syndicated loan contract into a simple loan contract, if there is a special clause for a case when the single agent is left in a syndicate. In such circumstances, the relationships of the creditor and the borrower and the syndicated loan contract should be governed by the principles of Chapter 42 of the Civil Code of the Russian Federation [8].

Although the Syndicated Loan Law has been in effect for three years already, it still misses clear clauses on the creditor rights' enforcement mechanism in case of the borrower's bankruptcy. The fact surely becomes another challenging aspect of the above law [9]. Federal Law, *On Insolvency (Bankruptcy)*, of October 27, 2002 № 127-ФЗ fails to entirely settle the volume of rights and obligations the agents of the above relations have in case of multiple creditors, which are related with additional contractual arrangements as part of the Syndicated Loan Contract they undertook to perform [10].

Currently, there is not a unanimous understanding whether syndicated loan documents may contain the information about the decline of some creditors' application to the court, soliciting to return overdue debts and recognize the borrower as a bankrupt, if such a right arises only upon the consent of the majority of creditors or it is conveyed to the credit administrator<sup>4</sup>. On the one hand, it would be reasonable to stipulate joint actions on a contractual basis in case of the borrower's insolvency. However, on the other hand, if the decline of the waiver of the court remedy right cause doubts how the court will consider such clauses of the contract [11].

<sup>4</sup>Belousov A.L. [Encouraging business initiatives in terms of the implementation of special investment contracts]. *Predprinimatel'skie initsiativy v proizvodstvennoi i pravovoi deyatel'nosti organizatsii: materialy kruglogo stola. Finansovyi universitet pri Pravitel'stve Rossiiskoi Federatsii* [Proc. Sci. Conf. Business Initiatives in Production and Legal Operations of the Entity. Financial University under the Russian Government]. Moscow, Dashkov i Ko Publ., 2018, pp. 14–17.

Another unregulated situation may take place if some creditor does get the right to apply to the court, soliciting to withhold their part of overdue debt from the borrower. In such circumstances, first, we can talk about the violation of the very gist of the syndicated loan, that is all creditors act jointly. Second, if the debt is withheld successfully, the creditor is still exposed to the risk of court requirements to return the funds to a pool of bankrupt's assets provided that the borrower bankruptcy proceedings are initiated [12].

Such issues can be resolved by introducing amendments to the Bankruptcy Law, so that the specifics of syndicated lending would be taken into consideration. Law-makers may choose two options to regulate creditors' rights in case of the debtor's insolvency under a syndicated loan [13]. As part of the first option, they may promulgate that the credit administrator holds the exclusive right to file an application to the court about the debtor's insolvency<sup>5</sup>. As part of the second option, each creditor may be conveyed the right to claim their respective portion of the debt on their own. The latter option was circulated in LMA standards [14].

In the mean time, speaking about regulatory gaps and loops of syndicated lending, which clearly stood out as the Syndicated Loan Law is enforced, positive results should also be mentioned. Hence, the *Project Finance Factory* was established under the aegis of the State Corporation VEB.RG in compliance with the Resolution of the Russian Government<sup>6</sup> and continue operating successfully. The institution is mainly designated to provide governmental assistance through mechanisms of syndicated lending to projects that are implemented in priority sectors of the Russian economy [15]. As for benefits from the above project, credit institutions mitigate their risk as they involve additional creditors, get entitled to use a special formula for assessing the capital adequacy, and make reserves for loans granted as part of the Project Finance Factory's activity<sup>7</sup>. Elvira Nabiullina, the Head of the Central Bank of Russia, mentioned this in her address at the online conference, stating that there are major borrowers, large entities that need credit funds, and, in her opinion, syndicated lending seems a very promising solution, though it is yet to be developed in the country. The allocation of risks among borrowers, risks diversified by creditors will help raise the amount of loans granted to major borrowers, without putting some financial institutions at stake<sup>8</sup>. Therefore, the creation of the institutional environment for the syndicated lending development can be viewed as a crucial driver of the national investment climate [16].

As a conclusion, I would note that it is an absolutely logic and correct step to regulate syndicated lending in the above manner in the Russian jurisdiction, since it contributes to the modern legislation that government credit relations and investing activity<sup>9</sup>. However, as seen for three years since the law has been enforced, the mechanism should be refined and specifically

<sup>5</sup> Golikova S.N. [The syndicated loan contract: Regulatory distinctions]. *Problemy razvitiya pravovoi sistemy Rossii: istoriya i sovremennost': materialy mezhuuzovskoi nauchno-prakticheskoi konferentsii* [Proc. Sci. Conf. Development Issues of the Russian Legislative System: The Past and the Present]. Tula, TulSU Publ., 2019, pp. 51–54.

<sup>6</sup> On the Program – The Project Finance Factory ( with the Rules for Federal Subsidies as Property Contributions of the Russian Federation to the State Corporation VEB.RF to Reimburse Lending Expenses as part of the Project Finance Factory: resolution of the Russian Government of February 15, 2018 № 158 (edited as of June 13, 2019).

<sup>7</sup> The special assessment formula for the capital adequacy and the formation of reserves for loans and credits granted as part of the Project Finance Factory: directive of the Bank of Russia of July 26, 2018 № 4874-У.

<sup>8</sup> The Speech of Elvira Nabiullina, the Head of the Bank of Russia, at the press-conference on May 22, 2020. URL: <http://www.cbr.ru/press/event/?id=6767#highlight=синдцированного%7Скредитования> (In Russ.)

configured by introducing amendments to the effective regulation. Most challenging issues can be addressed if we deny imperative principles, which prevail in the syndicated loan legislation to a certain extent, and opt for the freedom of the contract and dispositive method of legal regulation. The above quality is typical of the English law, which is now the main trend-setter in the syndicated lending regulation [17]. Amending the respective regulatory framework will contribute to the lucrativeness of the Russian jurisdiction and further growth of the national syndicated lending market. This issues get even more important as crises phenomena emerged in the Russian economic system that faced the pandemic-related restrictions and bans. In the current circumstances, the development of syndicated lending will substantially support medium-sized and large businesses. Subsequently, we may hope for the avoidance of downsizing, a growth in tax revenue to various budgets, and the higher competitiveness of the Russian business.

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<sup>9</sup> Emerov M. Yu. [The design of a syndicated loan in the Russian jurisdiction]. *Pravovaya kommunikatsiya gosudarstva i obshchestva: otechestvennyi i zarubezhnyi opyt: materialy mezhdunarodnoi nauchnoi konferentsii* [Proc. Int. Sci. Conf. The Legislative Communication of the State and the Public: The National and Foreign Practice]. Voronezh, Nauka-Yunipress Publ., 2020, pp. 386–391.

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