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Ambitions Unleashed

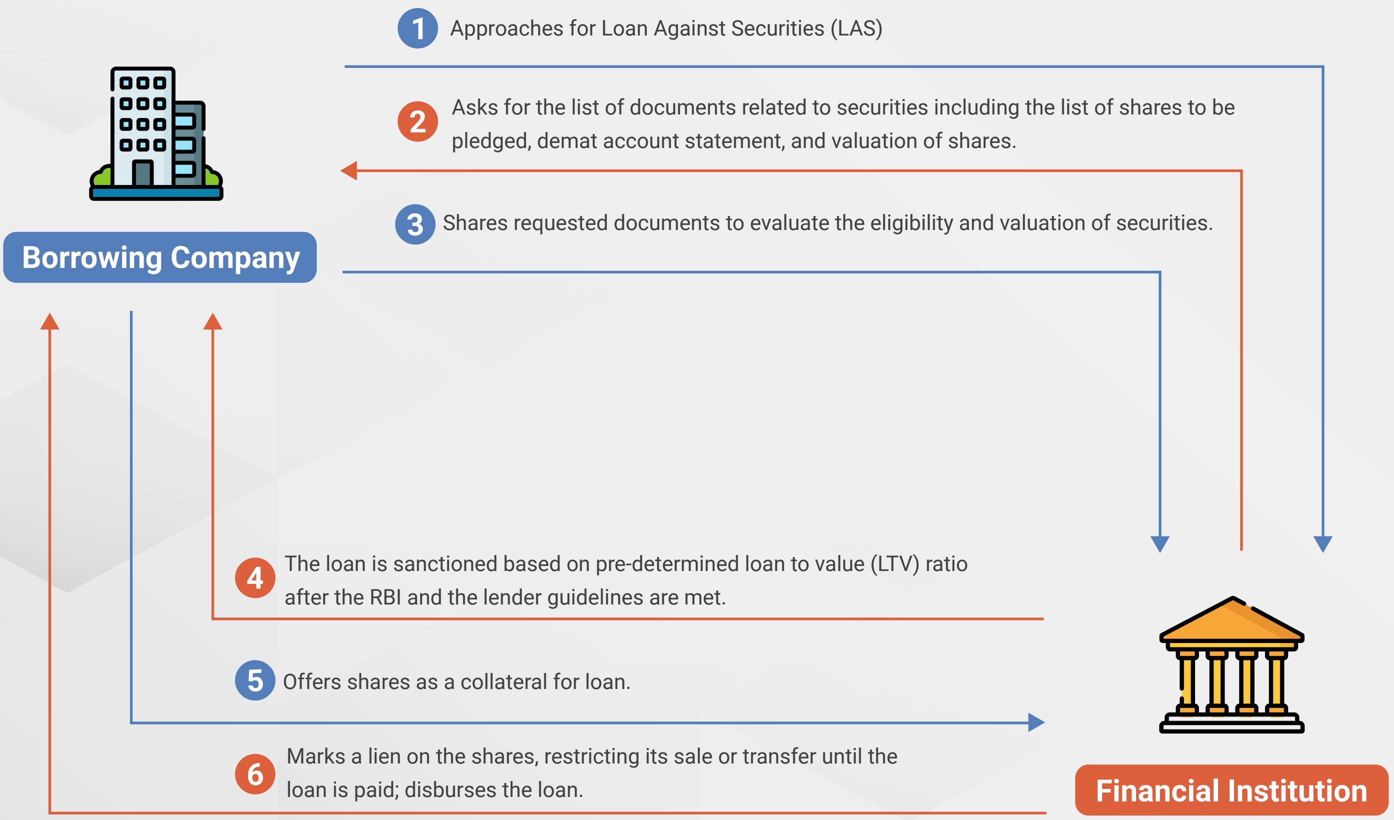
Understanding Loan Against Shares (LAS)

What is Loan Against Shares (LAS)?

Loan Against Shares (LAS) is a financial instrument that allows the company (borrower) to obtain credit by pledging their shares/securities as collateral. By leveraging the investments rather than liquidating them, the borrower continues to retain the ownership. The borrowing can be in the form of working capital demand loan (WCDL) or non-convertible debentures (NCDs), against the primary security of listed and / or unlisted shares.

A loan against shares is a secured borrowing, and the amount of loan is based on loan-to-value (LTV) ratio of the collateral securities. The repayment schedule can be fixed or flexible, with or without pre-payment features as per terms of the agreement. As the market value of shares can be volatile, the lending company may ask for additional collateral or top-up of more shares to maintain the LTV ratio.

How Does LAS Work?



Elements of LAS

Financial Institution

It refers to the lender providing funds against shares. It typically includes banks and NBFCs.

Eligible Borrowers

Any non-NBFC corporates established as companies and non-NBFC promoter body corporate (investment company or holding companies of promoter / promoter group)

Pledgor / Security Provider

It can be the company, the promoter of the company or other third party pledgor.

Guarantor

It can be the borrower, promoter or a third-party guarantor.

Eligible Security

The shares can be listed or unlisted and should be in demat account. The security should not have any obligations imposed internally or externally. It should have cleared all the assessments conducted by credit and risk teams.

End Use

The company should use the credit facility for general business purposes only such as working capital financing, equipment purchases, expansion plans, and refinancing.

Loan Tenor

The tenor of the facility can range up to 48 months.

Scale of Borrowing

The loan amount depends on the value and volume of the shares pledged. As per a mandate by the Reserve Bank of India, there should be a cover of 2x for listed shares while there is no such restriction on unlisted shares. However, the LTV for unlisted shares is usually kept much higher by lenders.

Benefits of LAS

Ownership Retention

The borrower retains the ownership of the shares pledged and continue to reap benefits in form of capital appreciation and dividends.

Immediate Funds

LAS provides borrowers with a quick and convenient hassle-free access to financing by leveraging their long-term investments.

Lower Interest Rate

The interest rates on LAS is usually lower because of collateral backing. It can vary from lender to lender.

Flexible Repayment

With LAS borrowers may have an option to choose between flexible renewal options and fixed maturity, depending on the terms of the loan agreement.

Regulatory Landscape

RBI, through its circular dated 10th April 2015, has mandated Non-Banking Financial Institutions (NBFCs) that have an asset size of 100 crores or above to always maintain an LTV ratio of 50%. This ensures that borrowers don't take excessive loans against the securities.

The RBI has also mandated lenders to disclose interest rates and terms of loan agreement, including any hidden cost. As per RBI guidelines, the lenders are required to monitor the market value of loan to avoid over leveraging by the borrowers. The guidelines are aimed at protecting borrowers' interest and encouraging fair lending practices.

Conclusion

LAS is an effective way to raise short term funds if a borrower has a portfolio of acceptable securities for collateral. This type of financing is ideal for the borrowers looking for a funding alternative that allows them to leverage their securities while retaining the ownership. LAS can help borrowers unlock liquidity while preserving investment portfolio, making it a convenient funding option.

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