

Have Debenture Trustees Delivered?



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Background on Debenture Trustees

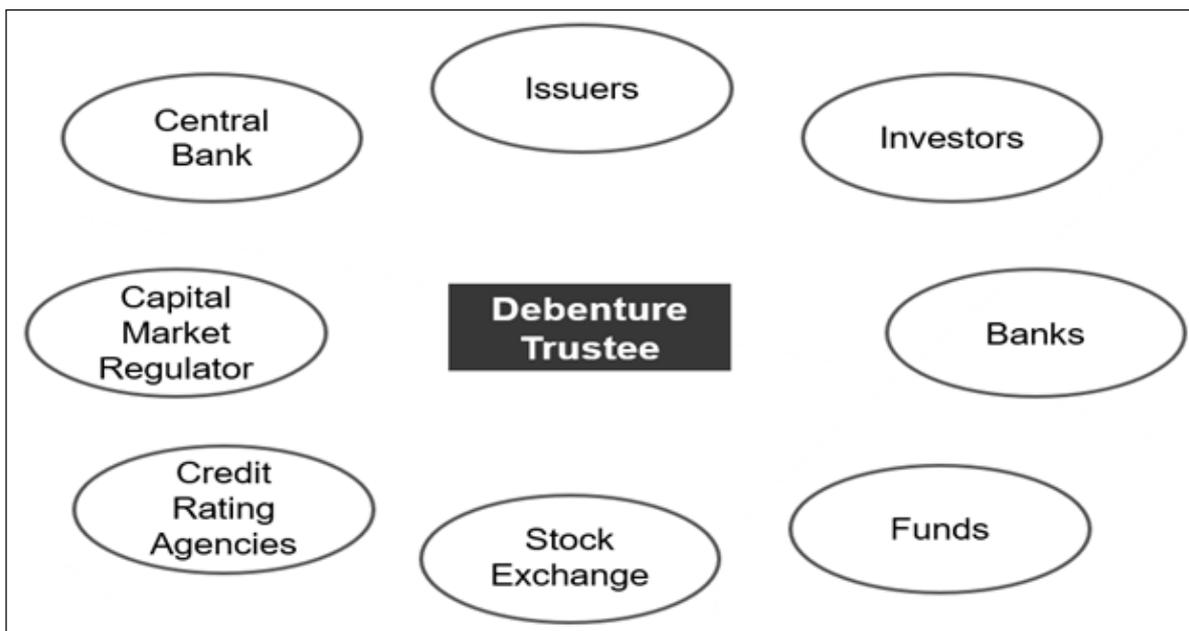
There is increasing demand for trust and transparency across capital markets globally. Debenture Trustees today play a vital role in providing the institutional framework for bond issuances in the economy and supporting the development of Corporate Bond market in India.

A Debenture Trustee (DT) is an independent entity appointed by the issuer of debentures to protect the interest of holders of debentures. To act as debenture trustee, the entity should either be a scheduled bank carrying on commercial activity, a public financial institution, an insurance company, or a body corporate. The entity should be registered with SEBI to act as a debenture trustee. The SEBI (Debenture Trustees) Regulations, 1993 governs the Debenture Trustees and provide for eligibility criteria for registration of Debenture Trustees, monitoring and review, code of conduct, procedure of action in case of defaults, avoidance of conflict of interest amongst other things.

Debenture Trustee is systemically important intermediary in capital markets landscape playing a significant role in creating and enforcing investor confidence both retail and institutional. During the holding period of these issuances, DT is actively engaged to ensure investor protection through constant monitoring and reporting framework of issuances. The DT would endeavor to get all information with respect to the bond issuances notified on timely basis to investors, regulators, agencies for any further action as necessary. Over a period, Debenture Trustees have effectively developed robust internal processes, frameworks, and IT systems to adapt to dynamic regulatory changes.

In case of secured debentures, creation of security in favor of Debenture Trustee entitles it to legal charge of the property for the benefit of debenture holders. The DT holds the secured property on behalf of issuer of security and for benefit of debenture holders and takes appropriate measures to protect the interest of debenture holders in the event of any breach of the trust deed or law. In order to understand the role of Debenture trustees properly, it is important to understand the debt market infrastructure and environment.

Capital Markets Infrastructure and Environment



Some of the main activities performed by the Debenture Trustees in India

- Ensure creation of security charge by Issuer in favor of Trustee
- Regulatory Compliances viz. Registrar of Companies (ROC), SEBI and Stock Exchange Filings
- Monitoring of payment of financial obligations to debenture holders and reporting to credit rating agency, Depository, Stock Exchanges, and other agencies in case of delay
- Monitoring various non-financial covenants as per transaction documents like downgrade of credit ratings, which might result in situation where Event of Default can be declared by Debenture holders
- Calling for periodical reports from Issuers to ensure regulatory compliances and monitoring of covenants as per transaction documents
- Enforcement Activities – Leading the Enforcement activities for Debenture Holders in case of default
- Active role played by DT in resolving debenture holders' grievances against the Issuer

Debenture trustees in India have been instrumental in providing critical inputs with respect to ever changing market risks and assisting the regulator in policy formation to strengthen the regulatory framework. Over the years the responsibilities and scope of work of DT have increased leading to additional reporting requirements to the regulators, credit rating agencies, investors etc.

The past two years or so have seen rapidly increasing stress in the Indian banking sector. The recent NBFC events have led to surge in defaults and DTs have acted promptly to undertake various actions under the existing legal framework of India including initiating legal proceedings for recovery of amounts due to debenture holders. In event of default by issuer of debentures, the Debenture Trustee have exercised their powers and authority to bring the secured property to sale, following the provision laid down in the trust deed and applicable law considering the nature of security and proceeds of sale are applied to redeem the debentures.

A look at emerging challenges and plausible solutions

Some of the challenges faced by Debenture trustee that often go unnoticed include lack of awareness on real role of trustees and understanding of what security really means and what does it take to enforce security through the legal framework in India.

Secured debt instrument means that it is supported with some assets having value that is equal or more than the outstanding there against. It does not assure recovery of entire amount invested / due to the Investors. Debenture Trustee is responsible for taking legal recourse for enforcing the Security but cannot be responsible for the outcome of the legal process or resolution process undertaken and the time required for actual funds to flow back to the Investors. Debenture Trustee do not have coercive powers or authority under law.

As per contractual provisions, following a default, the bond trustee will need to seek instructions from the bondholders as to the enforcement (or other) action that they wish it to take. It is pertinent to note some of the global best practices of trustee industry (Source: International Practices of Bond Trustee Arrangements by International Capital Market Association (ICMA)).

1. The bond trustee is entitled to seek indemnification, security and/or prefunding prior to taking any enforcement action
2. The bond trustee is not required to expend or risk its own funds under any circumstances, nor does it assume any of the issuer obligations or guarantee repayment by the issuer or endorse the issuer in any manner.

Policy suggestions for asset resolution

Debenture Trustees have been at the centre of debt markets and based on their real experience with market participants of corporate bond markets, are in a position to recommend policy action and reform for development of corporate bond markets.

The Trustee Association of India, which consists of members from Debenture Trustee industry, works closely with the Indian Capital Markets Regulator, SEBI and other stakeholders for investor protection and bond market development. This includes a recent white paper issued by SEBI to address emerging issues on security identification, joint resolution process of defaulting companies including NBFCs and creation of recovery fund at the time of issuance, to cater to cost of managing defaults and litigations (if any) for the future.

Reserve Bank of India (Prudential Framework for Resolution of Stressed Assets) Directions 2019 were issued with a view to providing a framework for early recognition, reporting and time bound resolution of stressed assets. In cases where Resolution Plan is to be implemented, all lenders are required to enter into an inter-creditor agreement (ICA) to provide for ground rules for finalisation and implementation of the RP. DTs have been prompt in highlighting ICA process to all the Debenture Holders, however, the resolution process may not achieve its ends in case debenture holders do not agree to be party to ICA. Hence, assets involving both lenders and debenture holders, the current policy framework is insufficient for resolution of such assets. Considering the interest of all stakeholders, a joint policy framework by SEBI and RBI would show the way for unified action against defaulting issuers and effective resolution of assets in India.

Finally, Debenture Trustees in India have been playing an intrinsic role as independent third parties between issuers of capital and investors. The Trustees continue to juggle the extremely dynamic landscape both economic and legal, and continue to deliver on their duties as envisaged in regulation and contractual documents. Keeping pace with the increasing responsibilities and rising spate of defaults, the trustees have developed mechanisms and created additional infrastructure through investments in expertise and automation. The DTs continue to be actively involved with Regulators and Industry bodies to increase the reach and awareness of corporate bonds for market development and market expansion in India.

Compared to other peer economies and growing defaults across global economies, the Debenture Trustees in India perform and deliver on a much larger role and responsibility for Indian and global investors. The same is reflected in the data published by debenture trustees for all issuers and defaults in India. In line with the development of financial services industry and legal frameworks, Debenture trustees in India have come a long way. Further enablement of DTs by stakeholders of debt markets, will further strengthen their efforts towards investor protection and support the creation and sustainability of a vibrant market for debt securities in India.
