

# Have the Debenture Trustees delivered?



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## Introduction/ Background

SEBI regulations define a Debenture trustee as “a trustee of a trust acting under a trust deed for securing any issue of debentures of a body corporate”.

The role of Debenture Trustees has been dichotomous in the Indian Markets. On the one hand, they remain one of the most important pillars of intermediary monitoring and onboarding while on the other hand, they are sometimes seen as just

necessary enough to execute Contractual documentation with the monitoring role completely overlooked by the Market.

## Trusteeship in Indian context

As we know, a Debenture is an instrument of debt executed by any company acknowledging its obligation to repay the sum at a specified rate and also carrying an interest. It is like a certificate of loan or a loan bond evidencing the fact that the company is liable to pay a specified amount with interest

A multi-jurisdictional study of the concept of trusteeship clarifies that ‘trustee’ is perceived very distinctly across the globe, as compared to India.

Interestingly, one factor was found common to trusteeship across various foreign jurisdiction, i.e., that role of trustee is akin to agency-ship and less fiduciary.

## Key Themes and Context

Role of debenture trustee in Indian jurisdiction has evolved a lot in recent years (and continues to do so).

The regulator rightfully saw the need for expanded scope of monitoring by intermediaries. Debenture Trustees and Rating Agencies were the most obvious choice considering their access to information and their role of Investor Protection. Accordingly, the new regulations were brought in and Trustees asked to play the role of being ‘Early Warning Signal’ generators for the stakeholders. The framework was set up to enable prevention of shocks in terms of sudden defaults that market is not able to preempt. Debenture Trustees stepped up to the occasion and accepted the expanded scope of responsibilities as their role of being Monitoring Agents. Trustees also saw themselves being Resolution and Bankruptcy Agents in one of the biggest bankruptcies in the Banking & Financial Service sector recently. These have been some of the earliest cases on IBC resolution cases and were fraught with complexity. In that sense, Trustees really stepped up and delivered responsibilities of anchoring bankruptcies that involved both retail and institutional investors.

The Market somehow missed the appreciation for these non-judicial set ups doing their best to fulfill the responsibility of Investor Protection.

### (i) *Understanding the need for independent Monitoring Intermediaries for Investor Protection*

The Market Participants need to understand how critical the role of regular Monitoring and Due Diligence Agents is. The framework of Early Warning Alerts that throws triggers for heightened Professional Skepticism becomes critical in situations of distance to default. These intermediaries can actually facilitate minimization of default damage by just triggering Early Warnings Alerts on time.

### (ii) *Structural Constraints and Market Peculiarities*

There are structural constraints like availability of data for unlisted and private issuances. Price Discovery does not have the support of an independent channel like CDS. Similarly, need for more Liquidity depth is a market peculiarity. These peculiarities make the role of Monitoring Intermediary critical and difficult at the same time.

### (iii) *Mechanism of monitoring*

Although Debenture trustees are entrusted with independent monitoring of covenants in transactions, the process and mechanism to do so effectively is still in the process of the evolving. Debenture Trustees are often found relying on the data submitted by the Borrowers, thereby compromising this essential function. However, important developments have taken place in this domain in recent years, e.g., involvement of Information Utilities to keep an eye on the status of default by any Issuer company.

### (iv) *Use of technology required to monitor the lifecycle of transaction*

The Digital Index of Debenture Trustee Operations needs significant upscale. The databases of Issuer and Investor information, availability of Financial and other Information required for active Monitoring and machine learning based triggers that can use updated information for predicting better are all priorities for the industry.

In recent times, an important addition to the existing set up is DLT platform, by way of which, the Issuer creates a unique identity over a security given to a Debenture Trustee and Debenture Trustee can confirm the same.

## Notable examples in recent times

Recent years have seen the biggest of financial defaults in the debt market.

In all the above-mentioned matters, there were thousands of individual investors involved and their interests were at stake. Starting from constituting a committee of decision-making debenture holders, initiating legal action, appointing nominee director, to taking all other crucial action, debenture trustee has to play a role of an anchor, which is expected to see the whole process through till the end.

## Conclusion

To summarize, the Debenture trustees have been agile and have put in serious efforts to play the expanded role of being Intermediaries that bring out Professional Skepticism Alerts that Market and Stakeholders can then respond to in terms of appropriate interventions. They have also anchored interventions to the best of their ability. In terms of way forward, it would be important to bridge the dichotomy. Issuers and Market Participants will have a role to play there. Market Participants will have

to understand how important the role of intermediaries that run the Monitoring and Early Warning Alerts is for a market like India that is constrained by structural constraints. These structural constraints include absence of a CDS Market that can help with price discovery, Information Asymmetry, a developing Credit Market with liquidity constraints in Papers rated below certain Ratings inadequacy of long term funding for long term Assets

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