



To,

Ms. Richa G. Agarwal,
Deputy General Manager,
Market Intermediaries Regulation & Supervision Department,
Securities and Exchange Board of India
Plot No. C 4-A, G Block, Near Bank of India,
Bandra Kurla Complex, Bandra East,
Mumbai, Maharashtra 400051

Sub: Representation to amend Regulation 54 of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 and SEBI Circular dated November 13, 2020.

Dear Ma'am,

About the Indian Securitisation Foundation (ISF)

ISF is a not-for-profit entity representing the securitisation industry in India. The members of the ISF includes NBFCs, microfinance institutions, other issuers and investors and securitisation professionals for promoting interest of securitization and fixed income securities in India. As ISF is dedicated to the cause of promoting securitization, asset-based financing and related areas in India, we humbly submit our recommendations herein below on the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (hereinafter referred to as "**Listing Regulations**") which may have a significant impact on issue of unsecured debt instruments in India.

Background

The need for a strong bond market in India is almost unarguable. A reasonably well-developed corporate bond market is very much required in any economy to supplement banking credit and the equity market and to facilitate the long-term funding requirement of corporate sector as well as infrastructure development in the country. Taking a note of the necessity of the development of the corporate bond market, the regulators have taken necessary action to open up the position of unsecured NCDs in the country. It is counter-

INDIAN SECURITISATION FOUNDATION

(A Not-For-Profit Company Licensed under Section 25 of Companies Act, 1956)

Regd. Office: 601-C, Neelkanth | 98, Marine Drive

Mumbai – 400 002

Phone: 022 22817427

Email: info@indiansecuritisation.com: vinod@vinodkothari.com

intuitive to expect a corporate to issue secured bonds; if the corporate had security to offer, it must have opted to access bank loans. Debentures are an incremental additional source of funding, and not the first source of borrowing for most companies.

There were several amendments that provided the regulatory impetus towards ensuring the development of the corporate bond market in India by facilitating unsecured corporate bonds which for so long were not permitted in the country and by increasing the investors base. We appreciate the changes introduced by the regulators.

However, we want to bring to your notice a practical difficulty/ interpretation issue in case of issuance of listed unsecured corporate bonds by way of this representation. There is lack of clarity on requirement of maintenance of asset cover in case of unsecured debt securities.

Maintenance of Asset Cover

Under Debt Listing Agreement [Clause 5 of Part A]

May 2009¹:

The Issuer agrees that it shall create and maintain security ensuring 100% security cover for listed secured debt securities at all times and ensure that the charges on the assets are registered.

November 2009²:

*In respect of its listed debt securities, the Issuer agrees that it shall maintain 100% **asset cover** sufficient to discharge the principal amount at all times for the debt securities issued and shall disclose to the exchange on half-yearly basis and in their annual financial statements the extent and nature of security created and maintained.*

January 2010³:

SEBI inserted the following proviso to Clause 5 of Part A which required issuers to maintain 100% asset cover for their listed debt securities:

That this requirement shall not be applicable in case of unsecured debt instruments issued by regulated financial sector entities eligible for meeting capital requirements as specified by respective regulators.

¹ https://www.sebi.gov.in/legal/circulars/may-2009/simplified-listing-agreement-for-debt-securities_4870.html

² https://www.sebi.gov.in/legal/circulars/may-2009/simplified-listing-agreement-for-debt-securities_4870.html

Under Listing Regulations (Reg. 54)

SEBI carried forward the above provisions relating to asset cover and asset cover certificates to the LODR Regulations as well. The relevant provisions are reproduced below:

Regulation 54: Asset cover

- (1) *In respect of its listed non-convertible debt securities, the listed entity shall maintain **hundred percent asset cover** sufficient to discharge the principal amount at all times for the non-convertible debt securities issued.*
- (2) *The listed entity shall disclose to the stock exchange in quarterly, half-yearly, year-to-date and annual financial statements, as applicable, the extent and nature of security created and maintained with respect to its secured listed non-convertible debt securities.*
- (3) *The requirement specified in sub-regulation (1), shall not be applicable in case of unsecured debt securities issued by regulated financial sector entities eligible for meeting capital requirements as specified by respective regulators.*

SEBI (LODR)(Third Amendment) Regulations, 2020

SEBI, further amended sub-regulation (1) and omitted sub-regulation 3 of Regulation 54 w.e.f. October 8, 2020 as under:

Regulation 54: Asset cover

- (1) *In respect of its listed non-convertible debt securities, the listed entity shall maintain hundred per cent. asset cover or asset cover as per the terms of offer document/Information Memorandum and/or Debenture Trust Deed, sufficient to discharge the principal amount at all times for the non-convertible debt securities issued.*

Under SEBI (Issue and Listing of Debt Securities) Regulations, 2008

Regulation 26: Obligations of the Issuer , Lead Merchant Banker, etc.

- (6) *The issuer and the merchant banker shall ensure that the security created to secure the debt securities is adequate to ensure 100% asset cover for the debt securities.*

Under SEBI (Debenture Trustees) Regulations, 1993

Regulation 15: Duties of the debenture trustees

- (t) *In case where listed debt securities are secured by way of receivables/ book debts it shall, -*

(i) on a Quarterly basis-

(a) **carry out the necessary due diligence and monitor the asset cover** in the manner as may be specified by the Board from time to time.

(ii) on a Half-Yearly basis-

(a) obtain a certificate from the statutory auditor of the issuer giving the value of receivables/book debts including compliance with the covenants of the Offer Document/Information Memorandum in the manner as may be specified by the Board from time to time.]

Asset Cover Certificate

Under Debt Listing Agreement [Clause 2(d) of Part A]

May 2009:

The Issuer agrees that it shall forward to the debenture trustee promptly, whether a request for the same has been made or not:

A half-yearly certificate regarding maintenance of 100% security cover in respect of listed secured debt securities, by either a practicing company secretary or a practicing chartered accountant, within one month from the end of the respective half year. (Not applicable for Bank or NBFC Issuers registered with RBI)

November, 2009:

A half-yearly certificate regarding maintenance of 100% asset cover in respect of listed debt securities, by either a practicing company secretary or a practicing chartered accountant, along with the half yearly financial results.

Provided that submission of such half yearly certificates is not applicable in cases where an issuer is a Bank or NBFC registered with RBI or where bonds are secured by a Government guarantee.

Under Listing Regulations (Reg. 56)

Regulation 56: Documents and intimations to Debenture Trustees

(1) The listed entity shall forward the following to the debenture trustee promptly:

(d) a half-yearly certificate regarding maintenance of hundred percent. asset cover in respect of listed non-convertible debt securities, by either a practicing company secretary or a practicing chartered accountant, along with the half yearly financial results:

Provided that submission of such half yearly certificates is not applicable in cases where a listed entity is a bank or non-banking financial companies registered with Reserve Bank of India or where bonds are secured by a Government guarantee.”

SEBI (LODR) (Third Amendment) Regulations, 2020

SEBI, further amended clause (d) of sub-regulation (1) of Regulation 56 w.e.f. October 8, 2020 as under:

Regulation 56:

(1) The listed entity shall forward the following to the debenture trustee promptly:

(d) a half-yearly certificate regarding maintenance of hundred percent asset cover or asset cover as per the terms of offer document/ Information Memorandum and/or Debenture Trust Deed, including compliance with all the covenants, in respect of listed non-convertible debt securities, by the statutory auditor, along with the half-yearly financial results:

Provided that the submission of half yearly certificate is not applicable where bonds are secured by a Government guarantee.

SEBI Circular on Monitoring and Disclosures by Debenture Trustee(s)

SEBI Circular dated November 12, 2020³ ('November Circular'), specifies the format for the asset cover certificate to be submitted that *inter-alia* includes furnishing of details of asset cover maintained for unsecured debt securities.

Table II of the format of the asset cover certificate requires to disclose the Assets Coverage Ratio which is required to be **100% or higher as per the terms of IM/DTD**.

Further, as per the format of the asset cover certificate, the issuer is required to disclose net assets available for unsecured lenders after deducting the total assets available for secured lenders/creditors on pari passu/exclusive charge basis.

³ <https://www.sebi.gov.in/legal/circulars/nov-2020/monitoring-and-disclosures-by-debenture-trustee-s-48159.html>

Practical issues:

The Banks and NBFCs usually issue unsecured debt securities to meet capital requirements specified by RBI, for instance, Basel III norms. Before the amendment in 2020, the banks and NBFCs were exempted from the following –

- Maintenance of 100% asset cover in case of unsecured debt securities for meeting capital requirements specified under law under regulation 54;
- Submission of the asset cover certificate, obtained from the statutory auditor, under Regulation 56(1)(d).

Subsequent to deletion of aforesaid exemptions, following issues are being raised:

1) 100% asset cover or asset cover as per the terms of issue:

As per the amended regulations 54 and 56, the issuer is required to maintain 100% asset cover or as per the terms of offer listed in the IM/ DTD, sufficient to discharge the principal amount at all time of its NCDs.

If asset cover is akin to security cover, and the offer document provides that the debt securities are ‘unsecured’ in the terms of issue, will it be regarded as sufficient compliance on the part of issuer to not maintain any asset cover.

The debenture trustees are insisting on insertion of clause relating to maintenance of asset cover and submission of asset cover certificate even in case of unsecured debt securities.

2) Implied risk in case of unsecured debentures

Debentures are considered as secured when they are backed by any security/ collateral. In case of a default, the collateral can be sold/ disposed off to repay the secured debenture holders.

In case of unsecured debentures, the repayment of principal or interest amount is not secured and thus there always lies an inherent risk that the debenture holders will lose their money. Thus, the requirement mandating issuers to maintain an asset cover on unsecured debentures doesn’t reflect a correct picture.

Even if the asset cover is maintained in case of unsecured debentures, they still remain unsecured and therefore such asset cover does not dilute the risk associated with such debentures. Details of asset cover will be illusory.

Section 71 of Companies Act, 2013 read with Rule 18 (1) (b) of Companies (Share Capital and Debentures) Rules, 2014 provides for security cover only in case of secured debentures as under:

“Such an issue of debentures shall be secured by the creation of a charge on the properties or assets of the company or its subsidiaries or its holding company or its associates companies, having a value which is sufficient for the due repayment of the amount of debentures and interest thereon.”

3) Enforcement of security interest

Even if asset cover is maintained against unsecured debentures, the holders are still not entitled to cause any action in case of such assets. Enforcement of such assets is not an option with the holders of unsecured debt instruments, for instance, enforcement of security interest under SARFAESI can only be undertaken if there exists a security interest. Similarly, in case of insolvency proceedings, secured debentures are treated superior to unsecured debentures in the waterfall arrangement. Thus, irrespective of the asset cover maintained, assets would first be used to repay the secured debenture holders and the remaining, if any, would then be distributed among the unsecured debentures.

4) Purpose of asset cover

Referring to the above points, the purpose of maintaining an asset cover in case of unsecured debentures still remains a question. The unsecured debenture holders do not gain anything from an asset cover as the same cannot be used to pay off their debts. Thus, whether the concept of asset cover is only to showcase that the liabilities of the issuer are represented by a certain amount of assets or to ensure that in case of a default in such unsecured debentures, such assets are available for being enforced.



Representation for amendment in Listing Regulations

In order to clear the ambiguity and to maintain 100% asset cover only in case of secured debentures, the following amendment may be made in the Listing Regulations:

Regulation 54:

*(1) In respect of its listed non-convertible debt securities, the listed entity shall maintain hundred per cent. asset cover or asset cover as per the terms of offer document/Information Memorandum and/or Debenture Trust Deed, sufficient to discharge the principal amount at all times for the **secured** non-convertible debt securities issued.*

Corresponding changes to be carried out in the format of asset cover certificate to be furnished by debenture trustees, as provided in Annexure A to SEBI Circular dated November 12, 2020.

As ISF is dedicated to the cause of contributing to the development of the financial services sector and capital market instruments in particular, in the event of any further clarification needed, we would be happy to provide the same.

Thanking you.

For Indian Securitisation Foundation

Vinita Nair
Director (DIN: 08067063)

Date: December 11, 2020