

CONSULTATION PAPER

Review of SEBI (Issue and Listing of Debt Securities by Municipalities) Regulations, 2015

A. Objective:

1. To seek public comments on the proposals relating to SEBI (Issue and Listing of Debt Securities by Municipalities) Regulations, 2015 (hereinafter referred to as "ILDM Regulations") with a view to, inter-alia, broadening the universe of issuers, strengthening investor protection measures and simplifying and easing the process for issuance of debt securities under these Regulations.

B. Background:

2. SEBI notified the ILDM Regulations, in July 2015, laying down a framework for issuance and listing of debt securities. Under these regulations, till date, seven municipalities have raised Rs. 1,389 crores through issuance of debt securities on private placement basis.
3. Based on international practice, experience gained from municipal bond issuances and discussions with municipalities, it is proposed to review the ILDM Regulations to further rationalize the process for issuers to raise resources through issuance of debt securities.

C. Proposals:

4. Expanding the definition of issuer:

4.1. Current regulatory requirement:

As per Regulation 2(h) of ILDM Regulations, an issuer means any municipality as defined under Article 243Q of the Constitution of India or a corporate municipal entity which is a subsidiary of a municipality and which is set up for the purpose of raising funds for a specific municipality or group of municipalities.

4.2. Need for review:

- i. It has been represented that entities/bodies such as urban development authorities and city planning agencies etc. perform functions, such as planning and execution of urban development projects/schemes, which are akin to those being performed by a

municipality. While these bodies carry out functions which are similar to the functions carried out by a municipality, they are not defined as municipalities under Article 243Q of the Constitution of India, thereby rendering these entities as ineligible to raise funds via issue of debt securities under the ILDM Regulations.

- ii. There are other structures wherein a group of municipalities pool their resources together to jointly raise funds through issuance of bonds. These structures are generally termed as Pooled Finance Development Funds. As these structures are not defined as municipalities under Article 243Q of the Constitution of India, they also become ineligible to raise funds via issue of debt securities under the ILDM Regulations.
- iii. Under the smart cities mission launched by the Ministry of Housing and Urban Affairs, the implementation of projects is done by a Special Purpose Vehicle (SPV) to be set up at city level in the form of a limited company under the Companies Act, 2013 and promoted by State/Union Territory and Urban Local Body (ULB). These SPVs have been set up to provide functions such as adequate water supply, sanitation, sustainable and inclusive development of cities etc. Thus, though these SPVs perform tasks, similar to that of municipalities, they are not defined as municipalities under Article 243Q of the Constitution of India and thus they also become ineligible to raise funds via issue of debt securities under the ILDM Regulations.

4.3. Proposal:

To enable fund raising by bodies/authorities which are carrying out functions akin to that of a municipality or are raising funds on behalf of municipalities, it is proposed to widen the definition of “Issuer” in ILDM Regulations to include the following:

- i. any Statutory Body or Board, Authority, Trust or Agency established or notified under an Act of Parliament or an Act of the State Legislature or any Special Purpose Vehicle notified by State Government or Central Government, subject to the condition that these entities perform one or more functions listed in the Twelfth Schedule of the Constitution of India;
- ii. any structure set up by the State Government under the Pooled Finance Development Fund Scheme of the Government of India, subject to the condition that Pooled Finance Development Fund raises funds for the purpose of financing one or more functions listed in the Twelfth Schedule of the Constitution of India.



5. Accounting, auditing and disclosure of financial statements:

A. Accounting:

5.1. Current regulatory requirement:

Regulation 4(b) and 15(1)(b) of the ILDM Regulations provide that accounts of a municipality shall be prepared in accordance with the National Municipal Accounts Manual or in accordance with similar Municipal Accounts Manual adopted by the respective State Governments.

5.2. Need for review:

As brought out above, SEBI is proposing to enhance the definition of issuer under the ILDM Regulations to include entities such as Statutory bodies, Board, Authority, Trust, Agency, Pooled Finance Development Funds etc. These issuers can be incorporated either as companies or trusts or statutory bodies, etc. or may follow accounting standards as applicable to them. Accordingly, it is essential that the scope of preparation of accounts, as given in the ILDM Regulations, be widened to take into account accounting practices applicable to all such entities.

5.3. Proposal:

ILDM regulations to be modified to include that preparation of accounts of issuers, covered under this Regulations, shall be in accordance with the following:

- a) National Municipal Accounts Manual (NMAM) or;
- b) Municipal Accounts Manual (similar to NMAM) as adopted by the respective State Governments; or
- c) Accounting standards, applicable to issuers, as prescribed in the Companies Act or;
- d) Accounting standards/policies, applicable to issuers, as specified in their respective Acts and/or Rules/Regulations under which such issuers have been incorporated or constituted.

B. Auditing and disclosure of financial statements:

5.4. Current regulatory requirement:

- a) **Audit of accounts:** Regulation 24(2) of ILDM Regulations provide that the accounts shall be audited by persons appointed by the municipality, as permissible under its constitution/state legislation.
- b) **Period of submission of accounts:**
- i. The un-audited financial results are required to be submitted, on a half yearly basis, to the stock exchange and debenture trustee within three months from the end of the half year; and
 - ii. The annual audited financial results are required to be submitted to stock exchange and debenture trustee within six months from the end of the financial year.

5.5. Need for review:

It is given to understand that presently municipalities are audited only by Comptroller and Auditor-General of India (CAG). As CAG also undertakes various other audit assignments, there may be delay on the part of the issuer in submission of financial results, to stock exchange/debenture trustee/regulatory bodies, within the specified timelines

It is noted that in the case of a listed Government company /Public sector undertakings etc. the first level audit of accounts is done by auditors appointed by CAG to ensure timely submission of financial results to stock exchanges. Thereafter, final audit is carried out by CAG based on the annual report of these auditors. Currently, under ILDM Regulations, there is no provision for accounts to be audited by CAG empanelled/approved auditors.

Representation has also been received that it becomes difficult for issuers to submit their annual audited accounts within six months from the end of the financial year as audit of their accounts and their approval by the competent authority takes substantial amount of time.



5.6. Proposal:

5.6.1. Audit of accounts:

In order to enable issuers to submit their audited accounts to the stock exchange/debenture trustee/regulatory bodies, within the specified timelines and in line with the provisions applicable to listed public sector undertakings, it is proposed to adopt a three step process for audit of accounts, given as under:

- a. The CAG shall appoint an auditor for audit of accounts of issuer.
- b. The auditor so appointed shall conduct first level audit of accounts of the issuer, who shall submit the audited accounts to the stock exchange and debenture trustee within the specified timelines, while simultaneously submitting the same to the CAG for finalizing the audit.
- c. The CAG shall finalize the audit of accounts and after approval of the audited accounts by the Standing Committee and/or the Governing Body or Board of Directors of the issuer, as applicable, the same shall be submitted to the stock exchange and debenture trustee promptly.

5.6.2. Period of submission of accounts:

- I. With regard to the submission of financial results, it is proposed as under:
 - a) The issuer shall submit its annual audited financial results, as audited by an auditor appointed by CAG, within two months from the end of the financial year. (The period of submission is in alignment with the time period prescribed for submission of financial results by issuers who have listed their debt securities and/or equity shares).
 - b) Additionally, the issuer shall submit its annual audited financial results as audited by CAG, within nine months from the end of the financial year.
- II. The unaudited results for the first half of the financial year shall be submitted within forty five days from the end of the first half year. (The period of submission

is in alignment with the time period prescribed for submission of financial results by issuers who have listed their debt securities and/or equity shares)

6. Facilitating ease of issuance:

The ILDM regulations, inter-alia, provide for the following provisions to be complied with by the issuer:

6.1. Current regulatory requirement:

- a) **Creation of escrow account:** Regulation 5(6) of ILDM Regulations provide for creation of a separate escrow account. Regulation 24(3) of the said regulations provide for audit of such escrow account by the persons appointed by municipality.
- b) **Appointment of monitoring agency:** Regulation 5(7) of ILDM Regulations provide for appointment of monitoring agency such as public financial institution or a scheduled commercial bank to monitor the earmarked revenue in the escrow account.
- c) **Appointment of debenture trustee:** Proviso to Regulation 5(7) and Regulation 20(1) of ILDM Regulations provide that debenture trustee or an independent trustee shall be appointed in the case of a corporate municipal entity or a municipality respectively, for creating security in favour of such a trustee.
- d) **Viability certificate or detailed project appraisal report:** Regulation 7(6) of ILDM Regulations provide that viability certificate or detailed project appraisal report shall be obtained by the issuer from a scheduled commercial bank or a public financial institution.
- e) **Separate project implementation cell:** Regulation 12(4) of ILDM Regulations provide for establishment of a separate project implementation cell to monitor the progress of the project(s).
- f) **Issuer's contribution for projects:** Regulation 12(5) of ILDM Regulations provide that Issuer's contribution for each project to be not less than twenty per cent of the project costs to be contributed from their internal resources or grants of the issuer.

- g) **Asset cover/creation of security for secured debentures:** Regulation 16 of ILDM Regulations provide for maintenance of 100% asset cover sufficient to discharge the principal amount at all times for the debt securities issued. Regulation 19(1) of ILDM Regulations provide that debt securities so issued shall be secured by creation of a charge, on the properties or assets or the receivables of the issuer. Further, in case of unsecured debentures, the debt securities shall be either backed by guarantee from State Government or Central Government or shall have structured payment mechanism.

6.2. Need for review:

It has been represented that presently certain provisions such as appointment of monitoring agency, obtaining viability certificate etc., as provided for in the ILDM regulations, increase the cost of issuance and compliance burden on the issuer without providing commensurate protection to the investors. As Debenture Trustee is already being appointed by issuers, the responsibility for carrying out monitoring function can also be cast on the Debenture Trustee itself, without the need for appointing separate agency.

Municipalities are constitutional bodies or are incorporated as statutory authorities. As the general security enforcement laws under Indian law may not be applicable to municipalities, as they are governed by the provisions of the state laws under which they are incorporated, winding/dissolution or liquidation of their assets to satisfy debts owed to creditors may face legal challenges. It has, therefore, been represented that creation of charge by municipalities on fixed or immovable assets may not be effective as creditors may not be able to enforce the charge in case of default by a municipality. Thus, the extant requirement of maintenance of 100% asset cover at all times by municipality, may not serve the desired objective.

6.3. Proposals:

6.3.1. Escrow account:

- a) An escrow account is an account created for the specific purpose of receiving and disbursing funds towards discharge of contractual obligations. Funds owed to investors/creditors are earmarked to such an account, thereby providing protection regarding payment of their dues i.e in one sense, an escrow account



provides charge on receivables of a municipality. Creation of an escrow account, thus, is a significant element in enhancing investor protection. Drawing lessons from the global best practices and in consultation with municipalities, it is, therefore, proposed to create the following specific escrow accounts for issuance of all types of debt securities to ensure timely servicing of debt obligations:

i. **“No Lien Escrow Account”**:

- All tax revenues and/or user charges and grants etc., as detailed in the offer document/private placement memorandum, to be deposited to this account to ensure timely servicing of debt obligations.

ii. **“Interest Payment Account”**:

- An Interest Payment Account is an account wherein the interest amount due to be paid by the borrower/issuer is deposited.
- Throughout the tenure of the debt securities issued, at least an amount equivalent to two interest obligations is to be kept in this account. The equivalent amount is to be transferred from the “No Lien Escrow Account” to the “Interest Payment Account”.

iii. **“Sinking Fund Account”**

- A Sinking Fund Account is an account that is created specifically for repayment of debt.
- The principal amount, due for repayment, is to be periodically transferred to this account, in proportion to the tenure of debt securities issued. The amount is to be transferred from the “No Lien Escrow Account” to the “Sinking Fund Account”.

iv. **“General Account” or “Municipal Fund”**:

- A “General Account” or “Municipal Fund” is an account that is created to set aside funds for the general purposes of the issuer/municipality.



- All funds set aside for general purposes and any surplus remaining in the “No lien escrow account” is to be transferred to this account.
- v. In addition to the aforesaid accounts, in case of issuance of debt securities by an issuer raising funds for new projects, a **“Project Escrow Funding Account”** needs to be created:
 - It shall be an account where an amount, not less than 20% of the project costs, may be deposited/contributed by the issuer, whether in cash or kind, before the commencement of the project.
- b) All the above accounts except “General Account or Municipal Account” to be supervised by the debenture trustee.
- c) The issuer shall, on a quarterly basis, disclose the balances in the aforesaid accounts along with notes pertaining to transfers made to/from these accounts, on its website.
- d) After all necessary transfers are made by the issuer from the “No Lien Escrow Account” to the “Interest Payment” and “Sinking Fund Account”, the Debenture Trustee may issue a certificate that the issuer has discharged its debt obligations in a timely manner and thereafter any balance remaining in “No Lien Escrow Account” may be transferred to the “General Account” or “Municipal Account”

6.3.2. Debenture Trustee: A SEBI regulated debenture trustee shall be appointed for all issuances.

6.3.3. Given the above, it is proposed to remove the following:

- i. Requirement of appointing a monitoring agency.
- ii. Requirement of obtaining Viability certificate or Detailed Project Appraisal report (DPAR) before filing of offer document in case of public issue.
- iii. Requirement of establishing a separate project implementation cell for monitoring of projects.
- iv. Requirement mandating the issuer to mandatorily contribute 20% of the project costs from its own internal resources or grants.



- v. Requirement of maintenance of 100% asset cover and specification of resources in whose favour charge can be created by the issuer.
- vi. Requirement of backing of State or Central Government and structured payment mechanism in case of unsecured debt securities.

7. Other changes:

7.1. Current regulatory requirement:

- a) Regulation 5(1) and Regulation 5(3), 5(4) of ILDM Regulations provide that if an issuer intends to make a public issue, then it can issue only revenue bonds with a minimum tenure of three years and maximum tenure of thirty years or such period as specified by SEBI from time to time.
- b) Regulation 15(1)(f) of ILDS regulations provide that for private placement, the minimum subscription amount per investor is rupees twenty five lakh or such amount as may be specified by SEBI from time to time.

7.2. Need for Review:

- a) It has been represented that restricting the ability of the issuers by specifying the type of bonds and the tenure for which the funds may be raised under ILDM Regulations reduces the flexibility of the issuers to structure their debt issuance as per their resource requirements. Given the investor protection measures relating to creation of specific Escrow Accounts, as given at para 6.3.1 above, it is proposed that the issuer may be permitted to offer any type of bond, whether revenue or general.
- b) The minimum subscription amount for corporate bonds, in case of private placement, is Rs 10 lakhs. However, the said requirement for municipal bonds, in private placement, is Rs 25 Lakhs. It has been represented that the requirement of minimum subscription for municipal bonds be aligned with that for corporate bonds.

7.3. Proposals:

- a) It is proposed to align the minimum subscription limit in case of private placement of debt securities under ILDM Regulations, with that for corporate bonds. The current

minimum subscription amount is therefore proposed to be reduced from rupees twenty five lakh rupees to rupees ten lakhs and in multiples of rupees ten lakhs.

- b) It is also proposed to delete the following provisions in ILDM Regulations:
- i. Issuer can issue only revenue bonds in case of public issue
 - ii. Revenue bonds shall have a minimum tenure of three years and maximum tenure of thirty years.

D. Public comments:

Public comments are invited on the proposals mentioned in this paper. The comments, may be sent by email or through post, latest by June 10, 2019, in the following format:

Details of Responder			
Name ¹ /Organization:			
¹ if responding in personal capacity			
Contact number:			
Email address:			
Comments on the proposals as mentioned in this paper			
Sr. No.	Para No.	Comment/proposed change	Rationale

While sending email kindly ensure the subject is “**Consultation Paper on Review of SEBI (Issue and Listing of Debt Securities by Municipalities) Regulations, 2015**”.

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