

DISCUSSION NOTE – BORROWINGS BY TRUSTS AND ENFORCEMENT

This note relates to the subject of trusts, and specifically real estate investment trusts (“REITs”) and infrastructure investment trusts (“InvITs”, together with REITs, the “Trusts”) availing loans including investment by foreign portfolio investors (“FPIs”) in debt securities issued by Trusts and the legal framework governing the same.

I. INTRODUCTION AND BACKGROUND

1. India’s attractiveness for a portfolio investor closely mirrors its attractiveness as a business destination. As the quality of businesses and the business environment have improved over the years, it has become very tough for serious global investors to ignore India. The continued independence and transparency of the Reserve Bank of India (“RBI”) and the Securities and Exchange Board of India (“SEBI”) have played an integral part in bolstering investor sentiment towards India. Foreign portfolio investment has become an important source of augmenting debt investment in the economy both in the infrastructure and real estate sector.
2. Given the asset-heavy nature of the business and investments required for successful operations, debt is an important component of the capital structure of a Trust. FPIs are key capital providers to Indian corporates and specifically real estate sector and hence appropriate amendments should be made to regulations to enable FPIs to invest in debt securities issued by a Trust.
3. The Trust structure is akin to a holding company for typical Indian companies. There is a holding company-subsidiary relationship between the Trusts and its underlying special purpose vehicles or holding companies and such debt issuances would be in the ordinary course of business. Further these Trusts provide a comprehensive holding and regulated framework with underlying income generating assets – which have been amongst the most secure asset class for banks and NBFCs in India and hence allowing FPIs to invest in a Trust, which is an aggregation of income producing assets is a “derisked” and appropriate structure
4. Our request would be for you to consider allowing FPIs to invest in debt securities issued by a Trusts.
5. Please note that not only are both FPIs and Banks are allowed to invest in the debt securities of underlying SPVs below a Trust and given the Trust only institutionalises the framework for governance and ownership, but also invest in the units of Trusts.
6. In the subsequent sections, we have highlighted the legal and regulatory considerations that provide safeguards and allow for enforcement of security by lenders, if required, resulting from a security invocation event in relation to borrowing by Trusts.

II. BORROWINGS BY TRUSTS

A. *Nature of Trusts and Regulatory Recognition of Borrowings by Trusts*

1. Under Section 3 of the Indian Trusts Act, 1882 (“Trusts Act”), a “trust” is an obligation annexed to the ownership of property. The “beneficial interest” or “interest” of the beneficiary is his right against the trustee as owner of the trust-property. Hence, under the Trusts Act, the trustee is recognized as the legal owner of the trust property, and holds the trust property in its own right for the benefit of the beneficiaries.

2. The Trusts Act does not contain any provisions that which either permit or prohibit trusts from availing loans. This is entirely governed by the powers conferred on the trustee in terms of the trust deed entered into by the trustee of the Trust. If a trust deed explicitly permits the trustee to avail loans for the benefit of the beneficiaries, the trustee is entitled to raise such debt. In case a borrowing is made pursuant to such provision in the trust deed: (a) the trustee will be the borrower on record; (b) the proceeds of the loan shall be applied towards the lawful purpose of the trust; and (c) in the event of a default in repayment of the loan, the trust properties shall be available to the trustee for applying towards the repayment of the loan and the lenders as set out in the commercial understanding.
3. We further understand based on discussions with market participants, even currently various Trusts including, educational trusts, hospital trusts avail of lending from various lenders including Banks and NBFCs.
4. Under the Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2014 (the “**SEBI REIT Regulations**”) and the Securities and Exchange Board of India (Infrastructure Investment Trusts) Regulations, 2014 (the “**SEBI InvIT Regulations**”, together with the SEBI REIT Regulations, the “**SEBI Regulations**”), it is the trustee who holds the assets for the benefit of the unit holders. On the other hand, a ‘unit’, by definition, represents the beneficial interest in the Trusts, and not the ownership interest in the Trusts or its assets. The rights of unitholders under the SEBI Regulations are similar to, and only on a slightly higher pedestal than the rights of beneficiaries in a typical trust, by virtue of the requirements of seeking unitholders’ approval in relation to certain matters.
5. Please note, that the Trusts are registered in terms of the Trusts Act and the SEBI Regulations with the Securities and Exchange Board of India (“**SEBI**”). Further, the trustees of the Trusts are required to be debenture trustees registered with SEBI in terms of the Securities and Exchange Board of India (Debenture Trustees) Regulations, 1993. Further, in terms of the Income-tax Act, 1961, “business trusts” have been recognised as “entities” on which there are certain tax implications and to which certain exemptions are made available, even though Trusts are not specifically recognised as legal persons.
6. Further, presently, listed Trusts are permitted issue listed debt securities in accordance with the SEBI Regulations and the Debt Issue Guidelines which prescribe certain conditions (which are highlighted below). Recently, the Reserve bank of India (“**RBI**”) has also permitted InvITs to avail loans from banking companies subject to certain conditions.
7. Under the Master Direction – External Commercial Borrowings, Trade Credit, Borrowing and Lending in Foreign Currency by Authorized Dealers and Persons other than Authorized Dealers (“**ECB Master Directions**”), eligible borrowers include those entities which are permitted to receive foreign direct investment. In terms of Paragraph 3.2.3 of Consolidated FDI Policy, effective August 28, 2017, issued by the Department of Industrial Policy and Promotion (the “**Consolidated FDI Policy**”) foreign direct investment is permitted in Trusts. Further, in terms of Paragraph 3.2.5 of the Consolidated FDI Policy, Trusts are permitted to receive foreign investments, including from foreign portfolio investors and non-resident Indians. Accordingly, Trusts may avail external commercial borrowings.

B. Regulatory Safeguards available to Trusts

1. In terms of the SEBI Regulations, the manager is the entity responsible for undertaking day to day activities of the Trusts, which is governed by a board of directors comprising of at least 50%

of independent directors. Additionally, the SEBI Regulations require that certain decisions including in relation to borrowing (50% or 75% of the unitholders present and voting, subject to the leverage limits), related party transactions (50% of the unitholders present and voting) are required to be approved by the unitholders of the Trusts (being the beneficiaries).

2. In terms of various applicable laws, the ability of Trusts to borrow has been widely recognised. Please note that the above principle of the liabilities of beneficiaries of a trust (or unitholders of Trusts) are also enshrined under various legislations. In terms of the SEBI Regulations, Trusts are permitted to borrow monies. The SEBI Regulations prescribe certain limits up to which the Trusts on consolidated basis may avail borrowings (70% of the InvIT assets for InvITs and 49% of the REIT assets for REITs) subject to certain conditions, including approval of the unitholders and credit rating for any borrowing above 25% of the Trusts' assets on consolidated basis. Please note that the above limits as prescribed under the SEBI Regulations are applicable to the Trusts, the Holdcos held by the Trust and the SPVs held by the Trust on aggregated and consolidated basis.
3. As such, lending to Trusts would enable lenders to diversify their portfolio by adding low risk completed, income generating assets with the added protection of a credit rating. Additionally, the SEBI Regulations also require that certain credit rating is obtained by the Trust and in respect of the borrowings availed by the Trust prior to availing such borrowings. Such ratings are required to be obtained from SEBI registered credit rating agencies.

C. Servicing of Debt and Liability for Repayment

1. The repayment of borrowings which are taken on behalf of the trust are on the trust properties – therefore on default it is the trust, and not the trustee¹ which is considered to be liable, and the repayment is made out of the assets of the trust. Even in this case, the unitholders of the trust do not have any additional liability or obligation to contribute towards the repayment either before, or after the occurrence of an event of default. In this context, the unitholders of a Trust are akin to the shareholders of a company, and the liability of unitholders in case of a default by a Trust is similar to the liability of shareholders in the event of default in repayment by the company.
2. Please note that the above principle of the liabilities of beneficiaries of a trust (or unitholders of a Trust) are also enshrined under various legislations, including Section 23 of the Trusts Act which states that *“the liability is squarely on the trustee”* and the SEBI Regulations which provides that Trust and the parties to the Trust (i.e. the trustee, the sponsor groups, the manager and the project manager, as applicable) which are responsible to the unitholders for their acts of commission or omissions. Further, neither the SEBI Debt Issue Guidelines, nor the Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2012 (**“SEBI ILDS Regulations”**) do not ascribe any liability on the unitholders of a Trust which has issued debt securities.
3. Specifically in the context Trusts, please note that in terms of the SEBI Regulations, it is mandatory that the SPVs are controlled by the Trusts in all circumstances other than as may be required under law or under concession agreements. Accordingly, any repayment shall effectively be made through the monies earned by the SPVs. Lending at the Trusts level would

¹ Unless there is a breach of trust by the trustee, in which the trustee itself and its assets could be liable.

also ensure that the debt of the Trusts may be serviced through the proceeds of all SPVs simultaneously. In the case of Trusts, it would be under the lenders' control to ensure that protection measures are built in for the purposes for of seeking recourse from the SPVs.

4. Further, please do consider that Trusts are generally rated higher than any one individual asset, and lenders at the Trust level, based on their internal credit requirements, may seek an appropriate security package from the assets of the Trust including cross collateralization and or from any or all of the SPVs controlled by the Trust.
5. Being regulated entities which are set up with the protection of the interests of the investors in mind, Trusts are even better suited to act as borrowers as compared to registered trusts which have the general flexibility to avail loans for the benefit of their beneficiaries.

III. ENFORCEMENT OPTIONS

A. *Enforcement Mechanisms available and IBC options*

1. At the outset it is important to note that the lenders to Trusts have robust and enforceable legal remedies available to them to recover the debt, and any security, created and perfected properly, is fully enforceable. Set out below are the various options available to different kinds of lenders and their applicability to Trusts.

Remedies available

2. In India, the various enforcement or recovery mechanisms available to lenders are under (i) the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("**SARFAESI Act**"); and (ii) the Recovery of Debts and Bankruptcy Act, 1993 (the "**RDB Act**"); (iii) the Code of Civil Procedure ("**Civil Code**"); (iv) Commercial Courts Act, 2015 (the "**Commercial Courts Act**") and (v) the Indian Arbitration and Conciliation Act, 1996 (the "**Arbitration Act**")
3. Under the SARFAESI Act, a statutory mechanism is available for to lenders for the purpose enforcement of security interest by a secured creditor without the intervention of a court or tribunal pursuant to a security agreement between the secured creditor and the borrower. However, this mechanism can be only invoked by a "secured creditor", specifically: (i) any bank or financial institution or any consortium of banks or financial institution; (ii) debenture trustee appointed by a bank or financial institution; (iii) asset reconstruction companies; (iv) debenture trustee appointed by any company for secured debt securities; and (v) any other trustee holding securities on behalf of a bank or financial institution in whose favour security interest is created. Foreign lenders, other than scheduled commercial banks and foreign branches of Indian banks, are not able to enforce their security interest under the SARFAESI Act. Even small non-banking financial companies cannot enforce security by institution of proceedings under the SARFAESI Act.
4. The RDB Act was enacted to ensure for expeditious adjudication and recovery of debts due to lenders. The options for recovery under the RDB Act are available only to banks and financial institutions and no other class of lenders including public trusts and foreign lenders. Please note, however, in terms of the RDB Act, a debenture trustee (being the debenture trustee for debt securities issued by Trusts) being a financial institution will be able to avail the recovery process under the RDB Act.

5. In addition to the above, the civil courts in India may be approached for the resolution of any civil dispute by any party, including lenders. Further, as one of the initiatives by the Government to ensure Ease of Doing Business in India, as a measure to streamline the procedures relating to commercial litigation including summary judgment of claims in case of commercial disputes introduced the Commercial Courts Act, 2015.
6. Further, in the event the agreement provides for arbitration, parties (i.e. lenders and borrowers) may also use arbitration for the purpose of recovery or enforcement or both.
7. In light of the above, we understand that for the purposes of recovery by all lenders, enforcement proceedings before civil courts and commercial courts and resolution through arbitration are commonly used and available.
8. These remedies are also available to lenders to Trusts, including bondholders and trustees of Trusts.

Insolvency and Bankruptcy Code

1. The Insolvency and Bankruptcy Code, 2016 (the “**Insolvency Code**”) is a mechanism by which lenders may obtain resolution by way of reconstruction of companies, limited liability partnerships, partnership. It is strictly not a method of enforcement, but a method to restructure all the liabilities of the notified debtors. The Insolvency Code does not apply to trusts, co-operative societies and body corporates. Additionally, the Insolvency Code does not explicitly provide a mechanism for recovery or enforcement by lenders but may be a consequence of restructuring process.
2. However, it is pertinent to note that the absence of a such applicability does not in itself prevent effective enforcement against the security or the ability of the lenders to enforce to recover the loans advanced by, or moneys owed to, them in respect of the debt securities.

On the above grounds and in light of the relevant Trusts being heavily regulated entities in India under the purview of SEBI and the relevant Income-tax authorities, and recourse available both contractually as well as statutorily, the Reserve Bank of India may take a positive view to allow FPIs to invest in the debt securities issued by a Trust.