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LIQUIDITY WINDOW FACILITY INTRODUCED IN THE CORPORATE BOND MARKET: EXIT OPTIONS IN AN EFFORT TO BOOST LIQUIDITY

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The Securities and Exchange Board of India (SEBI) recently introduced a new liquidity window facility for corporate bonds, effective from 1 November 2024 *vide* circular dated 16 October 2024 (Liquidity Window Circular).

SEBI has introduced the Liquidity Window facility in an attempt to improve the liquidity available in secondary market transactions in corporate bonds. This is aimed to improve investor confidence and improve investor participation in the corporate bond market. In this article, the authors discuss the key features, modalities and impact of the Liquidity Window facility.

Under the Liquidity Window Circular, SEBI allows issuers of listed debt securities to offer pre-set windows during which investors can exercise a put option under the Regulation 15 of the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 (NCS Regulations) to sell the securities back to the issuer before maturity (Liquidity Window). This Liquidity Window gives investors an early exit option.

Features of the Liquidity Window facility:

1. **Issuer Discretion and Prospective Applicability**: The Liquidity Window can only be provided at the discretion of the Issuer. Further, this option is only available for prospective issuances either by way of public issue or private placement.
2. **Eligible securities**: All listed debt securities governed by the SEBI NCS Regulations are eligible for the Liquidity Window Facility.
3. **Corporate Authorisations:**
    a) **Board of Directors**: Prior approval of the board of directors of the issuer is required to provide the Liquidity Window.

    b) **Stakeholders Relationship Committee (SRC):** For entities which have listed their specified securities, the implementation and outcome of the Liquidity Window shall be monitored by the SRC. However, for entities which only have listed debt securities (for whom constitution of SRC is not mandatory), the monitoring of the implementation and outcome of the Liquidity Window shall be under the aegis of the board of directors, or such board-level committee as determined by the board of directors.
4. **Eligible Investors**: The issuers have the option to specify the classes of investors for whom the Liquidity Window shall be provided.
5. **Investor Protection:** SEBI has mandated that the Liquidity Window must be offered in a non-discriminatory, non-discretionary, objective, and transparent manner to the class of investors identified by the issuer as eligible for the Liquidity Window. Further, the Issuer shall ensure that the Liquidity Window facility does not compromise the market integrity or risk management, liquidity management, corporate integrity, or asset liability management norms specified by its board of directors.

6. **Minimum Holding Period:** The Liquidity Window can only be offered to investors after the expiry of one year from the date of issuance of the debt securities.

7. **Exemption from ISIN count**: The ISINs under which the debt securities with Liquidity Window facility are issued shall be exempt from the calculation of the number of ISINs as provided under Chapter VIII of the SEBI master circular dated 22 May 2024, titled "*Master Circular for issue and listing of Non-convertible Securities, Securitised Debt Instruments, Security Receipts, Municipal Debt Securities and Commercial Paper*". However, re-issuances shall not be permitted under the same ISIN under which the Liquidity Window facility is being provided.

8. **Minimum Allocation:** If an issuer opts to provide a Liquidity Window facility for a particular issuance, it must allocate a minimum of ten per cent of the issue size (in terms of number of debt securities) for the same. The upper limit shall be at the discretion of the issuer. Additionally, issuers may set sub-limits on the number of securities that can be tendered in each Liquidity Window. In the event, the number of investors exercising a put option during a Liquidity Window period is exceeding the allocated sub-limit, the issuers must accept such put option on a proportionate basis.

9. **Period of Liquidity Window:** The issuers offering the Liquidity Window shall keep it open for a minimum of three working days. The Liquidity Window facility can be provided on a monthly or quarterly basis, but the schedule of such facility shall be provided upfront in the offer documents.

10 **Notice Requirements**: Issuers are required to send an intimation of the Liquidity Window to all the eligible holders of such securities and the debenture trustee(s), through SMS or WhatsApp message from the start of each financial year regarding the availability of the Liquidity Window. Such SMS or WhatsApp message shall be treated to be in compliance with Regulation 15(6) of the NCS Regulations.

11. **Reporting and Disclosure Requirements:** After closure of a Liquidity Window, the issuer is required to submit a report to the stock exchanges on which such debt securities are listed. However, the form and manner of such disclosures are yet to be specified by the stock exchanges in consultation with SEBI.

    Further, if the issuer decides to extinguish the debt securities tendered during a Liquidity Window, they must inform the debenture trustee and the depositories within three working days after the 45-day period following the closure of the relevant Liquidity Window.

    The issuers are also required to disclose the list of ISINs which have been provided with a Liquidity Window facility on their website when providing this facility. The various details to be disclosed in this regard are provided in paragraph 6.11 of the Liquidity Window Circular (Relevant Information).

    Such Relevant Information is also required to be disclosed to the depositories, stock exchanges, and the relevant debenture trustee who shall also host the same on their website or corporate bond database. Any changes to the Relevant Information shall be intimated to the depositories, stock exchanges, and the relevant debenture trustee within 24 hours of making such change. All such information may also be provided by stock exchanges and depositories to as a feed to Online Bond Platforms for their display.

Manner of operation of the Liquidity Window facility:

a) Upon opening of a particular Liquidity Window, investors who are eligible, can, during trading hours, exercise the put option by blocking such debt securities and can utilise the mechanism for notifying such put option exercise to the Issuer.

b) Issuers are allowed to offer a discount which shall not exceed 100 basis points on the valuation plus accrued interest on the debt securities eligible to be tendered during the relevant Liquidity Window.

c) Settlement shall take place within four working days, with payments issued one day after the closure of the Liquidity Window.

d) Eligible investors can modify or withdraw their bids during the Liquidity Window period.

e) Only put options received by the stock exchange until the end of the Liquidity Window period will be considered as duly tendered.

f) Within 45 days of closure of the relevant Liquidity Window or before the end of the relevant quarter, whichever is earlier, the issuers are allowed to deal with the debt securities tendered during the Liquidity Window by either selling or extinguishing them. The sale of such securities shall however be made only on the debt segment of the stock exchange, or on the request for quote platform (if the issuer is eligible), or through a SEBI registered online bond platform. The aggregate limit of the Liquidity Window facility shall be replenished with the number of debt securities sold by the issuer through the aforesaid means.

g) Stock exchanges are required to publish detailed operational guidelines in relation to the Liquidity Window facility in consultation with the clearing corporations and depositories including the mechanism in which the put options can be exercised.

Comments

The Liquidity Window facility provides structured exit options to investors which can have the effect of boosting investor participation. Further, issuers with low credit rating can adopt the Liquidity Window facility to improve investor confidence in their issuances. Further, the exclusion of the debt securities for which Liquidity Window is provided from the minimum ISIN calculations can be seen as an incentive for faster adoption of the Liquidity Window by the issuers. While this initiative aims to boost retail participation in the corporate bond market, it remains to be seen how widely the Liquidity Window facility will be adopted by issuers. It will be key to ensure that these procedures are designed and implemented in a manner that strikes a fine balance between the increased compliance requirements and encouraging the adoption of the Liquidity Window facility.

The modalities for implementation of the liquidity window facility by the stock exchanges and depositories also remains to be seen. In conclusion, the Liquidity Window facility represents a strategic step by SEBI towards revitalising the corporate bond market with an aim to create a more dynamic and attractive investment environment for both retail and institutional investors.

- *Manisha Shroff (Partner); Sriram Madhav Kommu (Senior Associate) and Palak Jhalani (Associate)*

For any queries please contact: editors@khaitanco.com