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PARADIGM SHIFT IN THE ROLE OF DEBENTURE TRUSTEES: ANALYSING RECENT REGULATORY CHANGES FOR LISTED DEBT ISSUANCES

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The increased defaults by a few financial institutions and the complications faced by debenture trustees in expeditious enforcement of collateral for debt securities has prompted the securities market regulator, Securities Exchange Board of India (SEBI) to review its regulatory framework for listed / "to be" listed debt securities and public issue of debt securities and debenture trustees to plug certain loopholes. In furtherance of this objective, and pursuant to the observations made in the SEBI Consultation Paper on review of the regulatory framework for corporate bonds and debenture trustees dated 25 February 2020 (SEBI Consultation Paper) , a slew of amendments (collectively, SEBI Amendments) have been notified recently to the SEBI (Issue and Listing of Debt Securities) Regulations, 2008 (ILDS Regulations), SEBI (Debenture Trustees) Regulations, 1993 (DT Regulations) and the SEBI (Listing Obligations and Disclosure Requirements), 2015 (LODR Regulations) to ensure adequate disclosures and strengthen the role of trustees for effective discharge of their role.

In support of the above amendments, a series of SEBI circulars have been issued in the last few weeks substantially modifying the regulatory framework for debenture trustees and debt issuances i.e. (a) Standardisation of procedure to be followed by debenture trustee(s) in case of 'default' by issuers of listed debt securities dated 13 October 2020 (ICA Circular); (b) Circular on contribution by issuers of listed or proposed to be listed debt securities towards creation of "recovery expense fund" dated 22 October 2020 (REF Circular); (c) Creation of security in issuance of listed debt securities and 'due diligence' by debenture trustee(s) dated 3 November 2020 (3 November Circular); (d) Monitoring and Disclosures by Debenture trustee(s) dated 12 November 2020 (12 November Circular); and (e) Non-compliance with provisions related to continuous disclosure (13 November Circular).

This article analyses the impact of the SEBI Amendments and modifications made through SEBI circulars set out above on disclosures and procedures for listed/ to be listed debt issuances and public issue of debt securities and increased roles and duties of debenture trustees in relation to such issuances.

A. ILDS Regulations: Recent Amendments Introduce Robust Framework of Disclosures

The ILDS Regulations and DT Regulations need to be interpreted together for issue of listed debt securities and we have accordingly analysed the concurrent amendments made in both the regulations to provide a full perspective. On 8 October 2020, SEBI has notified significant amendments in SEBI ILDS (ILDS Amendment), effective immediately from the date of the circular, as detailed below:

Disclosures regime tightened for listed private placements: To ensure adequate disclosure of all critical covenants and documents in entirety, Schedule I of the ILDS has been amended and it has now been mandated to disclose in the "issue details" section of the disclosure document, the following: (i) all covenants of the issue, specifically accelerated payment clause(s) or other covenants disclosed in side letters; (ii) details and purpose of the recovery expense fund; (ii) all conditions for breach of covenants, as stated in the debenture trust deed; (iii) risk factors pertaining to the issue; (iv) details of event of default including manner of voting/ conditions of joining an inter creditor agreement; and (v) details of security including which shall inter-alia state the type of security (movable/immovable/ tangible, etc.), type of charge (pledge/ hypothecation/ mortgage, etc.), minimum security cover, revaluation/replacement of security and date of creation of security to include likely date of creation of security.

Undertaking from issuers with respect to no-objection certificates to be obtained in case of non-exclusive charges: A new regulation 21B has been added to the ILDS Regulations mandating issuers to provide an undertaking prior to the issue stating that the assets on which charge is proposed to be created are free from any encumbrances and if there are existing encumbrances on the secured assets then the permission or consent to create a second or pari-passu charge has been obtained from the existing creditors has been introduced. This issuer undertaking shall form part of the disclosure document for listed debentures.

Creation of recovery expense fund (REF) mandatory for debt securities which are proposed to be listed: From debt issuances after 1 January 2021 onwards, prior to making a listing application for the debt securities, the issuers are required deposit an amount of 0.01% of the issue size (subject to a cap of INR 25 lakhs) with the designated stock exchanges in the form of cash or cash equivalents or bank guarantees, prior to making an application for listing of securities. The creation of REF will aid debenture trustees in the enforcement of security in case of 'default' and towards meeting the recovery proceeding expenses. SEBI has issued a detailed framework in relation to REF vide the REF Circular. Existing issuers have been given a period of 90 days to comply with the REF requirements.

Standard Format of Trust Deed: It has now been made mandatory to bifurcate the trust deed in two parts. Part A of the trust deed shall contain statutory/standard provisions and Part B shall include issue specific clauses/ covenants. The segregation of trust deeds henceforth shall help standardize the format of trust deeds and ensure easier comprehension of commercial covenants by debenture holders.

Standardisation of timeline for listing of debt securities – Clarifications provided: While not part of the ILDS Amendment, with a view to streamline the process and reduce the time taken for listing of debt securities, SEBI has on 5 October 2020, released uniform timelines (applicable from 1 December 2020) for listing of debt securities issued on a private placement basis (SEBI standardization of Timelines Circular). Timelines stipulated are as follows:

Sr No.	Activity	Due Date
1.	Closure of issue	T day
2.	Receipt of funds and Allotment of Securities	To be completed by T + 2 trading day
3.	Listing application to stock exchange(s) and listing permission from stock exchange(s)	To be completed by T + 4 trading day

The depositories will activate the ISIN of debt securities issued on private placement basis, only after the stock exchanges have accorded their approval for listing of such securities. In the

event of delay in listing: (a) the issuer will have to pay a penal interest of 1% per annum over the coupon rate for the period of delay to the investor (i.e. from date of allotment till the date of listing; and (b) restriction will be placed on the issuer to utilise the issue proceeds of its two subsequent privately placed issuances of securities, only, after receipt of final listing approval from stock exchanges.

KCO Observations: SEBI in the consultation paper dated 25 February 2020, had observed that hidden covenants in bilateral arrangements acted as key attributors in the recent cases of defaults in debt securities. For instance, an 'accelerated payment clause' exercised by one lender will also have a negative impact on the repayment for other lenders, affecting the liquidity and operations of the issuer and any form or side letters will need to be disclosed in the disclosure document. Accordingly, the recent amendments will limit any information asymmetry between investors. Further, any no-objection certificates from existing lenders will now need to be obtained and furnished to the debenture trustee prior to entering into the debenture trustee agreement (usually executed prior to issue opening and upload of IM on the electronic book mechanism (EBP) platform). It would be advisable henceforth, to ensure receipt of all lenders' consents as a condition precedent to the issue and listing of debt securities for listed private placements and public issues of debt securities.

B. DT Regulations: Snapshot of Amendments Notified

On same date as the ILDS Amendments, another notification issued by SEBI dated 8 October 2020 has introduced significant amendments to the DT Regulations (DT Regulations Amendments) which are effective from the date of notification mainly to bring the DT regulations in line with the ILDS Regulations amendments.

War chest for enforcement and stricter Assets Cover monitoring: Prior to this amendment, it was the duty of the debenture trustee to inter- alia ensure the implementation of conditions regarding creation of security and debenture redemption reserve. Henceforth, debenture trustees will also have to ensure creation of the new fund namely REF, which is to be created by issuers of listed debt securities prior to making an application for listing of the securities. The REF shall be utilized exclusively for enforcement of security in the event of default by the issuer.

Monitoring of asset cover: SEBI has now by way of the amendments to the DT Regulation imposed an additional duty on debenture trustees to undertake a quarterly diligence to monitor the asset cover of the issuer. Further, the 12 November Circular provides that the debenture trustee shall include terms on periodical monitoring in the DTD and the issuer shall comply with such timelines, including with respect to the submission of an asset cover certificate in the format provided in Annexure A of the 12 November Circular, on a quarterly basis, within 60 days from end of each quarter. In case, a listed entity has more than one debenture trustee for its listed debt securities, then the debenture trustees may choose a common agency for preparation of asset cover certificate.

As against earlier requirement of quarterly and yearly certification for maintenance of asset cover where receivables/ book debts were charged as security, SEBI has made this compliance process more stringent by placing an additional duty on debenture trustees to undertake quarterly diligence to monitor the asset cover of the issuer. Further, the previous requirement of an annual certificate from statutory auditor has now been substituted with a half yearly certificate certifying the value of book debts/ receivables and compliance with the covenants of offer document in the manner as prescribed by SEBI.

Independent due diligence by debenture trustee increased manifold: The requirement for an independent due diligence by debenture trustee has increased manifold by way of the SEBI Amendments, the 3 November Circular and the 12 November Circular and shall become effective from 1 January 2021. The debenture trustee will have to conduct an independent due diligence in relation to any proposed secured to ensure that security proposed to be provided

by the issuer is free from any encumbrance or the issuer has obtained necessary consent from other charge-holders if the security has an existing charge.

While the ILDS Amendment places an obligation on the issuer to provide an undertaking in this regard which will form a part of the disclosure document, it seems the intention of the regulator is to also ensure independent confirmation by the debenture trustee of encumbrance-free security or receipt of proper no objection certificate from the existing lenders.

According to the 12 November Circular, the debenture trustee shall include the terms of periodical monitoring of the security proposed to be offered, in the DTD and shall provide relevant information to the stock exchange(s) in the following manner:

a. Asset cover certificate, statement of value of pledged securities and debt service reserve account: Quarterly within 60 days from end of each quarter

b. Net worth certificates of guarantor (secured by way of a personal guarantee): Half yearly basis within 60 days from end of each half-year

c. Value of guarantor prepared on basis of audited financial statement etc. of guarantor (secured by way of corporate guarantee) along with title search report or valuation report of the movable/immovable assets: Annually within 75 days from end of each financial year.

For existing debt securities, listed entities and trustee(s) shall enter into supplemental or amended DTD within 120 days from the date from 12 November 2020 (i.e. 10 March 2021) incorporating the changes in the DTD.

Debenture trustee as 'financial creditor' under IBC framework: Guidelines for entering into Inter-Creditor Agreements (ICAs): Under the 7 June 2019 circular of the Reserve Bank of India (RBI) (which specifies the mechanism for resolution of stressed assets) investors in debt securities being 'financial creditors', are approached by the lender to sign an ICA. Under the ICA Circular, the debenture trustee, on behalf of the debenture holders, may enter into ICAs as per the prevailing norms prescribed by the RBI, subject to the approval of the debenture holders and the conditions as may be specified by SEBI from time to time. In this regard, the ICA Circular specifies the procedure to be followed by debenture trustees for seeking consent for enforcement of security and entering into an ICA from the debenture holders.

The ICA Circular is effective from the date of its release. The ICA Circular provides for a notice to be given to investors within 2 days from the event of default (EOD) specifying that a meeting of investors shall be convened within 30 days of EOD (not applicable in case of public issue of debentures). The debenture trustee can take necessary action to enforce the security or enter into an ICA as decided in the investor meeting if majority of investors (75% of investors by value of outstanding debt and 60% by number of ISIN level) have consented. In case consents are not received the debenture trustee shall take action as per the decision taken in the meeting of investors. Subject to the decision taken in the investor meeting, the debenture trustee may form a representative committee of the investors to participate in the ICA and consider a resolution plan or enforce the security outside the ICA framework.

Forms of debenture trust deed (DTD) prescribed: Amendments consistent with the amendments in the ILDS Regulations have now made it mandatory to bifurcate the trust deed in two parts.

KCO Observations: SEBI in its efforts to put in place a regulatory framework that would secure the interests of debenture holders and enable trustees to perform their duties more effectively has introduced these procedures. From recent cases of default by certain NBFCs, where the lender bank invited the trustees to be a part of the ICA, there were mixed responses or no consent for joining the ICA, which resulted in delay in investors receiving their dues. This is

indeed a welcome move to make the resolution of stressed assets more inclusive of debenture holders rather than primarily focusing on the interest of banks.

C. LODR Regulations modifications notified: Continuous maintenance and certification of asset cover for debt issuances made mandatory

On the same date as amendments to the ILDS Regulations and DT Regulations, amendments consistent with other SEBI Amendments have been notified on 8 October 2020 in the LODR Regulations, which are effective from the date of notification. The key changes introduced in relation to monitoring of asset cover thereunder have been discussed below:

Maintenance of minimum 100% asset cover made compulsory: The existing Regulation 54(1) of the LODR Regulations, have been substituted, making it mandatory for debt listed entities to maintain 100% asset cover or more, as specified in the OD/IM and/or the DTD, such that the asset cover is sufficient to discharge the principal amount of the debt securities issued at all times.
Further, Regulation 54(3) of the LODR Regulations which had provided exemptions to certain issuers of unsecured debt securities issued by regulated financial sector entities eligible for meeting capital requirements as specified by respective regulators from complying with asset cover requirements, has been omitted.

Statutory Auditor certification mandated for asset cover maintenance: The previous requirement of submission of 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 (Asset Cover Certificate), along with the half yearly financial results has now been amended to ensure such Asset Cover Certificate is provided by the issuer's statutory auditor. Additionally, the statutory auditor must also ensure certification of compliance with all covenants in respected of the listed debt security in the Asset Cover Certificate. Such certification is not required where bonds are secured by a government guarantee. Further, regulation 56(1) has been amended to include a requirement that issuers are now required to inform the debenture trustee regarding all covenants of the issue (including side letters, accelerated payment clause, etc.) in line with other SEBI Amendments. Another requirement to intimate stock exchanges regarding initiation of any forensic audit (along with reasons) on the listed issuers has been introduced.

The 13 November Circular lays down a uniform structure for imposing fines for non-compliance with continuous disclosure requirements to ensure effective enforcement of continuous disclosure obligations by issuers of listed non-convertible debt securities or redeemable preference shares or commercial papers in order to effectively enforce the LODR Regulations.

KCO Observations: While debenture trustees have been obligated to confirm maintenance of a minimum 100% asset cover such that it is sufficient to discharge the principal amount at all times, the term "asset cover" remains undefined and it is unclear whether this requirement applies only for secured issuances. In the SEBI Consultation Paper, the term asset cover has been discussed in the context of security creation and quality of such security. Further clarity in the regulations on the understanding of the term "asset cover" will be required to guide issuers and debenture trustees, in order to comply with the LODR Regulations and their applicability in respect of unsecured debt issues.

D. 3 November and 12 November Circulars: Nuances of due diligence and monitoring by debenture trustees elaborated

The 3 November Circular has provided clarity on (i) issuer's obligations to submit documents to the debenture trustee to enable due diligence; (ii) due diligence obligations of the debenture trustee and (iii) disclosures required to be made under Schedule I of the ILDS Regulations by issuers. The 3 November and 12 November Circulars shall be applicable to all debt issuances proposed to be listed on and after 1 January 2021. Issuers will need to create the charges

specified in the OD/IM and also execute the security documents, before making application for listing of securities. The stock exchanges shall list the debt securities only upon receipt of the due diligence certificate and confirmation of creation of charge, from the debenture trustee.

Extensive documents/ consents required to be given by issuer prior to any issue: The SEBI Amendments have also introduced Regulation 15(6) to the DT Regulations, mandating all debenture trustees to exercise independent due diligence to ensure that (i) the security is free from any encumbrances; or (ii) in case of existing charge, the issuer has obtained the necessary consents from other charge-holders. In furtherance of such obligations, the 3 November Circular states that all issuers are required to submit the documents listed below (based on the type of asset and charge) to the debenture trustee prior to the issue opening and at the time of entering into the DTA to facilitate the due diligence required for security creation. Such documents include:

a. Details of assets, movable property and immovable property on which charge is proposed to be created including title deeds or title reports, copy of evidence of registration with Sub-registrar, Registrar of Companies (ROC), Central Registry of Securitization Asset Reconstruction and Security Interest (CERSAI) etc;

b. For creation of charge on unencumbered assets, an undertaking that the assets on which charge is proposed to be created are free from any encumbrances;

c. For encumbered assets, on which charge is proposed to be created, inter-alia, the following consents along-with their validity as on date of their submission:

   - Details of existing charge over the assets along with details of charge holders, value/ amount, copy of evidence of registration with Sub-registrar, ROC, CERSAI, Information Utility (IU) registered with Insolvency and Bankruptcy Board of India (IBBI) etc. as applicable;

   - Consent/ NOC/ conditional NOC from existing charge holders for further creation of charge on the assets to the issuer, along-with terms of such conditional consent/ permission, if any;

   - Consent/ NOC from existing unsecured lenders, in case, negative lien is created by issuer in favour of unsecured lenders.

d. In case of personal guarantee or any other document/ letter with similar intent is offered as security:

   - Details of guarantor viz. relationship with the issuer;

   - Net worth statement (not older than 6 months from the date of DTA) certified by a chartered accountant of the guarantor;

   - List of assets of the guarantor including undertakings/ consent/ NOC (as per para b and c above);

   - Conditions of invocation of guarantee including details of put options;

- Executed copies of previously entered agreements for providing guarantee.

e. In case of corporate guarantee or any other document/ letter with similar intent is offered as security:

- Details of guarantor viz. holding/ subsidiary/ associate company etc.;
- Audited financial statements (not older than 6 months from the date of DTA) of guarantor including details of all contingent liabilities;
- Other documents same as in d. above;
- Impact on the security in case of restructuring activity of the guarantor;
- Undertaking by the guarantor that the guarantee shall be disclosed as "contingent liability" in the "notes to accounts" of financial statement of the guarantor;
- Copy of Board resolution of the guarantor and executed copies of agreements;

f. In case securities (equity shares etc.) are being offered as security then a holding statement from the depository participant along-with an undertaking that these securities shall be pledged in favour of debenture trustee(s) in the depository system.

g. Details of any other form of security being offered viz. Debt Service Reserve Account etc.

KCO Observations: While the SEBI has taken a step in the right direction by providing an exhaustive list of information to be submitted to the debenture trustee to aid the due diligence process, issuers and arrangers will need to specifically keep in mind the timeframe involved in the process of collating such information, diligence by the debenture trustee or its appointed agencies keeping in mind the timelines involved in obtaining no dues certificates from the Income Tax authorities for immovable property as security, governmental agencies and corporation, SEBI may also consider providing an exemption from obtaining such NOCs prior to the issuance. In such instances, SEBI may dilute the requirement of obtaining NOCs and limit the same to application for the same. Further, SEBI's approach towards listing of specific assets and charges along with supporting documents will need to be elaborated upon to specifically include creation of floating charges over general assets (not just a specified list of assets), especially in the context of NBFC issuers which have dynamic pool of receivables as their only assets.

The information must be submitted by the issuer prior to entering into the DTA, which is prior to the issue opening. Hence, a myriad of activities i.e. obtaining NOCs or regulatory consents, for which a 90 days' timeline was given, has now been cut short. The 90 days' timeline to execute the DTD has perhaps, now been made redundant since the recent amendments will lead to all documents for debenture issue (including security document) being signed upfront or within days of listing (pursuant to the SEBI Standardization of Timelines Circular, security creation needs to be completed with 4 days of issue close date). There is no flexibility to include additional security at a future date as that would mean that the NOC for such additional security will need to be taken upfront. If there are delays in obtaining these NOCs or providing title search reports or proper supporting documents in accordance with the exhaustive list

prescribed, there will be delay in funding of the debt securities which may cause a liquidity issue for the issuers. The requirements of such a prescriptive list would also mean that an issuer may not be able to promptly issue debt securities when the market rate is most conducive if they are commercially not able to fulfill all security creation requirements prior to issue.

Independent verification of Due diligence by debenture trustees for creation of security: Under the provisions of the 3 November Circular a debenture trustee may independently or via experts appointed by them conduct due diligence. The terms and conditions with respect to exercising such due diligence shall also be included in the DTA, to be executed by the issuer and the debenture trustee.

Debentures trustees shall verify whether the assets provided by issuer for creation of security are free from any encumbrances or necessary permissions has been obtained by carrying out the following checks:

1. Verify from ROC, Sub-registrar, CERSAI, IU or other sources where charge is registered/ disclosed as per terms.

2. In case of conditional consent/ permission received:

    - Verify whether such consent by existing charge holders is valid as per terms of transaction documents;

    - Intimate to existing charge holders via e-mail about the proposal to create further charge on assets by issuer seeking their comments/ objections, if any, to be communicated to debenture trustee within next 5 working days;

3. In case of personal guarantee, corporate guarantee verify the relevant filings made on websites of Ministry of Corporate Affairs, Stock Exchange(s), CIBIL, IU etc and obtain an appraisal report, necessary financial certificates viz. from statutory auditor/chartered accountant, as applicable.

Onus has been placed on the debenture trustees to independently or via its appointed experts (such as chartered accountant firm, registered valuer, legal counsel etc.) to prepare reports (valuation report, ROC search report, title search report/ appraisal report, asset cover certificate, etc.) and shall independently assess that the assets for creation of security are adequate for the proposed issue of debt securities. Debenture trustees are required to maintain records and documents of such due diligence exercised for a minimum period of 5 years from the date of redemption of the debt securities.

KCO Observations: Instead of merely relying on issuer disclosures and confirmations, SEBI has now tasked debenture trustees to confirm the security creation requirements applicable to issuers. Additionally, it will be crucial for debenture trustees to appoint experienced and reliance experts to help them with the due diligence, especially with respect to confirmation of financial and legal covenants.

Considering the mammoth task of diligence, monitoring and confirmations required from the debenture trustee, a potential increase in debenture trustee fees and overall cost for listed issuances is foreseen. Issuers will also have to account for the charges of any independent agencies or experts, such as valuation agencies and legal counsels that the debenture trustee may appoint, and the DTA/ consent letter should clearly identity such details. Additionally, the

terms of appointment of the debenture trustee should also identify the liability obligations, in case of any breach of contract by its appointed agents.

In cases where debenture trustees are required to confirm receipt of conditional NOCs, it may also be helpful to ensure that the issuer submits a certificate (including a certificate form a chartered accountant confirming compliance with all financial covenants) to confirm no conditions of the underlying financial document have been breached, instead of just submitting the terms. Further, the requirement to receive any comments/ reservation from existing charge holders within 5 days from intimation shared by the debenture trustee may reduce the time to obtain the same and make it more efficient. However in cases where another debenture trustee or security trustee is the existing charge holder, such trustee will be required to obtain consent of the beneficial holders in accordance with the underlying contact and may not have sufficient time for providing notices/ obtaining consents.

Due Diligence Certificate by debenture trustee mandatory for all listed debt issuances (both private and public): The 3 November Circular requires debenture trustees to issue a "due diligence certificate", the format of which has been included in Annexure A (Due Diligence Certificate) upon completion of their diligence and prior to filing of the information memorandum (IM) or offer document (OD). This certificate shall confirm inter alia the following compliances:

1. Information on consents/ permissions required for creation of further charge on assets are adequately disclosed in the IM / OD;
2. All disclosures made in the OD or IM with respect to creation of security are in confirmation with the clauses of DTA.
3. All covenants proposed to be included in DTD (including any side letter, accelerated payment clause etc.) are disclosed in OD or IM.
4. The issuer has given an undertaking that charge shall be created in favour of debenture trustee as per terms of issue before filing of listing application.

KCO Observation: The Due Diligence Certificate will play a crucial role in boosting investor confidence and will help monitor any potential defaults in the domestic debt securities markets. This requirement is further significant in the context of investment by retail investors in public issuances of debt securities. However, it is essential to note that one of the certification requirements in Annexure A, required the issuer to create charge prior to filing the listing application. In effect, this will limit the ability of issuers and investors to structure debt issuances in which security could be created in the future. Additionally, in light of the SEBI Standardization of Timelines Circular, which shall become applicable from 1 December 2020, issuers (issuing debt securities on a private placement basis) will now be required to ensure security creation before T+4 trading days, wherein T signifies issue close date.

Increased disclosures in the OD/ IM to be made by issuers: Issuers of listed debt securities on a private placement basis or via public issue are now required to disclose the following in the OD or IM:

1. Inclusion of the following: "Debt securities shall be considered as secured only if the charged asset is registered with Sub-registrar and Registrar of Companies or CERSAI or Depository etc., as applicable, or is independently verifiable by the debenture trustee".

2. Terms and conditions of DTA including fees charged by debenture trustees(s), details of security to be created and process of due diligence carried out by the debenture trustee shall be disclosed.

3. Due Diligence Certificate of the debenture trustee.

Further, issuers proposing to file their draft OD or IM through EBP or serially printing the IM in accordance with Section 42 of Companies Act, 2013 can submit the Due Diligence Certificate to the stock exchange while filings the OD/ IM.

These disclosures are required to be made in addition to the ILDS Amendments' which mandated issuers to disclose: (i) the details and purpose of the REF; (ii) all conditions for breach of covenants, as stated in the DTD; (iii) risk factors pertaining to the issue; (iv) details of event of default including manner of voting/ conditions of joining an ICA; and (v) details of security including which shall inter-alia include (a) type of security (movable/immovable/ tangible, etc.); (b) type of charge (pledge/ hypothecation/ mortgage, etc.); and (c) date of creation of security.

KCO Observation: The regulator's intention to ensure complete transparency in issue and security/ charge related disclosures is clearly indicated and will make disclosures by issuers more robust. SEBI has also provided operational flexibility for issuers using EBP or printing the information memorandum in line with Form PAS-4 of the Companies Act, 2013 flexibility of directly submitting the Due Diligence Certificate to the Stock Exchange.

The 3 November Circular read in consonance with the SEBI Standardization of Timelines Circular, requires issuers undertaking private placement, from 1 January 2021 to ensure that the security documents and DTD are executed creation before T+4 trading days, wherein T signifies issue closing date.

Creation and registration of charge of security by issuer applicable on and after 1 January 2021: The 3 November Circular states that the issuer shall be required to create the charge (as disclosed in the OD or IM) in favour of the debenture trustees and execute the DTD prior to application for listing of debt securities. SEBI has also mandated issuer to register the charge with the Sub-registrar, ROC, CERSAI, depository etc. as applicable, within 30 days of creation of charge. In case the charge is not registered anywhere or is not independently verifiable, then the same shall be considered a breach of terms of the issue by the issuer.

Debenture trustees have also been mandated to submit another certificate confirming (i) charge creation in accordance with the DTA and terms of the OD/ IM; (ii) issuer has executed the DTD as per terms of the OD/IM and DTA; and (iii) receipt of undertaking from issuer for registration of charge with the Sub-registrar, ROC, CERSAI, depository etc as applicable, within 30 days of creation of charge. The format of this certificate has been provided in Annexure B of the 3 November Circular. Stock exchanges shall only list debt securities on receipt of this certificate in format of Annexure B from debenture trustees.

KCO Observations: The 3 November Circular provides that creation of security and execution of the DTD is required to be made prior to application for listing of debt securities. As mentioned, in our observations earlier this will limit any flexibility provided for structuring timelines for security creation and to offer security as a condition subsequent, even if disclosed. However, issuers and investors may evolve structures wherein the initial security cover of 1x is required to be maintained, in accordance with applicable SEBI regulations at the time of issuance and thereafter additional security may be provided by way of addendums to the OD/IM. However, not having any assurance on the additional security may be difficult for the investors to agree upfront without providing for it in the initial documentation.

Concluding Comments:

The recent SEBI Amendments are indicative of the pro-active approach adopted by SEBI in empowering debenture trustees, ensuring market transparency and investor protection. There is a fundamental change in the role debenture trustees for both public issue of debentures and listed private placements where for the first time due diligence obligations have been placed on the debenture trustees which was previously only required to be done by issuers. Prior to the recent amendments, SEBI had never prescribed such detailed requirements in relation to independent due diligence or security creation in relation the listed private placement and these changes will bring the debentures holders at par with other lenders (banks and financial institutions) in enforcement situations. With the introduction of the SEBI Amendments, any security creation for debentures will be water tight and strict periodical certified monitoring of asset cover will ensure that in case of default, collateral is available for successful recovery and repayment to debenture holders. Monitoring will ensure that risk of defaults will be highlighted early on. It is worthwhile to note that the abovementioned changes will not only bridge information asymmetry between investors but also have the potential to significantly boost investor confidence and strengthen Indian debt capital markets.

However, certain challenges which we can anticipate are, the procedural impediments of coordination between debenture trustees and issuers, debenture trustees and their appointed experts, agencies and submission of due diligence certificates will need to be ironed out in the coming months and require a more disciplined approach overall. The limitations on flexibility provided to issuers with respect to security creation and execution of DTDs is set to undergo a change. Further, potential hurdles regarding due diligence requirements of debenture trustees, receipt of NOCs, timelines for receipt of regulatory authorities NOCs' may need to be tested and addressed, basis the feedback from market participants. Since the process of obtaining NOCs/ consents takes time, it will add to the timelines for obtaining funds via issuance of debt securities. Accordingly, issuers may consider seeking debentures/borrowings and pari passu security creation NOCs from all its lenders on a yearly basis for an overall limit once a year.

The stringent requirements of the SEBI Amendments and circulars are perhaps too prescriptive and do not provide flexibility for refinancing deals where security is released only upon repayment from proceeds of the debentures or does not take into account the timelines which banks take to provide NOCs or infrastructure/real estate companies which need to take government approvals to provide charge on land. Perhaps it also does not consider the timelines for obtaining title search report, valuations, auditor certifications and the overall increase in cost for debt issuances.

Further, the amendments remain silent on how floating charges will be treated, which is commonly seen in case of NBFCs providing a floating charge on all their assets (which have loan receivables as their inventory). Guarantees by promoters and group companies are important tools in enforcements and allows lenders/trustee to initiate IBC against the guarantors in addition to IBC against issuers. However, given the additional requirements of providing list of assets/net-worth statements etc., there may be a lot of resistance in providing guarantees for debenture issuances going forward.

Further, since the amendment to the Indian Stamp Act, 1899 (Act) by way of the Part I of Chapter IV of the Finance Act 2019 (No. 7 of 2019), immovable property security is not required any longer for obtaining stamp duty benefits. Considering the requirement to obtain NOC from tax authority, title search reports, lender/government consents, registration with the sub-registrar etc, for immovable property as security, a likely consequence of these amendments may be that, immovable property is no longer offered by issuers as part of the collateral for debentures in order to save time, cost and procedural formalities. Perhaps, a longer timeline for different type of collateral could have been prescribed given the procedural requirements. Flexibility to provide security (and all formalities related thereto as condition subsequent) post

issuance as additional collateral so long as asset cover is met at the time of issue could have been considered.

Since similar requirements are not applicable in case of unlisted debt issuances and banks/NBFC finance, these requirements may mark a shift from listed debt securities to traditional financing options. The large borrower entities which are mandated to avail at least 25% of their incremental borrowings from the debt market mandatorily will probably prefer unsecured issuances at higher cost in order to meet the debt market requirements. While the SEBI Amendments are a welcome move, given the practicalities and commercial requirements, it remains to be seen whether various stakeholders will be able to adapt and adopt the changes in the policies.

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