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Analysing developments impacting business

DEBENTURE TRUSTEE DUTIES CONSOLIDATED AND EXPANDED FOR LISTED DEBT SECURITIES UNDER SEBI'S MASTER CIRCULAR

20 September 2023 **Background**

In a move to streamline the framework dealing with the issuance and listing of non-convertible securities (NCS), the Securities and Exchange Board of India (SEBI) had consolidated various circulars pertaining to disclosure requirements and various procedures and obligations in relation to the debenture trustees (DT) into a single operational circular dated 31 March 2023¹, with a view to remove inconsistencies and repetitions contained in the existing circulars (which now stand rescinded either in whole or in part). The consolidated circular provided listed issuers of NCS (Issuers) and DTs with a uniform framework for referring to all regulations and guidelines applicable to them. The aforementioned circular has now been renamed as the '*Master Circular for Debenture Trustees*'² with effect from 6 July 2023 (Master Circular). The detailed stipulations contained in the superseded circulars have been arranged chapter-wise in the Master Circular, the provisions of which have come into effect from 1 April 2023.

KEY CHANGES

1. DT's DUE DILIGENCE OF SECURED LISTED NCS

In order for DTs to exercise due diligence with respect to creation of security, Issuers were required to provide certain information and documents to the DTs, prior to and post security creation, pursuant to the very detailed SEBI circular dated 3 November 2020³ (November 3 Circular). The list of documents and consents which the Issuers must mandatorily provide DTs at the time of entering the DTA have now been set out under Chapter II of the Master Circular.

Under the November 3 Circular, DTs were required to issue a 'due-diligence certificate' as per the format specified in Annexure A to the November 3 Circular, confirming certain aspects in relation to consents, permissions, disclosure pertaining to security creation and various covenants in the debenture trust deed. This due-diligence certificate is required to be in place at the time when the Issuer applied for in-principle approval from the stock exchange. The Master Circular now requires DTs to issue the above due diligence certificate as per the format specified in Annexure-

¹ Circular No. SEBI/HO/DDHS/P/CIR/2023/50 - Operational Circular for Debenture Trustees, dated 31 March 2023.

² Circular No. SEBI/HO/DDHS-PoD1/P/CIR/2023/109.

³ Circular No. SEBI/HO/MIRSD/CRADT/CIR/P/2020/218 - Creation of Security in issuance of listed debt securities and 'due diligence' by debenture trustee(s).

IIA of Chapter II of the Master Circular (which is similar to the format provided under Annexure A of the November 3 Circular).

Chapter II of the Master Circular also brings clarity in the manner in which the due-diligence certificate is required to be obtained in cases where the security package has not been finalised at the time of filing the shelf prospectus (in case of public issue of NCS) or placement memorandum (in case of private placement of NCS). It essentially states that at the time of filing the shelf prospectus (in case of public issue of NCS) or 'placement memorandum'⁴ (in case of private placements of NCS), the due diligence certificate shall confirm aspects other than security creation and at the time of filing the tranche prospectus (in case of public issue of NCS) or placement memorandum (in case of private placements of NCS), the due diligence certificate shall cover all aspects including those pertaining to security creation.

2. **'ENCUMBRANCE' EXPLAINED AND MANNER OF SECURITY CREATION SPECIFIED**

The Master Circular sets out that in case of encumbrance over securities for any listed debt issuance, such encumbrance shall be created only through the depository system. Further, it also clarifies what would comprise encumbrance and this explanation is similar to the explanation provided for encumbrance under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

'Encumbrance' in relation to the above shall mean the following:

- a) pledge, hypothecation, mortgage, lien, negative lien, non-disposal undertaking or non-disposal agreement;
- b) any restriction on the free and marketable title to the asset, by whatever name called, whether executed directly or indirectly; and
- c) any covenant, transaction, condition or arrangement in the nature of encumbrance, by whatever name called, whether executed directly or indirectly.

This would effectively mean that in case of financial securities in the nature of shares and debentures, only dematerialised shares and debentures would be capable of being charged.

Further, under the November 3 Circular, stock exchange(s) would list the debt securities only upon receipt of a due diligence certificate provided in the format specified in Annexure B of the November 3 Circular. The Master Circular continues to use the same format of the due diligence certificate and only changes the reference of the due diligence certificate from Annexure B under the November 3 Circular to Annexure-IIB of Chapter II of the Master Circular.

3. **SECURITY AND COVENANT MONITORING**

The SEBI circular dated August 13, 2021 on 'Security and Covenant Monitoring' using Distributed Ledger Technology (DLT Circular)⁵ and SEBI Operational Guidelines for 'Security and Covenant Monitoring' using Distributed Ledger Technology, which set out the processes using the distributed ledger platform (DLT) in relation to the manner of recording security created by Issuers, manner of monitoring of security created by DTs and monitoring of covenants of debt securities, have been rescinded. The detailed provisions for security and covenant monitoring using the DLT are now contained under Chapter III of the Master Circular.

⁴ Pursuant to the SEBI (Issue and Listing of Non-Convertible Securities) (Second Amendment) Regulations, 2023, all references to 'placement memorandum' under the SEBI (Issue and Listing of Non-Convertible Securities) 2021, as amended, shall mean the relevant general information document and key information document issued by an Issuer.

⁵ SEBI/HO/MIRSD/MIRSD/CRADT/CIR/P/2021/618 dated August 13, 2021 and Circular No. SEBI/HO/MIRSD/CRADT/CIR/P/2022/38 dated 29 March 2022.

Issuers are now required to record in the format set out under Annexure-III A of Chapter III of the Master Circular (which is similar to the format provided under Annexure – A1 of the DLT Circular), the following:

- a) details related to security cover and asset details in the DLT system at the time of creation of temporary ISIN/ ISIN;
- b) half yearly certificate by statutory auditors of an Issuer certifying the security cover;
- c) half yearly certificate by statutory auditors of an Issuer certifying the security cover;
- d) information relating to payment of interest and repayment of principal of the debt securities at the time of creation of ISIN/ temporary ISIN.

Under the DLT platform, a system generated unique identifier (Asset ID) will be allotted for each asset offered by an Issuer as security for the debt securities and the Asset ID will be generated as in the format provided in Annexure-IIID of Chapter III of the Master Circular (which is similar to the format provided under Annexure A2 of the DLT Circular). Further, DTs have clarified that in order to generate the due diligence certificate as prescribed under Annexure-IIA of Chapter II of the Master Circular, all the requisite details under Annexure-III A of Chapter III of the Master Circular would need to be uploaded by Issuers in the DLT platform. Therefore, the timelines for upload of information in the DLT system vis-à-vis Annexure-III A of the Master Circular, has been shifted prior to applying for in-principle approval by the Issuer.

4. SECURITY COVER CERTIFICATE AND PERIODICAL/ CONTINUOUS MONITORING BY DTs

SEBI vide circular dated November 12, 2020, read with circular dated 19 May, 2022⁶ (Security Cover Certificate Circulars), required Issuers to furnish to DTs, a security cover certificate on a quarterly basis, in the format specified under Annexure I of Security Cover Certificate Circular, which provided a holistic picture of all the borrowings and the status of encumbrance on the assets of the Issuer. The Master Circular now provides for submission of the security cover certificate as per Annexure-VA of Chapter V of the Master Circular (which is similar to the format provided under Annexure I of the Security Cover Certificate Circulars). In addition to Issuers, the DTs, are also required to independently, on a quarterly basis, certify the market value of assets based on the due diligence carried out by it or its appointed agencies and submit the above certificate in respect of the secured debt securities.

Further, the timelines for submission by Issuers to provide the security cover certificate, valuation reports, quarterly compliance reports and other specified reports to DTs, so as to enable the DTs to submit all relevant documents/ information to stock exchanges have been consolidated under Chapter VI of the Master Circular.

5. DISCLOSURE BY DTs ON THEIR WEBSITE

Chapter VII of the Master Circular combines three circulars in respect of information disclosure by the DT, namely, the (i) Security Cover Certificates; and (ii) SEBI circular dated 27 May 2019⁷.

⁶ Circular No. SEBI/HO/MIRSD/MIRSD_CRADT/CIR/P/2022/67 - Revised format of security cover certificate, monitoring and revision in timelines.

⁷ Circular No SEBI/ HO/ MIRSD/ DOS3/CIR/P/2019/68.

The aforesaid circulars require DTs to make, inter alia, the following disclosures on their website as specified below:

- a) Revision in credit ratings;
- b) Monitoring of the security cover certificate and quarterly compliance reports of the Issuer;
- c) Status of information regarding breach by an Issuer of any covenants/terms of issuance of an NCS; and
- d) Status of information regarding any default by an Issuer and action taken by a DT.

A DT is also required to display on its website, ISIN wise details of interest and redemption which are due to the holders of listed debt securities in respect of all issues during a financial year within a period of 5 (five) working days of start of the financial year.

6. BREACH OF COVENANTS, DEFAULT AND REMEDIES

The SEBI circular dated 13 October 2020 on "Standardisation of Procedures to be followed by Debenture Trustee(s) in case of 'Default' by Issuers of listed securities"⁸(Defaults Circular) has been superseded. The provisions under the Defaults Circular are incorporated under Chapter X of the Master Circular, which provide for, *inter alia*, the following:

- a) Process for convening meeting of holders of an NCS and obtaining consent of investors for enforcement of security and for signing any Inter Creditor Agreement (ICA);
- b) Conditions for signing of an ICA by DTs on behalf of Issuers; and
- c) Actions to be taken in case of breach of covenants or terms of an issuance of NCS.

In the notice to be issued by the DTs to the investors of defaulted debt securities, in addition to such requirements prescribed in the Defaults Circular, the following provisions are required to be included:

- a) Positive consent for signing the ICA (in case the DTs are approached by other lenders for signing or joining the ICA); and
- b) A disclosure to the effect that in case requisite consents are not received either for enforcement of security or for signing ICA, then the DTs shall take further action, if any, as per the decision taken in the meeting of the holders of listed debt securities.

7. OPERATIONAL FRAMEWORK FOR TRANSACTIONS IN DEFAULTED DEBT SECURITIES

The operational framework for transactions in defaulted debt securities, i.e., debt securities where redemption amount has not been paid on maturity or redemption date, was outlined in Chapter XI of the SEBI operational circular dated 10 August 2021⁹.

⁸ Circular No. SEBI/HO/MIRSD/CRADT/CIR/P/2020/203.

⁹ Circular No. SEBI/HO/DDHS/P/CIR/2021/613.

The provisions of the above chapter now stand incorporated, to the extent applicable to DTs, under Chapter XI of the Master Circular. The said chapter details, inter alia, the role of DTs if an Issuer fails to intimate the status of payment of the debt securities within the stipulated timelines and the process of continuous assessment and reporting of the status of default of such debt securities.

8. Recovery Expense Fund (REF)

The SEBI circular dated 22 October 2020¹⁰ read with the SEBI circular dated 19 May 2022, contained provisions requiring Issuers to contribute towards creation of an REF to enable the DTs to take prompt action for enforcement of security and legal proceedings in case of 'default' in respect of listed debt securities. The above circulars now stand superseded and Chapter IV of the Master Circular consolidates the above-mentioned circulars, providing for the manner of creation of REF and the utilisation of the funds therein.

Comment

SEBI's shift to merge and align the existing guidelines for DTs in respect of listed debt securities into a single consolidated master circular will improve readability and ensure that there is a single point reference for all relevant information. It also streamlines the various aspects in relation to debt securities and enables all stakeholders to have complete clarity in relation to the role of a DT in a debt issuance in one place which will enable better compliance.

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¹⁰ SEBI/HO/MIRSD/CRADT/CIR/P/2020/207 - Contribution by Issuers of listed or proposed to be listed debt securities towards creation of "Recovery Expense Fund".