

## SEBI's Enhanced Guidelines for Debenture Trustees

written by Jidesh Kumar | November 10, 2022



On August 4, 2022, the Securities and Exchange Board of India ('SEBI') issued enhanced guidelines for debenture trustees and listed issuer companies on security creation and initial due diligence to protect investor's interests in securities, promote securities market growth, and regulate the securities market, particularly in the case of debenture trustees.[1] The revised requirements relating to encumbrance of securities and debenture trustee due diligence as outlined in the circular dated November 3, 2020, for the Creation of Security in the Issuance of Listed Debt Securities and Due Diligence by Debenture Trustees now includes the ability to create additional security post-listing of the Non-Convertible Debentures ('NCDs') as well as the conversion of both secured and unsecured listed NCDs.[2]

However, who are debenture trustees? To understand this, one must first understand that a debenture is a financial instrument signed by the corporation that acknowledges its duty to repay the principal amount at a predetermined rate while also bearing interest. It is an approach to increasing the funding or capital of the organization. Thus, a debenture is similar to a loan certificate which evidences the company's commitment to pay a predetermined sum with interest; however, the money raised through debentures does not constitute share capital, while being added to the company's capital structure. Thus, a debenture trustee refers to a trustee of a trust deed that secures a corporation's capacity of issuing debentures.

[3]The enhanced guidelines apply to issuers who have listed or intend to list NCDs, securitized debt instruments, security receipts, municipal debt securities, commercial paper, depositors, trustees, and credit rating agencies that are SEBI-registered ('Stakeholders').

## Significant Changes

Manner of change in Security/creation of additional security/conversion of unsecured to secured in case of already listed NCD securities

Under Regulation 59 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ('SEBI LODR'), any change in security,

creation of additional security in the case of already secured debt securities, or creation of security in the case of unsecured debt securities, will result in structural changes in the terms of listed debentures. The new guidelines offer the following:

Step 1: For any change in security, formation of security, or extra security, the debenture trustee must conduct due diligence per the Due Diligence Conditions outlined in paragraphs 4 - 7 of the 3<sup>rd</sup> November 2020 circular and the debenture trustee is required to issue 'due-diligence certificate' as per the format specified therein. Before proceeding, the security and debenture trustee must issue a no-objection certificate ('NOC') to the Issuer who intends to proceed with the proposed changes in the structure / creation of security.

Step 2: The Issuer shall execute the proposed security and charge in favor of the debenture trustee upon completion of the due diligence requirements and upon the receipt of a certificate confirming that there are no objections. Furthermore, the charge must be registered within 30 days with the appropriate sub-registrar, company registrar, depository, Central Registry of Securitization Asset Reconstruction and Security Interest of India, etc., as the case maybe. If the charge is not registered or cannot be independently verified, the Issuer is deemed to have breached the covenants and/or terms of issue associated with the issuance of the listed NCDs.

Step 3: To include all terms and conditions resulting from the debenture trustee's due diligence and the security created by the Issuer, the Issuer and debenture trustee must sign an additional or revised debenture trust deed.

Step 4: The NOC, the Debenture Trustee Deed, an undertaking from the debenture trustee that the security has been created and registered, and any other documents or consents in accordance with Regulation 59 of SEBI LODR (and other applicable circulars) must be submitted to the depositories and stock exchanges by the Issuer.

Step 5: The competent depository will assign the listed NCDs a new International Securities Identification Number ('ISIN') and notify the recognized stock exchanges about the same.

Encumbrance on securities for issuance of listed debt securities

Any encumbrance placed on securities used to secure NCDs must be done through the depository system only and per all applicable laws and regulations.

Furthermore, an "encumbrance" is defined as any restriction on the free and marketable title to securities, regardless of the term used or whether it was performed directly or indirectly, as well as any covenant, transaction, condition, or arrangement like an encumbrance.

Due diligence in the case of Shelf Prospectus/Memorandum

The debenture trustee must do due diligence in the process as explained below, if the security's specifications were not finalized at the time the Issuer issued a drafted shelf prospectus or placement memorandum. The process is as follows:

- The debenture trustee may issue a due diligence certificate attesting to the completion of due diligence for clauses other than those involving securities mentioned in Annexure A of the 3 November 2020 Circular and the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 ('SEBI NCS').
- Second, at the time of the issuance of the tranche memorandum/ prospectus when the issue structure has been determined and finalized, the debenture trustee

will be required to issue a due diligence certificate covering all clauses of the formats prescribed under the relevant provisions of the SEBI NCS Regulations and Annexure A of the 3<sup>rd</sup> November 2020 Circular at the time of the issuance of the memorandum/prospectus.

#### Empanelment of External Agencies by Debenture Trustee

The debenture trustee has the authority to appoint third parties to conduct due diligence. Before making such an appointment, debenture trustees must adopt a board-approved empanelment criteria/policy and publish it on their website. In addition, they must develop and publicize a conflict-of-interest policy. A policy of this type must state that an external agency cannot have had any financial ties to the Issuer in the last 3 years prior to the issue. Compliance with SEBI circulars on 'Security & Covenant Monitoring System' The stakeholders must ensure compliance with all SEBI circulars related to the distributed ledger technology system, such as the SEBI circular on Security and Covenant Monitoring using Distributed Ledger Technology[4] and the SEBI circular on Operational Guidelines for Securitization.[5] Such compliance would ensure the efficient recording of information regarding the creation of security and the supervision of covenants via the system run by depositories using distributed ledger technology.

#### Conclusion

SEBI has increased its pressure on the debenture trustee to ensure that the necessary filings and documents for the formation or change of securities are in place. Under Regulation 59 of the SEBI LODR, it is possible to offer extra security after an NCD has been listed and to convert unsecured listed NCDs into secured listed NCDs after listing. Now, since any significant modification to the structure of listed NCDs requires prior approval from the stock exchange, SEBI has broadened the term of "encumbrance", which can include listed NCDs. Issuers and debenture trustees will now be required by the depository to report any encumbrance (as defined by the term's enlarged definition).

This has the logical consequence that listed NCDs can no longer be charged against physical securities. Furthermore, any encumbrance on listed or unlisted securities appears to be required to be notified to the repository for listed NCDs. In conclusion, SEBI as the Capital Markets regulator has tightened the limitations on debenture trustees holding listed stocks.

#### FAQs

##### Who Is A Debenture Trustee?

The Issuer Company appoints a Debenture Trustee to act as a liaison between the Issuer Company and the Debenture Holders and to protect the Debenture Holders' interests.

##### Who can be a debenture trustee?

Regulation 7 of the SEBI (Debenture Trustees) Regulations, 1993, specifies who is qualified to be appointed as a Debenture Trustee. These are:

1. A scheduled bank carrying on commercial activity
2. A public financial institution
3. An insurance company
4. A body corporate

The entity should be registered with SEBI to act as a debenture trustee

What are the duties of a debenture trustee under the SEBI debenture trustees Regulations 1993? .

Regulation 15 (duties of debenture trustee) in addition to Schedule III (Code

of conduct of debenture trustee) of the SEBI (Debenture Trustees) Regulations, 1993, specifies the various duties of a Debenture Trustee. They are:

1. Call for periodical reports from the body corporate, i.e., issuer of debentures.
2. Take possession of trust property in accordance with the provisions of the trust deed.
3. To take appropriate measures for protecting the interest of the debenture holders as soon as any breach of the trust deed or law comes to his notice.
4. Enforce security in the interest of the debenture holders

[1][https://www.sebi.gov.in/legal/circulars/aug-2022/enhanced-guidelines-for-debenture-trustees-and-listed-issuer-companies-on-security-creation-and-initial-due-diligence\\_61629.html](https://www.sebi.gov.in/legal/circulars/aug-2022/enhanced-guidelines-for-debenture-trustees-and-listed-issuer-companies-on-security-creation-and-initial-due-diligence_61629.html).

[2][https://www.sebi.gov.in/legal/circulars/nov-2020/creation-of-security-in-issuance-of-listed-debt-securities-and-due-diligence-by-debenture-trustee-s-\\_48074.html](https://www.sebi.gov.in/legal/circulars/nov-2020/creation-of-security-in-issuance-of-listed-debt-securities-and-due-diligence-by-debenture-trustee-s-_48074.html).

[3][https://www.sebi.gov.in/sebi\\_data/faqfiles/dec-2016/1482144051182.pdf](https://www.sebi.gov.in/sebi_data/faqfiles/dec-2016/1482144051182.pdf).

[4][https://www.sebi.gov.in/legal/circulars/mar-2022/operational-guidelines-for-security-and-covenant-monitoring-using-distributed-ledger-technology-dlt-\\_57331.html](https://www.sebi.gov.in/legal/circulars/mar-2022/operational-guidelines-for-security-and-covenant-monitoring-using-distributed-ledger-technology-dlt-_57331.html).

[5][https://www.sebi.gov.in/legal/circulars/apr-2022/updated-operational-circular-for-issue-and-listing-of-non-convertible-securities-securitised-debt-instruments-security-receipts-municipal-debt-securities-and-commercial-paper-modifications-in-cha-\\_58060.html](https://www.sebi.gov.in/legal/circulars/apr-2022/updated-operational-circular-for-issue-and-listing-of-non-convertible-securities-securitised-debt-instruments-security-receipts-municipal-debt-securities-and-commercial-paper-modifications-in-cha-_58060.html).

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