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## Recent changes to the SEBI regulations relating to the listed NCDs

The Securities and Exchange Board of India (“SEBI”) has recently amended the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 (“NCS Regulations”) and the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“LODR Regulations”) on April 11, 2022, in relation to the issue of non-convertible debentures (“NCDs”). Further, SEBI has also introduced a new circular titled ‘Revised format of security cover certificate, monitoring and revision in timelines’ dated May 19, 2022 (“SEBI Circular”), to clarify and address the operational challenges faced by market participants.

The key changes introduced by the amendments and the SEBI Circular are discussed below:

1. **100% or higher security cover for secured debt securities:** The NCS Regulations, clarify that for secured debentures, the issuer should maintain 100% security cover or higher security cover as per the terms of the offer document and/or debenture trust deed, which should be sufficient to discharge the principal amount and the interest thereon at all times for the issued debt securities.

The NCS Regulations further clarify that the issuers, trustees and investors would need to ensure that the security cover also accounts for the interest and not just the principal amount. This requirement earlier existed only under the Companies Act, 2013.

2. **Submission of a due diligence certificate:** The amended NCS Regulations prescribe a new requirement for submission of a due diligence certificate by the debenture trustee to the stock exchange/SEBI for unsecured debt securities as per the prescribed format. The certificate confirms that: (a) all disclosures in the offer document are true, fair and adequate; (b) the issuer has disclosed all covenants proposed to be included in debenture trust deed (including any side letter, accelerated payment clause etc.), in the offer document; and (c) the issuer has given an undertaking that debenture trust deed will be executed before filing of listing application. Accordingly, such debenture trust deed must be executed prior to making the listing application as per the SEBI circular dated November 3, 2020. As per the SEBI operational circular dated August 10, 2021, the NCDs must be listed within 4 working days of the issue closure.

While earlier a similar certificate was required by the stock exchange at the time of obtaining listing approvals for NCDs, now this requirement has been set out under the NCS Regulations.

3. **Undertaking that the assets are free from encumbrances or if encumbered, consents having been obtained:** Prior to the NCS Regulations amendment, the charge created in respect of secured debt securities was required to be disclosed under the offer document along with an undertaking that all the assets on which security has been created are unencumbered and if the assets are encumbered, the permissions or consents to create any

further charge on the assets has been obtained from the existing creditors to whom the assets are charged, prior to creation of the charge, with respect to those charged assets which constitute the 100% security cover.

After the amendment, the undertaking will now need to be obtained with respect to all the charged assets and not only those constituting 100% security cover. Parties were utilising this provision to limit the scope of the due diligence required for the purpose of the security cover up to 1x, which practice would need to be re-examined in light of the above regulatory amendment.

4. **Credit Rating:** Under the NCS Regulations, the requirement that the rating letter issued should not be older than 1 month on the date of the opening of the issue has been removed. The amendment now requires the disclosure of the details of the credit rating along with the latest press release of the credit rating agency in relation to the issue, which should not be older than one year from the date of opening of the issue. Further, the placement memorandum should contain a declaration that the rating is valid as on the date of issuance and listing.
5. **Substitution of asset cover requirement to security cover:** The requirement under the NCS Regulation prior to the amendment, to maintain 100% asset cover, has been removed. As per the amended NCS Regulations, the issuers of the secured debentures will have to maintain 100% or higher security cover with respect to its secured listed non-convertible securities, as per the terms of the offer document and/ or the debenture trust deed, sufficient to discharge the principal amount and the interest thereon, for the non-convertible debt securities.
6. **Monitoring and reporting of security cover and covenants and disclosures in relation to the recovery expense fund:** In order to address the issues related to operational challenges faced by the issuers, debenture trustees and other market participants in complying with certain provisions of circulars issued by SEBI with respect to periodical monitoring and disclosures of security cover and covenants by debenture trustees of listed / to be listed non-convertible securities and requirement for creation of the recovery expense fund, the SEBI Circular has been introduced. The key features of the SEBI Circular are as follows:

(a) **Security Cover (Part A of the SEBI Circular)**

- (i) **Security Cover Ratio:** In order to standardize calculation of security cover ratio, the following formulas will need to be used:
  - (A) security cover ratio in case of exclusive security cover will be calculated as the ratio of (I) the value of assets having exclusive charge; to (II) the aggregate of the outstanding value of corresponding debt and interest accrued; and
  - (B) security cover ratio in case of *pari passu* security cover will be calculated as the ratio of (I) the value of assets having *pari passu* charge; to (II) the aggregate of the outstanding value of corresponding debt and interest accrued.

The assets that are not paid for will not be included as part of any security cover calculation.

(ii) **Security Cover Certificate**

- (A) **Format of the security cover certificate:** The format for preparation of the asset cover certificate for listed debt securities which was prescribed in Annexure A of the SEBI circular dated November 12, 2020 ("**November 12 Circular**"), for disclosure of the asset cover to stock exchanges by the debenture trustees of the listed entity, has now been rescinded. The revised format of a security cover certificate has now been prescribed to provide a holistic picture of all the borrowings and the status of encumbrance on the assets of the listed entity.
- (B) **Frequency:** The security cover certificate is required to be prepared on a quarterly basis and the requirement of the statutory auditor of the listed entity to certify the book values of the assets provided in such certificate continues to apply. Where frequency of valuation for asset classes has been prescribed by SEBI, the market value should be provided in the certificate. For asset classes where there is no regulatory guideline on frequency of valuation, then it will be on a quarterly basis.

However, in case the issuer company has more than one debenture trustee for its listed debt securities, the listed entity will need to prepare a separate certificate for each debenture trustee.

- (C) **Standalone/Consolidated**: If the security cover offered for the debt securities comprises the assets of the listed entity only, the security cover will need to be prepared on standalone basis. If the debt securities are secured by creation of charge on the assets of third party/subsidiary/group/holding company or assets of the listed entity are offered for securing the debt securities issued by third party/ subsidiary/ group/ holding company or assets of the listed entity are offered for securing the other liabilities of third party/subsidiary/group/holding company, the listed entity will need to make disclosure in two separate tables: (I) table for security cover on standalone basis for the listed entity; and (II) table on net summary basis on a consolidated level.
- (D) **Statutory Auditor Certification**: The book value for security cover will need to be certified by the statutory auditor of the third party/ subsidiary/ group/ holding company with respect to third party/subsidiary/ group/ holding company assets being offered as underlying security. In case it comprises of an exclusive charge, it will include details of the assets including book value. In case, security cover comprises *pari-passu* charge on third party/subsidiary/group/holding company assets, the security cover certified by the statutory auditor of the concerned third party entity will include details of all encumbrances on such assets. An additional column for debt not backed by any assets offered as security to capture details of unsecured debentures has also been included in the certificate.
- (E) **Debenture trustee Certification**: Debenture trustees will need to, on quarterly basis, certify the market value of assets based on the due diligence carried out by it or its appointed agencies and submit the security cover certificate, to the extent of the charge held by it.
- (F) **Unique Document Identification Number (“UDIN”)**: The UDIN will be generated for each certificate issued by the statutory auditor and by empanelled chartered accountants.

**(b) Monitoring and reporting of breach of covenants (Part B of the SEBI Circular)**

- (i) The listed entity will need to furnish the compliance status with respect to financial covenants of the listed debt securities certified by the statutory auditor of listed entity to the debenture trustee on a quarterly basis.
- (ii) The debenture trustee will need to establish board approved internal policies for effective monitoring of breach of covenants.
- (iii) The debenture trustee will have to formulate the category wise list of covenants applicable to the particular issuance defining the frequency of each covenant to be monitored viz. continuous, quarterly, half yearly or annual. The covenants may be categorized *inter alia*, as financial covenants, affirmative covenants or negative covenants. A guidance note for the list of covenants to be prepared is prescribed.
- (iv) The debenture trustee will have to furnish a status report on its website and to the stock exchange(s) for further dissemination on a quarterly basis.
- (v) The requirement of quarterly certification of the financial covenants may pose an additional requirement over the issuers where the testing of financial covenants has been commercially agreed to be on an annual or semi-annual basis.

- (c) **Disclosures to the stock exchange (Part C of the SEBI Circular)**: The debenture trustee must, within 48 hours, disclose (i) any no-objection certificate /no-dues certificate/consent/permission issued by it to the listed entity including the consent/ no-objection certificate for further borrowings; and (ii) breach of minimum security cover.

- (d) **Lead debenture trustee (Part D of the SEBI Circular):** In case of *pari-passu* charge, wherein multiple debenture trustees are holding charge over the same assets, a lead debenture trustee may be decided amongst the debenture trustees based upon the amount of the charge each debenture trustee holds and accordingly the exercise of carrying out the valuation and preparation of the valuation report may be carried out by the lead debenture trustee.
- (e) **Timelines for submission of documents (Part D of the SEBI Circular):** The SEBI Circular has revised the timelines provided under the November 12 Circular in relation to submission of the security cover certificate, valuation report, title search reports and compliance reports by the debenture trustees. The revised timelines are provided below for reference.

(i) **Submission to stock exchange by debenture trustee:**

Report / Certificate	Earlier Timelines	Amended Timelines
<b>Security cover certificate for each quarter except the last quarter</b>	Within 60 days from the end of each quarter	Within 75 days from the end of each quarter except the last quarter of financial year
<b>Security cover certificate for the last quarter</b>	Within 60 days from the end of the quarter	Within 90 days from the end of financial year
<b>Valuation report</b>	Annual basis within 75 days from the end of each financial year	Once in three years within 75 days from the end of the financial year
<b>Title search report</b>	Annual basis within 75 days from the end of each financial year	Once in three years within 75 days from the end of the financial year

(ii) **Website disclosure by debenture trustee:**

Report / Certificate	Earlier timeline	Amended Timelines
<b>Security cover certificate for each quarter except the last quarter</b>	Within 60 days from the end of each quarter	Within 75 days from the end of each quarter except the last quarter of financial year
<b>Security cover certificate for the last quarter</b>	Within 60 days from the end of the quarter	Within 90 days from the end of financial year
<b>Quarterly compliance report for each quarter except the last quarter</b>	Within 60 days from the end of each quarter	Within 75 days from the end of each quarter except the last quarter of financial year
<b>Quarterly compliance report for the last quarter</b>	Within 60 days from the end of the quarter	Within 90 days from the end of financial year

(iii) **Submission to SEBI by debenture trustee:**

Report	Earlier Timelines	Amended Timelines
<b>Half-yearly compliance report</b>	Half-yearly basis within 30 days of the end of each half-year	Half-yearly basis within 75 days of the end of each half-year
<b>Details of other activities carried out by the debenture trustee(s) including type of activity, description of activity, etc.</b>	Half-yearly basis within 30 days of the end of each half-year	Half-yearly basis within 75 days of the end of each half-year

**(f) Recovery Expense Fund (Part E of the SEBI Circular)**

- (i) It has been clarified that the 'recovery expenses fund' under the SEBI circular dated October 22, 2022 has to be created and utilized for both, secured and unsecured listed debt issuances and 'enforcement of security' under the SEBI circular should be read as 'enforcement/legal proceedings'. The stock exchanges were, in any case, taking the view that the recovery expense fund is required for unsecured NCDs and accordingly, the issuers of unsecured NCDs were also required to maintain the recovery expense fund.
  - (ii) The debenture trustee(s) is required to take confirmation from the designated stock exchange(s) or any other independent source in writing regarding the creation of the recovery expense fund by the listed entity.
- (g) **Effectiveness:** The provisions mentioned in Part A and B of the SEBI Circular will come into force with effect from October 1, 2022. The other provisions have been made effective from the date of the SEBI Circular.

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