



August 2022

Enhanced guidelines on security creation relating to listed debt securities

The Securities and Exchange Board of India (“SEBI”) has issued enhanced guidelines for debenture trustees and listed issuer companies on security creation and initial due diligence by way of a circular dated August 4, 2022 (“**Enhanced Guidelines**”).

Previously, SEBI had issued a circular on ‘*Creation of Security in issuance of listed debt securities and due diligence by debenture trustee(s)*’ dated November 3, 2020 (“**November 3 Circular**”) pursuant to which debenture trustees are required to, inter alia, carry out due diligence with respect to creation of security for issuances of listed non-convertible debentures (“**NCDs**”). To enable the debenture trustee to carry out such due diligence, issuers of listed NCDs (“**Issuer(s)**”) are required to provide information / documents to their debenture trustee as specified in the November 3 Circular. Further, the November 3 Circular specified that (a) Issuers should create security in favour of the relevant debenture trustee as specified in the offer document / placement memorandum and also execute the debenture trust deed with the debenture trustee *before* making an application for listing of NCDs; and (b) stock exchanges should list the NCDs only upon receipt of the due diligence certificate from the debenture trustee confirming creation of security and execution of the debenture trust deed. As a result of the aforementioned requirements, the market view that developed was that security for listed secured NCDs had to be created only prior to listing.

The Enhanced Guidelines now permit creation of additional security post listing of the NCDs as well as conversion of unsecured listed NCDs to secured listed NCDs and revise certain other requirements in relation to encumbrances and due diligence by debenture trustees which were prescribed under the November 3 Circular.

Key Changes

The key changes introduced by the Enhanced Guidelines are discussed below.

1. Manner of change in security / creation of additional security / conversion of unsecured to secured in case of already listed NCDs:

(a) **Changes to Security Structure Permitted:** Under the Enhanced Guidelines, SEBI has acknowledged that Regulation 59 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“**SEBI LODR Regulations**”) provides for a change in terms of listed NCDs and that a change in the structure of the listed NCDs may include, *inter alia*, (i) a change in security, (ii) creation of additional security in case of already secured listed NCDs or (iii) creation of security in case of unsecured listed NCDs. Accordingly, in order to harmonise the process of security creation in case of listed NCDs, SEBI has issued additional directions under the Enhanced Guidelines as summarised below –

(i) **Amendment to the Debenture Trustee Agreement:** In case of any proposed change in security, creation of additional security or creation of security for unsecured listed NCDs, before initiating due

diligence the debenture trustee and Issuer will have to enter into an amended debenture trustee agreement to incorporate the following:

- obligations arising out of provisions specified in paragraphs 4 to 7 of the November 3 Circular which deal with, *inter alia*, information to be provided by the Issuer for enabling the debenture trustee to conduct a due diligence with respect to security creation and the manner in which the debenture trustee should exercise due diligence (collectively, “**Due Diligence Conditions**”);
 - obligations in relation to continuous monitoring prescribed in terms of the SEBI circular on ‘*Monitoring and Disclosures by Debenture Trustees*’ dated November 12, 2020 (“**November 12 Circular**”) and the SEBI circular on ‘*Revised format of security cover certificate, monitoring and revision in timelines*’ dated May 19, 2022; and
 - any other stipulations of SEBI from time to time with respect to security creation, initial due diligence and continuous monitoring by debenture trustees.
- (ii) **Due diligence and NOC:** The debenture trustee will be required to carry out due diligence in accordance with the Due Diligence Conditions for any change in security or creation of security / additional security. Pursuant to such due diligence exercise, the debenture trustee will have to issue a no-objection certificate (“**NOC**”) to the Issuer for proceeding with the proposed change in the structure of, or creation of, security.
- (iii) **Creation and Perfection of Security:** Upon completion of the due diligence and issuance of a NOC as above, the Issuer must create the proposed security and charge in favour of the debenture trustee. Further, the Issuer must within 30 (thirty) days register the charge with the sub-registrar, registrar of companies, Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI), depository, etc. as applicable. If the charge is not registered as aforesaid or if it is not independently verifiable, then the same will be considered a breach by the Issuer of the covenants and terms in relation to the issue of the listed NCDs.
- (iv) **Amendment to Debenture Trust Deed:** Pursuant to the security creation and registration as above, the Issuer and debenture trustee must execute a supplemental or amended debenture trust deed (“**Revised DTD**”) to include all the terms and conditions arising out of the due diligence carried out by the debenture trustee and the security created by the Issuer.
- (v) **Submission to Stock Exchanges and Depositories:** Subsequently, pursuant to execution of the Revised DTD, the Issuer will have to submit the following documents to the stock exchanges and depositories:
- the no-objection certificate issued by the debenture trustee for creation of, or change in, security;
 - the executed Revised DTD;
 - an undertaking from the debenture trustee that security has been created and registered; and
 - any other documents or consents required to be submitted to depositories and stock exchanges in terms of Regulation 59 of the SEBI LODR Regulations and circulars issued thereunder, and by-laws of the depositories and stock exchanges, as applicable.
- (vi) **New ISIN:** Upon submission of the documents specified above, the relevant depository will assign a new International Securities Identification Number (“**ISIN**”) to the listed NCDs and share information with respect to the change in ISIN with the stock exchanges.

2. Encumbrance on securities for issuance of listed debt securities:

- (a) **Recording in the Depository:** As per the Enhanced Guidelines, creation of ‘encumbrance’ on securities for securing listed NCDs must be through the depository only in accordance with the Depositories Act, 1996, the SEBI (Depositories and Participants) Regulations, 2018, by-laws of the relevant depository and other applicable regulations and circulars.

- (b) **Meaning of Encumbrance:** SEBI has specified that the term ‘encumbrance’ will mean the following:
- (i) pledge, hypothecation, lien, negative lien, non-disposal undertaking or non-disposal agreement;
 - (ii) any restriction on the free and marketable title to securities, by whatever name called, whether executed directly or indirectly; and
 - (iii) any covenant, transaction, condition or arrangement in the nature of encumbrance, by whatever name called, whether executed directly or indirectly.

3. **Due diligence certificate in case of shelf prospectus / memorandum:**

If details of the security have not been finalized at the time of filing a draft shelf prospectus / placement memorandum by the Issuer, then as per the Enhanced Guidelines the debenture trustee will be required to undertake due diligence as follows:

- (a) The debenture trustee *may* furnish a due diligence certificate confirming that it has carried out due diligence for clauses other than those relating to security specified in the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 (“**SEBI NCS Regulations**”) and Annexure A of the November 3 Circular.
- (b) At the time of issuance of the tranche memorandum / prospectus when the issue structure, including terms relating to security, have 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 November 3 Circular.

4. **Policies to be framed by debenture trustees:**

Debenture trustees will now be required to:

- (a) adopt an empanelment criteria / policy as approved by their board of directors for the purpose of empanelment of external agencies for carrying out due diligence and disclose the same on their website; and
- (b) formulate a policy on mitigating conflict of interest and disclose the same on their website. The policy should include, *inter alia*, a requirement that the empaneled agency will have no pecuniary relationship with the Issuer for the period 3 (three) years prior to the issue of the listed NCDs.

5. **Compliance with SEBI circulars on ‘Security & Covenant Monitoring System’:**

The Enhanced Guidelines prescribe that various stakeholders such as issuer entities, depositories, debenture trustees and credit rating agencies will be required to ensure that they are compliant with various circulars issued by SEBI with respect to the distributed ledger technology system, including the SEBI circular on ‘*Security and Covenant Monitoring using Distributed Ledger Technology*’ dated August 13, 2021 and the SEBI circular on ‘*Operational guidelines for Security and Covenant Monitoring using Distributed Ledger Technology (DLT)*’ dated March 29, 2022. Such compliance will ensure efficient recording of details regarding creation of security and monitoring of covenants via the system hosted by depositories using distributed ledger technology.

JSA Comment

The Enhanced Guidelines have put to rest the controversy on whether additional security can be created post listing of the NCDs or whether unsecured listed NCDs can be converted into secured listed NCDs after listing. The onus has been shifted on the debenture trustees to ensure that appropriate due diligence is conducted on the new or additional security to be provided and that appropriate documentation is entered into for creation and perfection of the security.

It is noteworthy that under Regulation 59 of the LODR Regulations, prior consent of the stock exchange is required for making any material modification to the structure of listed NCDs. Given that the Enhanced Guidelines prescribe a detailed process for obtaining the no-objection of the debenture trustee, amending the debenture trustee agreement and the debenture trust deed, and filings to be made with the stock exchanges and depositories after additional / new security has been created, it remains to be seen whether prior approval of the stock exchange in terms of Regulation

59 of the LODR Regulations is still required for any change in the security structure even if the process laid down in the Enhanced Guidelines is followed. A clarification from SEBI on this point would be useful in removing any ambiguity.

Further, the scope of “encumbrance” on any securities for listed NCDs has been expanded. Going forward, Issuers and debenture trustees will have to ensure that any encumbrance (as per the expanded meaning of the term) must be registered with the depository. A sequitur to this is that an encumbrance on securities in physical form can no longer be created for listed NCDs. The Enhanced Guidelines are also silent on whether securities on which the encumbrance requirements apply must be listed or unlisted securities. Therefore, it appears that for listed NCDs, any encumbrance on listed or unlisted securities will have to be recorded with the depository.

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