RECENT AMENDMENTS IN REGULATORY FRAMEWORK FOR ISSUE AND LISTING OF DEBT SECURITIES

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Introduction

The Securities and Exchange Board of India ("**SEBI**") has recently amended various regulations and also issued further guidelines pertaining to debt securities, primarily with a view to strengthen the role of debenture trustees ("**DTs**") and protect the interests of the investors.

This note provides a brief overview of the recent amendments made in the SEBI (Issue and Listing of Debt Securities) Regulations, 2008 ("**ILDS Regulations**"), SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("**LODR Regulations**") and SEBI (Debenture Trustee) Regulations, 1993 ("**DT Regulations**") as well as certain new guidelines issued by SEBI.

Amendments to SEBI ILDS Regulations

On October 8, 2020, SEBI *vide* the SEBI (Issue and Listing of Debt Securities) (Amendment) Regulations, 2020 ("**Amendment Regulations**") amended the ILDS Regulations, *inter alia*, to align it with the provisions of the Companies Act, 2013 ("**Act**").

The key amendments made to the ILDS Regulations are as follows:

Change in the definition of private placement

Prior to the amendment, the definition of private placement provided that the offer shall be made to less than 50 persons. Pursuant to the Amendment Regulations, the definition of private placement has been linked to the provisions of the Act. Currently, the maximum number of persons to whom a private placement offer can be made is 200 in aggregate in a financial year.

Contents of the debenture trust deed

The Amendment Regulations provide that the debenture trust deed (*in case of a public issue*) should contain the matters prescribed under Section 71 (*Debentures*) of the Act and Form No. SH-12 (*Contents of debenture trust deed*) of the Companies (Share Capital and Debentures) Rules, 2014. Further, such trust deed should consist of two parts, i.e., Part A containing statutory/ standard information pertaining to the debt issue and Part B containing details specific to the particular debt issue.

Creation of security

The issuer is now required to give an undertaking in the information memorandum ("**IM**") that the assets on which charge is created are free from any encumbrances and in case where the assets are already charged to secure a debt, the permission or consent to create a second or *pari passu* charge on the assets of the issuer has been obtained from the earlier lender.

Disclosures

Schedule I of the ILDS Regulations, which sets out the disclosures required to be made in the disclosure document for listing of debt securities issued by way of private placement, has been amended to include the following additional information which should be incorporated in the summary term sheet for the issue:

- Recovery expense fund ("**REF**"), including the details and purpose of the REF;
- All covenants of the issue (including side letters, accelerated payment clause, etc.);
- Events of default, including manner of voting/ conditions of joining inter-creditor agreement ("**ICA**");
- Conditions for breach of covenants (as specified in debenture trust deed);
- Description regarding security (where applicable) including type of security (movable/ immovable/ tangible etc.), type of charge (pledge/ hypothecation/ mortgage etc.), date of creation of security/ likely date of creation of security; and
- Risk factors pertaining to the issue.

Additionally, a note has been inserted in Schedule I which provides that it is the duty of the DT to monitor that the security is maintained, however, the recovery of 100% of the amount will depend on the market scenario prevalent at the time of enforcement of the security.

Amendments to SEBI LODR Regulations

SEBI also notified the SEBI (Listing Obligations and Disclosure Requirements) (Third Amendment) Regulations, 2020 ("**LODR Amendment Regulations**") amending the LODR Regulations, on October 8, 2020.

The key amendments made to the LODR Regulations are as follows:

Asset Cover

By way of the LODR Amendment Regulations, SEBI has now removed regulation 54(3) of the LODR Regulations, which provided an exemption from maintenance of asset cover to regulated financial sector entities issuing unsecured debt securities for meeting capital requirements as specified by their respective regulators.

Documents and Intimation to Debenture Trustees

Listed entities are now additionally required to promptly forward to the DT, intimation regarding all covenants of the issue (including side letters, accelerated payment clause, etc.).

Half-yearly certificates

Earlier, the LODR Regulations required listed entities to submit a half-yearly certificate regarding maintenance of 100% asset cover by either a practicing company secretary or a practicing chartered accountant. Pursuant to the LODR Amendment Regulations, the aforesaid half-yearly certificate must now be provided by the statutory auditor and is also required to incorporate compliance with all covenants in respect of the listed debt securities.

Further, earlier, the submission of such half-yearly certificates was not applicable to banks or non-banking financial companies ("**NBFCs**") or where bonds were secured by a government guarantee. This exemption for banks and NBFCs has been withdrawn pursuant to the LODR Amendment Regulations.

Forensic Audit

By way of the LODR Amendment Regulations, SEBI has specified that in case of initiation of forensic audit, the following disclosures should be made to the stock exchanges by listed entities:

- the fact of initiation of forensic audit along-with name of entity initiating the audit and reasons for the same (if available); and
- final forensic audit report (other than for forensic audit initiated by regulatory / enforcement agencies) on receipt by the listed entity along with comments of the management, if any.

Amendments to SEBI Debenture Trustee Regulations

SEBI has, on October 8, 2020, also notified SEBI (Debenture Trustees) (Amendment) Regulations, 2020 ("**DT Amendment Regulations**") amending the DT Regulations.

The key amendments made to the DT Regulations are as follows:

Form and manner of Trust Deed

Regulation 14 of the DT Regulations has been substituted to provide that a DT is required to accept the trust deeds which contain the matters as specified in section 71 of the Act and Form No. SH.12 specified under the Companies (Share Capital and Debentures) Rules, 2014, where such trust deed has to now consist of the following 2 parts:

- Part A: containing statutory/standard information pertaining to the debt issue,
- Part B: containing details specific to the particular debt issue.

Listed debt securities secured by way of receivables/ book debts

Regulation 15(t) of the DT Regulations specifies duties of the DTs, in cases where listed debt securities are secured by way of receivables/ book debts. Regulation 15(t) has now been substituted to widen the duties of the DT to provide that in such cases the DT is required to:

- On a quarterly basis, carry out the necessary due diligence and monitor the asset cover in the manner as may be specified by SEBI; and
- On a half yearly basis, obtain a certificate from the statutory auditor of the issuer giving the value of receivables/ book debts, including compliance with the covenants of the offer document ("**OD**") or IM, in the manner as may be specified by SEBI.

Meeting of Debenture Holders on breach/ default

Pursuant to regulation 15(2)(b) of the DT Regulations, the DT is required to call/ cause to be called a meeting of the debenture holders, upon happening of any event which constitutes a default. By way of the DT Amendment Regulations, Regulation 15(2)(b) of the DT Regulations has been amended to broaden the requirement to convene a meeting of the debenture holders, even where there is any breach of covenants under the OD/ IM/ debenture trust deed or on the occurrence of an event which in the opinion of the DT affects the interest of the debenture holders.

Independent due diligence by debenture trustee

By way of the DT Amendment Regulations, Regulation 15(6) of the DT Regulations has been added, specifying additional duties of the DT to exercise independent due diligence, before creation of a charge on the security for the debentures, to ensure that such security is free from any encumbrance or that necessary consent from other charge holders, if any, has been obtained, in the manner as may be specified by SEBI from time to time.

Inter-creditor agreements by debenture trustee

The DT has been empowered to enter into ICAs, on behalf of the debenture holders, as provided under the framework specified by the Reserve Bank of India ("**RBI**"), subject to the approval of the debenture holders and the conditions as may be specified by SEBI from time to time.

Role of Debenture Trustee in Investor Protection

In furtherance to the abovementioned amendments in the ILDS Regulations and the DT Regulations, SEBI *vide* its circular, dated November 3, 2020, has issued guidelines on creation of security in respect of listed debt securities and due diligence to be undertaken by DTs. These guidelines will come into force with effect from January 1, 2021 for new issuances proposed to be listed post January 1, 2021.

Creation of security

Issuers are required to provide the DT with certain information while entering into the debenture trustee agreement ("**DTA**") in order to enable the DT to exercise due diligence with respect to creation of security, including the following:

- details of assets on which charge is to be created, including title deeds and title reports;
- an undertaking to the effect that the assets over which charge is proposed to be created are free from encumbrances;
- in case there are existing encumbrances on the assets over which charge is proposed to be created, (i) details of such encumbrances; (ii) consent from existing charge holders; (iii) consent from existing unsecured lenders, if any negative lien is created in favour of such unsecured lenders;
- details of guarantee or any similar document offered as security, such as, details of the guarantor, net worth statement/ audited financials, list of assets, conditions of invocation of guarantee, etc.;
- in case any securities are being offered as security, a holding statement from the depository participant along with an undertaking stating that the securities pledged in favour of the DT in the depository system.

Due diligence by debenture trustee

The DT is required to independently carry out due diligence with respect to the security and prepare all the requisite reports and certificates. Further, the DT is required to independently assess whether the assets for creation of security are adequate for the proposed issue.

The DT is also required to perform certain checks to verify that the assets provided by the issuer for creation of security are free from encumbrances and that necessary consents have been obtained from existing charge holders, if any. In case a conditional consent has been issued by existing charge holders, the DT should intimate them via e-mail about the proposal to create further charge and seek their comments/ objections, which should be communicated to the DT within 5 working days.

Further, in respect of guarantees, the DT is required to verify the relevant filings made on websites of Ministry of Corporate Affairs, stock exchange(s), CIBIL, information utilities etc. and also obtain necessary appraisal reports and financial certificates in respect of the guarantor.

The DT is required to issue a due diligence certificate addressed to the stock exchange, as per the format specified, provided that:

- consents/ permissions required for creation of further charge are adequately disclosed in the OD/ private placement memorandum ("**PPM**")/ IM;
- disclosures made in OD or PPM/ IM about creation of security are in confirmation with DTA;
- all covenants proposed to be included in debenture trust deed are disclosed in OD or PPM/ IM.

Where the issuer is filing the draft OD or PPM/ IM through electronic book mechanism or serially printing PPM/ IM, it should submit the due diligence certificate as mentioned above to the stock exchange.

The records and documents pertaining to due diligence are required to be maintained by the DT for a minimum period of 5 years from redemption of the debt securities.

Disclosures in the offer document/ private placement memorandum/ information memorandum

The following disclosures should be made in addition to those required under the ILDS Regulations:

- debt securities will be considered as secured only if the charged asset is registered with the Sub-Registrar of Assurances and the Registrar of Companies or CERSAI or the depository etc., as applicable, or is independently verifiable by the DT.
- the terms and conditions of the DTA, details of security to be created and process of due diligence carried out by DT.
- due diligence certificate mentioned above.

Creation and registration of charge

The issuer should create the charge as specified in the OD or PPM/ IM in favour of the DT and execute a debenture trust deed with the DT, before making an application for listing of the debt securities. The stock exchange will list the debt securities only upon receipt of the due diligence certificate from the DT in the format specified. The charge must be registered with the relevant authorities, within 30 days of creation of such charge.

Timelines for Listing

On October 5, 2020, SEBI by way of its circular standardised timelines for listing of securities issued on a private placement basis under the: (a) ILDS Regulations; (b) SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013; (c) SEBI (Public Offer and Listing of Securitised Debt Instruments and Security Receipts) Regulations, 2008; and (d) SEBI (Issue and Listing of Municipal Debt Securities) Regulations, 2015. This circular will come into force with effect from December 1, 2020.

The following timelines have been stipulated by SEBI:

S. N.	Details of Activities	Due Date
1.	Closure of issue	'T'
2.	Receipt of funds	To be completed by T + 2 trading day
3.	Allotment of securities	To be completed by T + 2 trading day
4.	Issuer to make listing application to stock exchange(s)	To be completed by T + 4 trading day
5.	Listing permission from stock exchange(s)	To be completed by T + 4 trading day

In case of delay in listing of securities beyond the timelines stipulated above, the issuer will be required to pay penal interest of 1% per annum over the coupon rate for the period of delay to the investor. Further, the issuer will be permitted to utilize the issue proceeds of its subsequent privately placed issuances of securities only after receiving final listing approval from stock exchange(s).

Standardised Procedure in Case of Default

On October 13, 2020, SEBI introduced the standardised procedure to be followed by DTs in case of default by issuers of listed debt securities which is applicable to all issuers who have/ propose to have their debt securities listed, as well as all DTs registered with SEBI.

Event of default to be reckoned at the International Securities Identification Number level

Under the LODR Regulations, a 'default' has been defined as non-payment of the interest or principal amount in full on the pre-agreed date, which will be recognized at the first instance of delay in the servicing of any interest or principal on debt.

In view of the fact that multiple International Securities Identification Number ("**ISIN**") may have been issued under the same IM or a single ISIN may have been split across multiple IMs, SEBI has clarified that an 'event of default' will be reckoned at the ISIN level since all terms and conditions of issuance of security are same under a single ISIN even though they may have been issued under multiple IMs.

Consent of investors for enforcement of security and for signing the inter creditor agreement

RBI had, on June 7, 2019, issued the RBI (Prudential Framework for Resolution of Stressed Assets) Directions 2019 ("**RBI Directions**"). In terms of the RBI Directions, investors in debt securities, being financial creditors, may be approached by other lenders of the issuer to sign ICA in line with the RBI Directions.

As the resolution plan ("**RP**") under the ICA may involve restructuring, including roll-over of debt securities requiring consent of investors, the following process for seeking consent for enforcement of security/ entering into the ICA has been specified:

- The DTs shall send a notice to the investors within 3 days of an event of default.
- The aforementioned notice shall contain (a) negative consent for proceeding with the enforcement of security; (b) positive consent for signing the ICA; (c) the time period within which the consent needs to be provided; and (d) date on which meeting will be convened.
- The DTs shall convene the meeting of investors within 30 days of the event of default.
- In case of debt securities issued by way of public issue, the notice sent by the DT shall not contain the negative consent for proceeding with the enforcement of security and the requirement to convene a meeting for enforcement of security as mentioned above shall not be applicable.
- The DTs shall take necessary action to enforce security or enter into the ICA as decided in the investors' meeting. However, (a) in case where the majority of investors express their dissent to enforcement of security, the DT shall not enforce security; (b) in case where majority of the investors express their consent to enter into the ICA, the DT shall enter into the ICA; (c) in case consent is not received for enforcement of security and for signing the ICA, the DT shall take further action, if any, as per the decision taken in the meeting; and (d) the DT may form a representative committee of investors to participate in the ICA to enforce the security as may be decided in the meeting.
- The consent of the majority of investors shall mean the approval of not less than 75% of the investors by value of the outstanding debt and 60% of the investors by number at the ISIN level.

Conditions for signing the inter creditor agreement

The DTs may sign the ICA and consider the RP on behalf of the investors upon compliance of the following:

- Signing of the ICA and agreeing to the RP should be in interest of the investors. Further, the ICA and the RP should be in compliance with the Act, the Securities Contract (Regulations) Act, 1956 and the SEBI Act, 1992 and the rules, regulations and circulars issued thereunder.
- If the conditions imposed on the DTs are not in compliance with what is mentioned hereinabove, the DT shall be free to exit the ICA altogether with the same rights as if it had never signed the ICA and the RP will not be binding upon the DTs.
- The RP shall be finalized within 180 days from the end of the review period. If the RP is not finalized within the aforesaid period, the DT shall be free to exit the ICA altogether with the same rights as if it had never signed the ICA and the RP will not be binding upon the DTs. However, if the finalization of the RP extends beyond the aforesaid period, the DTs may consent to an extension beyond 180 days subject to the approval of the investors regarding the total timeline. However, the total timeline shall not exceed 365 days from the commencement of the review period.
- If any terms of the approved RP are contravened by any of the signatories to the ICA, the DT shall be free to exit the ICA and seek appropriate legal recourse/ any other action as may be deemed fir in the interest of investors.

The DTs are required to ensure that the conditions pertaining to exiting the ICA as aforesaid are suitably incorporated in the ICA before signing the ICA.

Recovery Expense Fund

Regulation 26 of the ILDS Regulations has been amended to provide that the issuer is required to create a REF in the manner as maybe specified by SEBI from time to time and inform the DT of the same. In furtherance to the said amendment, SEBI *vide* its circular dated October 22, 2020 outlined the manner of creation, operation and utilisation of the REF. The provisions of this circular will come into force with effect from January 1, 2021 and all the applications for listing of debt securities made on or after January 1, 2021 are required to comply with the condition of creation of the REF. For existing issuers, whose debt securities are already listed on stock exchange(s), SEBI has given an additional time period of 90 days to comply with the terms of this circular for creation of the REF.

Deposit of amounts

An issuer proposing to list debt securities is required to deposit an amount equal to 0.01% of the issue size subject to a maximum of Rs. 25,00,000 per issuer towards the REF, with the designated stock exchange.

Manner of creation and maintenance of the Recovery Expense Fund

At the time of making the application for listing of debt securities, the issuer is required to deposit cash or cash equivalent(s) (including bank guarantees) towards contribution to the REF.

In case of bank guarantee provided by the issuer, the following conditions would be appliable:

- It should remain valid for 6 months post the maturity date of the listed debt security;
- It should be renewed at least 7 working days before its expiry date; and
- On failure to renew/ maintain validity of the bank guarantee, the stock exchange will invoke such bank guarantee.

Where the contribution is received from the issuer in the form of cash, the designated stock

exchange is required to invest the same in Government Securities, treasury bills or fixed deposit with a Scheduled Commercial Bank, gilt / debt mutual / debt exchange trade funds. The income/interest earned from the same will be added to the REF.

Manner of utilization of the Recovery Expense Fund

On the occurrence of an event of default:

- the DT or the lead DT (as chosen by the other DTs or the DT of more than 50% of the outstanding value of debt securities) is required to obtain the consent of the holders of debt securities for enforcement of security and inform the same to the designated stock exchange;
- within 5 working days of receipt of such intimation, the designated stock exchange should release the amount lying in the REF to the DT/ lead DT; and
- the DT is required to keep a proper account of all expenses incurred out of the funds received from the REF towards legal expenses cost for hosting meeting etc. towards enforcement of security.

Refund of balance in the Recovery Expense Fund to the issuer

The balance in the REF will be refunded to the issuer on repayment to the holders of debt securities on their maturity or at the time of the exercise of call or put option, for which a no-objection certificate shall be issued by the DT to the designated stock exchange. However, the DT should be satisfied that there is no default on any other listed debt securities of the issuer before issuing the aforesaid no-objection certificate.

This update has been contributed by Aastha (Partner), Swaraj Singh Narula and Ashwarya Bhargava (Associates).

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