Ch-14 Raising of Funds from Debt and Procedural Aspects

Synopsis.

PART-1

- → Regulatory Framework for Debt Security.
- → Major Reforms under the SEBI NCS Regulation.
- → Debentures
- → Types of Debentures
- → Bonds
- → Various risk associated with Bond investment
- → Kinds of Bonds

PART - A

⇒ Regulatory framework for debt securities.

- The companies Act, 2013 and the co. (share cap and debent.) Rules, 2014.
  ⇓
  Section - 71. prescribes the condition for issue of deb.

- SEBI (Issue of capital and Disclosure req.) Regulations, 2018 (ICDR)
  ⇓
  Debt sec. which are convertible either partially or fully / optionay

- SEBI (Listing obligation and Discl. req.) Reg. 2015 (LODR)
  ⇓
  Listing ensured by way of an agreement betⁿ SE & issuing co.

- SEBI (Issue and Listing of Non Convt. sec.) Reg. 2021.
  ⇓
  Provide for listi of -
  Debt securities
  Non covt. Red. prsh
  comm. paper.

⇒ A Debt market in India comprises mainly of two segments - The Goverment securities market consisting of central and state Govt securities, zero coupen Bond, PSU Bonds, Corporate Bonds etc.

⇒ It is a market for the issuance, trading and settlement of various types and features of fixed income securities.

⇒ Major Reforms under SEBI NCS Regulation.

Debt sec. → SEBI (ILDS) Reg.

Pref. sh. → SEBI (NCRPS) Reg

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SEBI (IL NCS) Regulation, 2021

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Major reforms brought in by NCS Regulation, 2021

1] Road map for listing of debt securities by newly incorporated entity.	• Even a Newly incorpo. entity (other than REIT / INVIT) is allowed to raised funds subject to following conditions. → Made only on private placement basis. → Made on the EBP platform → subscribed by only QIBs
2] Removal of restrictions - ease of doing business.	• No minimum rating - AA ⊗ • No minimum tenure - 3 yrs ⊗ • No restriction on no. of issuance under a shelf prospectus. • No min issue size - 100 cr. ⊗ • Size of abridged prospectus. - Reduce from 50 pages to 10 pages.
3] Appointment of debenture trustee. -	• Certain provisions were made applicable to be complied by debenture trustee while the appointment of deb. trustee in case of debt securities was not mandatory. hence the NCS regulation clearly provide for app. of deb. trustee mandatory.
4] Call and Put option	• In order to provide greater flexibility to issuer, the option of call and put has been introduced in case of debt securities issued on private placement basis.
5] Certain other changes.	→ period for exercise of call & put option 24 months → 12 months. → EBP platform for issue of ₹ 50 crore and above. → in case the issuer wishes to roll over the debt security the provision of e-voting has been introduced. → Parameter for identification of risk factor have been introduced. → in case the issuer is an NBFC, addition discl. on Asset Liab. mgt are required to be provided for pvt. placement too.

⇒ Debentures.

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Section 2(30) of the companies Act, 2013 defines a debenture which include deb. stock, bond or any other instrument of a co. evidencing a debt, whether consituting a charge on the assets of the company or not.

⇒ Basic features of Debentures. :-

- A co. may issue deb. with an option to convert in to shares.
- No co. shall issue any debentures carrying any voting rights.
- secured deb. may be issued by a co. subject to such terms and conditions as may be prescribed.
- The co. shall create a debenture redemption reserve (DRR) out of profits of the co. available for payment of dividend.
- The co. shall pay int. and redeemed the debenture in accord. with the terms and conditions of their issue.

⇒ Types of Debentures.

→ **On the Basis of security. :-**

Secured Debentures.

- where a charge is created on the assets of the co. for the purpose of payment.

Unsecured Debentures.

- Also known as naked deb.
- Not secured by way of charge on company's Assets

→ **Tenure :**

Redeemable debenture. - payable on expiry of specified period (max 10 yrs from date of issue).

→ **Mode of Redemption.**

- Convertible Debenture.
- Non-convertible Debenture.
- Partly - conv. Debenture.
- Optionally conv. Debenture.

→ On the Basis of Negotiability.

Bearer Deb.

- Payable on bearer of debenture and trf. by mere delivery.

Registered debenture

- Not transferable by mere delivery.
- Shall be transferred by executing transfer deed and trf. Reg by the co.

→ **Market Linked Debentures** -

→ Market linked debt securities have an underlying principal component issued with market linked return.

→ These returns are linked to benchmark such as
- Exchange traded derivatives.
- MYBOR
- GDP, inflation rate
- underlying security or indices.

→ Debt security which do not promise to return the principal amount in full at the end of tenor of instru. shall not be considered as debt security.

→ **Eligibility criteria for issuer** - Min Net worth - 100 cr.

→ **Disclosure requirement** -

→ Credit Rating by any CRAs shall bear a prefix "PP - MLD" denoting principal protecting market linked debt security.

→ A detailed scenario analysis / valuation matrix showing value of security under diff. market conditions such as rising, stable and falling market condition.

→ where indicative returns / int. rate shown on annual basis

→ Latest and historical valuation for such securities shall be made available on the website.

→ commn paid to distributor - disclose in offer doc.

→ condition for premature termination redn shall be dis. in offer doc.

Bonds.

Bonds are used by companies, municipalities, states and sovereign goverments to raise money to finance variety of projects and activities.

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It is an instrument in which an investor loans money to an entity which borrows the funds for a defined period of time at variable or fixed rate of interest

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- Bonds are referred to as bills or short term bond and long term bond.
- Fixed face value.
- Investor receive regular payment of int. semi-annually or anually.
- Amount to be returned to the investor upon maturity of the bond.
- int. is calculated as certain percentage of face value known as coupen payment.

→ Role of corporate Bond Markets.

- The total capital raised in primary markets during the F.Y. 2021-22 stood at ₹ 8.3 Lakh crore.
- According to CIRSIL, outstanding corporate Bond market in India is expected to double and shall reach 65-70 Lakh crore by the year 2025.

⇒ Various Risk associated with Bond investment.

- Interest Rate Risk : Rising int. rates are a key risk for Bond investor.
- credit Risk. : Issuer is unable to make interest or principal payments.
- Inflation Risk : Inflation reduces the purchasing power of bond's future coupen + princip
- Re-investment Risk : when int. rates are ↓ investor may have to reinvest their coupen income and principal at lower rate.
- Liquidity Risk : Investor may have difficulty in finding buyer. when they want to sell.

⇒ Different kinds of Bonds.

1] Fixed-rate Bonds	interest remains fixed throughout the tenure of the Bond.
2] Floating rate Bonds	Have a fluctuating interest rate as per the current market referance rate
3] Inflation indexed Bonds -	Bonds linked to the inflation are called infl^n linked Bonds. int. rate is generally lower than fixed rate bonds.
4] Perpetual Bonds.	Bonds with no maturity date. Holders enjoy int. throughout.
5] Bonds with call or put option.	Callable bonds are high coupen paying securities that give the issuer the right to call back the bonds at a pre-agreed price and date. Puttable bonds gives the bondholder the right to return the bonds and ask for repayment of principal at pre-agreed date before maturity. These Bonds pay lower return
6] Zero coupen Bonds.	These Bonds do not pay periodic coupens during their tenure. Issued at discount and repayable at par value
7] Convertible Bonds.	Get a right to convert the Bond to a pre-defined number of eq. share in the listing co. at a particular time from the tenure.
8] Green Bonds.	Primarily raised for Green investments such as solar power projects, land rehabilit^n sewage mgt. etc.