Raising of Funds from Debt and Procedural Aspects

Lesson 14

KEY CONCEPTS

■ Debentures ■ Non-Convertible Securities ■ Deposits ■ Bonds ■ Bank Finance ■ Working Capital ■ Overdrafts ■ Cash Credit ■ Factoring ■ Forfeiting ■ NBFC ■ Letter of Credit ■ Bank Guarantee

Learning Objectives

To understand:

- The concept of Debt Funding and governing framework for Debt Securities
- Major Reforms under the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021
- Concept of Online Bond Platform Providers and its significance
- Concept of Request for Quote (RFQ) Platform
- General Compliance Obligations and Pre-listing Compliances
- Role of Company Secretary in Corporate Bond Market
- Concept of Public Deposits and NBFC Funding
- Various types of credit facilities granted by banks viz. Overdrafts, cash credit, bill finance, lease finance etc.
- Operating cycle of Working Capital Management
- Concept of Letter of Credit and its types
- Bank Guarantee
- Appraisal Methodology for different type of Non-Fund Based Credit Products

Lesson Outline

- Introduction
- Debt Market
- Regulatory Framework for Debt Securities
- Debentures and its Types
- Bonds
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- Green Debt Securities
- Disclosure Requirements for issue & listing of Debt Securities
- Green Bonds and Greenwashing
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- Compliances as per SEBI NCS Regulations
- Concept of Public Deposits and NBFC Funding
- Various types of credit facilities granted by banks viz. Overdrafts, cash credit, bill finance, lease finance etc.
- Loan against Securities and Loan against Properties
- Concept of Discounting, Factoring and Forfeiting
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SECTION – I
INDIAN FUND BASED

INTRODUCTION

A vibrant securities market, both equity and bond, has to play an increasingly pivotal role to facilitate fund mobilization for sustaining India's projected economic growth momentum.

The banking sector is a very important financial intermediary in India's debt market. Over the last few years the bond market has emerged as an alternative to the banking sector especially for the top rated firms. There is a need for mobilization of funds from the Corporate Bond Market as it provides an alternative source of finance and supplements the banking system to meet the requirements of the corporate sector to raise funds for long-term investment. It is believed that this segment acts as a stable source of finance when the equity market is volatile, and also enables firms to tailor their asset and liability profiles to reduce the risk of maturity. This trend has been pronounced ever since the banking sector started reporting high levels of non-performing assets.

The existence of a deep and liquid corporate debt market could make emerging economies less vulnerable; especially to volatile capital flows. A reasonably well developed bond market could supplement the banking system in meeting the requirements of the corporate sector for long term capital investment and asset creation. It could provide a stable source of finance; especially when the equity market is volatile and resource requirements of the corporate entities are large. In the case of India, development of a corporate bond market has become even more crucial especially, in view of the need for raising large amount of resources for infrastructure development in the country in the immediate future.

A debenture being an attractive source of funding, is a long-term debt instrument issued by corporates and Government to secure fresh funds or capital. Coupons or interest rates are offered as compensation to the lender. The Company issues non-convertible debentures to attract lenders and investors, these come with higher interest rates. The role of corporate bond market becomes even more important now, given the stress on the banking sector.

Keeping in view the larger complementary role that corporate bonds have to play along-side bank credit for financing economic activities and promoting ease of doing business in India, several policy measures have been taken by the Government and the Regulators to develop a vibrant corporate bond market.

Some important measures include:

- Framework for allowing banks to undertake priority sector lending and provide Partial Credit Enhancement for enhancing creditworthiness;
- Information Repositories developed by Exchanges and Depositories to provide consolidated information on primary issuance and secondary market trades in corporate bonds;
- Electronic Book Building mechanism for providing enhanced transparency in issuance of debt securities on private placement basis;
- Enhanced standards for Credit Rating Agencies for timely monitoring of credit quality of bonds;
- Specifications related to International Securities Identification Number (ISINs) for debt securities to encourage liquidity and reduce fragmentation of issues;
- Tri-Party Repo trading on Stock Exchanges to enhance liquidity and price discovery in corporate bonds;

DEBT MARKET

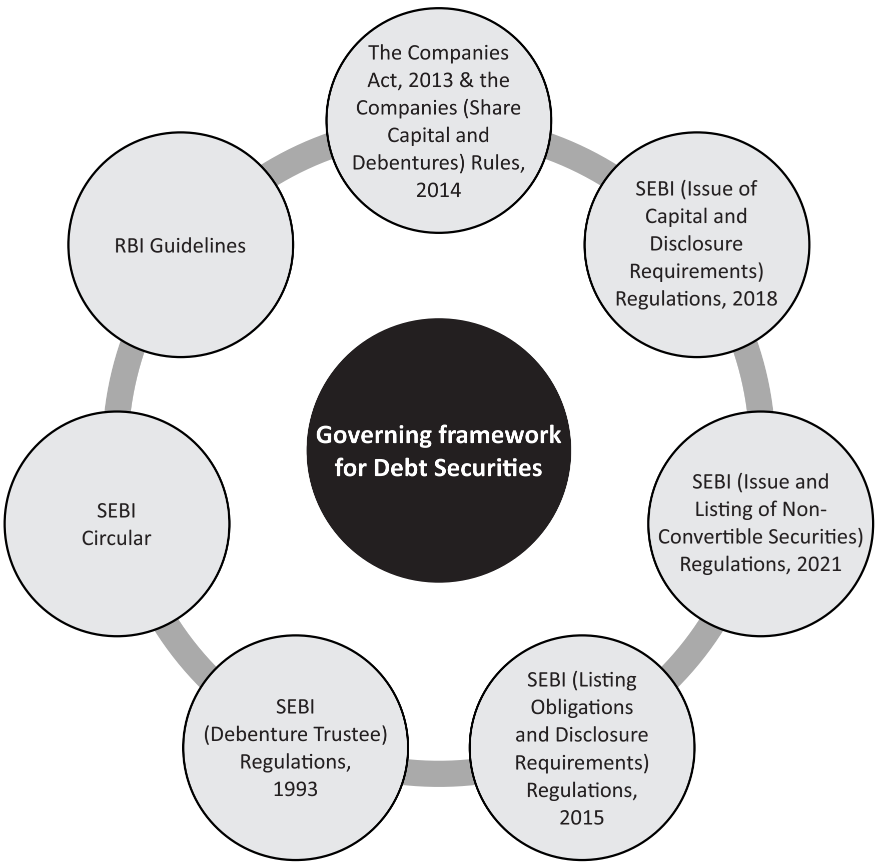
Debt markets are markets for the issuance, trading and settlement of various types and features of fixed income securities. Fixed income securities can be issued by any legal entity like central and state governments, public bodies, statutory corporations, banks and institutions and corporate bodies.

The debt market in India comprises mainly of two segments viz. the Government securities market consisting of Central and State Governments securities, Zero Coupon Bonds (ZCBs), Floating Rate Bonds (FRBs), T-Bills and the corporate securities market consisting of FI bonds, PSU bonds, and Debentures/Corporate bonds. Government securities form a major part of the market in terms of outstanding issues and trading value.

The trading of government securities on the Stock exchanges is currently through Negotiated Dealing System using members of Bombay Stock Exchange (BSE) / National Stock Exchange (NSE) and these trades are required to be reported to the exchange. The bulk of the corporate bonds, being privately placed, were, however, not listed on the stock exchanges and the trend is changing now. Most of the debt securities which are privately placed are now listed either on both the exchanges or on one of the exchange. SEBI has introduced a reform that all listed companies shall ensure that all debt is listed. Two Depositories, National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL) maintain records of holding of securities in a dematerialized form. Records of holding of Government securities for wholesale dealers like banks/Primary Dealers (PDs) and other financial institutions are maintained by the RBI.

Negotiated Dealing System (NDS) is an electronic platform for facilitating dealing in Government Securities and Money Market Instruments. NDS facilitates electronic submission of bids/application by members for primary issuance of Government Securities by RBI through auction and floatation. It will provide an interface to the Securities Settlement System.

REGULATORY FRAMEWORK FOR DEBT SECURITIES



(1) The Companies Act, 2013 & the Companies (Share Capital and Debentures) Rules, 2014

Section 71 of the Companies Act, 2013 prescribes the conditions for issue of debentures. A debenture is a legal document that represents a secure means by which a creditor can lend money to the debtor. A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption.

The Section covers provisions relating to Conditions for Issue, Appointment of Debenture Trustee, Signing of Trust Deed and Creation of Debenture Redemption Reserve.

The company is required to comply with Section 71 (Debentures) read with Rule 18 of the Companies (Share Capital and Debentures) Rules 2014.

(2) SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018

Debt securities which are convertible, either partially or fully or optionally into listed or unlisted equity shall be guided by the disclosure norms applicable to equity or other instruments offered on conversion in terms of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.

(3) SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations)

The listing of securities is ensured by way of an agreement which is entered into between a stock exchange and the issuing company. This agreement called listing agreement. All Listed entities shall comply with the listing conditions as stipulated in Listing Regulations to provide substantial information about the company to the stock exchanges. The provisions of Chapter V from Regulation 49 to 62 of 'Listing Regulations' shall apply only to a listed entity which has listed its 'Non-convertible Securities' as well as an entity that has listed both its convertible securities and non- convertible securities on a recognised stock exchange in accordance with SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021.

(4) SEBI (Issue and Listing of Non-convertible Securities) Regulations, 2021

In May 2021, SEBI reviewed and merged the SEBI Issue and Listing of Debt Securities) Regulations, 2008 (hereinafter referred as "ILDS Regulations") and SEBI (Issue and Listing of Non- Convertible Preference Shares) Regulations, 2013 (hereinafter referred as "NCRPS Regulations") into a single regulation - SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 (hereinafter referred as "NCS Regulations") vide its notification dated August 09, 2021.

The new NCS Regulations provide for issuance and/or listing of the following securities:

a. Debt securities;

b. Non-Convertible redeemable preference shares;

c. Perpetual debt instruments, Perpetual Non-cumulative preference shares or similar non-equity regulatory capital instruments;

d. Commercial Paper.

Since the enactment of ILDS Regulations and NCRPS Regulations, SEBI had issued multiple circulars covering procedural and operational aspects thereof. In order to enable the stakeholders to have an access to all the applicable circulars/directions at one place, the provisions of the circulars issued May 21, 2024 are incorporated Master Circulars.

IMPORTANT TERMINOLOGIES UNDER NCS REGULATIONS

- Debt securities, Non-convertible redeemable preference shares, Perpetual debt instruments, Perpetual Non-cumulative preference shares or similar non-equity regulatory capital instruments are collectively referred to as "**non-convertible securities**"
- "**Debt securities**" means non-convertible debt securities with a fixed maturity period which create or acknowledge indebtedness and includes debentures, bonds or any other security whether constituting

a charge on the assets/ properties or not, but excludes security receipts, securitized debt instruments, money market instruments regulated by the Reserve Bank of India, and bonds issued by the Government or such other bodies as may be specified by the SEBI.

(Note - Students are advised to refer Lesson 10 of Capital Market and Securities Laws, Executive Programme for provisions pertaining to Issue and Listing of Non-Convertible Securities)

Major reforms under the SEBI NCS Regulations

The new NCS Regulations have enshrined a number of new reforms, notably the following:

1. **Road map for listing of debt securities by a newly incorporated entity**

   The major change brought out in the NCS Regulations is that even a newly incorporated entity, is allowed to raised funds through the issuance of corporate bonds and tap the listed space of bond market provided it fulfils the following conditions:

   - Issuance of debt securities is made only on a private placement basis;
   - Such issuance is made on the Electronic Book Provider (EBP) platform irrespective of the issue size; and
   - Such issue may be subscribed by only Qualified Institutional Buyers.

   [As defined under SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.]

   Earlier, one had to be in existence for a period of atleast three years to tap the bond market. This will enable Special Purpose Vehicles created for specific infrastructure purposes/ NBFCs/ listed REITs/ listed InvITs and other companies who propose to list debt securities purely on private placement basis but who do not have a three-year existence history, to list their debt securities issued on private placement basis, while, all other requirements under the NCS Regulations and operating stipulations of the EBP mechanism shall continue to apply to such issuers.

2. **Removal of restrictions – ease of doing business**

   The NCS Regulations give a huge fillip to the ease of doing business. The following requirements which exited in the earlier ILDS / NCRPS Regulations have been done away with in order to provide greater flexibility to issuers and also to have wider pool of issuers tapping the market:

   - **No Minimum rating**

     Requirement to have a minimum rating of AA- for a public issuance of NCRPS' has been removed.

   - **No minimum tenure**

     Requirement of a minimum tenure of three years for a public issuance of NCRPS has been removed.

   - **No restriction on number of issuances under a shelf prospectus**

     The Restriction of a maximum of four issuances of debt securities in a year through a single shelf prospectus has been removed, in order to enable issuers to raise funds quickly without filing a separate prospectus.

   - **No minimum issue size for pubic issues of debt**

     The Stipulation regarding minimum issue size of Rs. 100 crore for public issue of debt securities, which existed earlier, has been removed.

- **Size of Abridged prospectus reduced**

  Size of abridged prospectus in case of public issues of has been reduced from around 50 pages to around 10 pages, thereby reducing cost to the issuers coming out with public issuances. Less number of pages with more relevant information related to issuer also enhances readability for the investor.

3. Appointment of Debenture trustee

Since enactment of ILDS Regulations, certain provisions were made applicable to be complied by debenture trustee while the appointment of debenture trustee in case of debt securities was not mandatory; hence the NCS Regulations clearly provide for the appointment of debenture trustee mandatary in case of debt securities. Debenture Trustees need to undertake due diligence w.r.t defaults, creation of security, asset cover etc. irrespective of the debentures being issued publicly or on a private placement basis. The NCS Regulations now provide for due diligence by a Debenture Trustee in case of private placement also.

4. Call and put option in order to provide flexibility

The earlier ILDS Regulations provided provisions and a defined process to be followed for call and put option in debt securities issued on only public issue basis. In order to provide greater flexibility to issuers, the option for call and put has been introduced in case of debt securities issued on private placement basis. This will provide greater flexibility to the issuers and investors of debt securities and NCRPS as well.

5. Certain other changes brought out in NCS Regulations

- **Put and call option:**

  The period for exercise of call and put option has been brought down to 12 months from 24 months in order to provide increased flexibility, both to issuers as well as investors.

- **EBP Platform for issues of Rs.50 crore and above:**

  The Electronic Book Provider (EBP) platform has been made mandatory for issuance of eligible securities on private placement basis proposed to be listed amounting to INR 50 crore or above in a financial year which will improve price discovery and transparency in the corporate bond market.

  In order to streamline procedures for issuance of debt securities on private placement basis, SEBI vide its circular no SEBI/HO/DDHS/ DDHS_Div1/P/CIR/2022/00139 dated October 10, 2022 (Updated master circular issued in July 2023) has issued Operational Circular for issue and listing of Non-Convertible Securities, Security Receipt, Municipal Debt Securities and Commercial paper. Chapter VI of the Operational Circular provides framework for issuance of debt securities on Private Placement basis through an Electronic Book mechanism. This circular replaces the chapter VI (Electronic Book Provider Platform) of the SEBI circular no. CIR/HO/DDHS/P/CIR/2021/613 dated August 10, 2021

  The usage of this platform is mandatory for the issuers with an issue size of INR 50 crores and above, inclusive of green shoe option (if any). However the platform can also be used for issues less than INR 50 crores.

- **Rollover of debt securities**

  In case an issuer wishes to roll over the debt securities the provision of e-voting has been introduced in addition to postal ballot to facilitate issuers to seamlessly obtain voting for passing the resolution. This will also encourage wider investor participation in the voting.

- **Risk factors**

  Parameters for identification of risk factors have been introduced to assist issuers in disclosing pertinent risk factors on risks intrinsic to the issuer as well as the instrument, other risk factors which may have an impact on the issue etc.

- **Issuers curing default allowed to raise funds**

  Issuers who have cured the default in payment of interest/dividend/redemption amount to raise funds through non-convertible securities, have been permitted to file shelf prospectus post such curing of default provided they have cured the default atleast 30 days prior to filing the draft shelf prospectus.

- **Harmonization of provisions on creation of charge with those of the Companies Act, 2013**

  The provision of creation of charge on the assets and properties of the issuer has been harmonized with the Companies Act thus allowing issuer to have adoption to create charge over its properties or assets (movable, immovable, tangible, intangible), shares or any interest thereon, of the issuer or its subsidiaries or its holding companies or its associate companies. This will provide greater flexibility to the issuers for creation of charge.

- **Additional ALM disclosures for NBFCs**

  In case the issuer is an NBFC (including a Housing Finance Company), additional disclosures on Asset Liability Management (ALM) pertaining to the latest audited financials are required to be provided for private placements too.

DEBENTURES

Debenture is a document evidencing a debt or acknowledging it and any document which fulfills either of these conditions is a debenture. They can be either convertible or non-convertible into equity shares at a later point in time. Debenture is a written instrument acknowledging a debt to the Company. It contains a contract for repayment of principal after a specified period or at intervals or at the option of the company and for payment of interest at a fixed rate payable usually either half-yearly or yearly on fixed dates.

In essence, it represents a loan taken by the issuer who pays an agreed rate of interest (decided at the time of issue only) during the life time of the instrument and repays the principal normally, unless otherwise agreed, on maturity.

> Section 2(30) of the Companies Act, 2013 defines a debenture which includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not.

Further, section 71 of the Companies Act, 2013 states as follows:

(1) A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption.

However, the issue of debentures with an option to convert such debentures into shares, wholly or partly, shall be approved by a special resolution passed at a general meeting.

(2) No company shall issue any debentures carrying any voting rights.

(3) Secured debentures may be issued by a company subject to such terms and conditions as may be prescribed.

(4) Where debentures are issued by a company under this section, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilised by the company except for the redemption of debentures.

(5) No company shall issue a prospectus or make an offer or invitation to the public or to its members exceeding five hundred for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees and the conditions governing the appointment of such trustees shall be such as may be prescribed.

(6) A debenture trustee shall take steps to protect the interests of the debenture-holders and redress their grievances in accordance with such rules as may be prescribed.

(7) Any provision contained in a trust deed for securing the issue of debentures, or in any contract with the debenture-holders secured by a trust deed, shall be void in so far as it would have the effect of exempting a trustee thereof from, or indemnifying him against, any liability for breach of trust, where he fails to show the degree of care and due diligence required of him as a trustee, having regard to the provisions of the trust deed conferring on him any power, authority or discretion.

However, the liability of the debenture trustee shall be subject to such exemptions as may be agreed upon by a majority of debenture-holders holding not less than three-fourths in value of the total debentures at a meeting held for the purpose.

(8) A company shall pay interest and redeem the debentures in accordance with the terms and conditions of their issue.

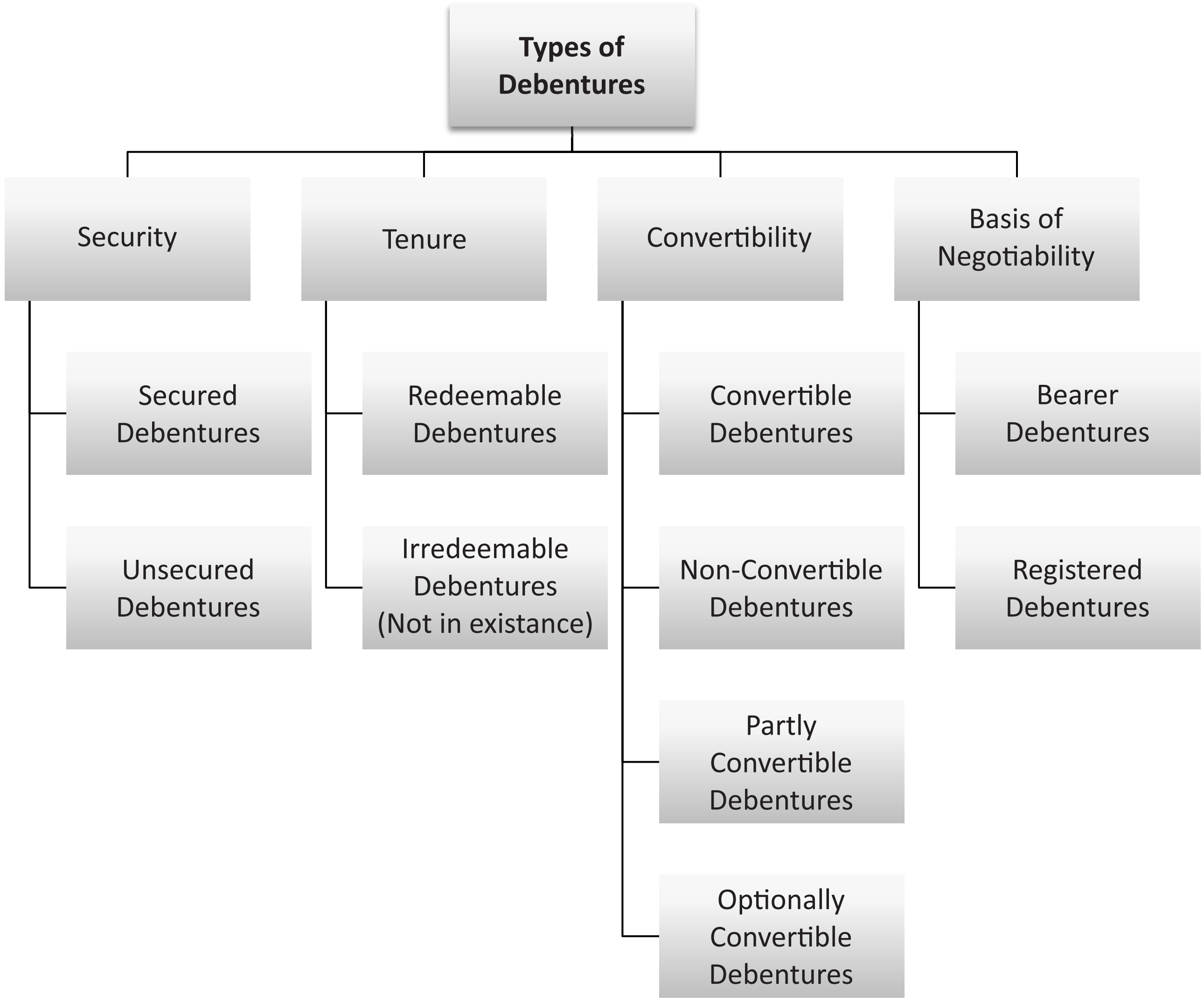
(9) Where at any time the debenture trustee comes to a conclusion that the assets of the company are insufficient or are likely to become insufficient to discharge the principal amount as and when it becomes due, the debenture trustee may file a petition before the Tribunal and the Tribunal may, after hearing the company and any other person interested in the matter, by order, impose such restrictions on the incurring of any further liabilities by the company as the Tribunal may consider necessary in the interests of the debenture-holders.

(10) Where a company fails to redeem the debentures on the date of their maturity or fails to pay interest on the debentures when it is due, the Tribunal may, on the application of any or all of the debenture-holders, or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith on payment of principal and interest due thereon.

(11) A contract with the company to take up and pay for any debentures of the company may be enforced by a decree for specific performance.

(12) The Central Government may prescribe the procedure, for securing the issue of debentures, the form of debenture trust deed, the procedure for the debenture-holders to inspect the trust deed and to obtain copies thereof, quantum of debenture redemption reserve required to be created and such other matters.

TYPE OF DEBENTURES



Security

(a) Secured Debentures

Secured debentures refer to those debentures where a charge is created on the assets of the company (mostly immovable) for the purpose of payment in case of default.

The secured debenture holders have greater protection. Holders of secured debentures remain convinced about the payment of interest and payment of principal in the event of redemption.

(b) Unsecured Debentures

These debentures are also known as naked debentures. These debentures are not secured by way of charge on the company's assets. Interest rate payable on unsecured debentures is generally higher than that which is payable on secured debentures but the risk is comparatively high too.

Tenure

Redeemable Debentures

Redeemable debentures are those which are payable on the expiry of the specific period (Maximum period 10 years from the date of issue, or upto 30 years in case the company is engaged in infrastructure projects or is an infrastructure finance company) either in lump sum or in instalments during the lifetime of the company. Debentures can be redeemed either at par or at premium.

Convertibility

On the basis of convertibility, a debenture may be classified under the following categories:-

(a) Convertible Debenture

These debentures are fully converted into equity shares of the company on the expiry of a specified period.

(b) Non-Convertible Debenture

Non-convertible debentures do not have any option to be converted into equity shares and are redeemed at the expiry of specified period(s).

(c) Partly Convertible Debenture

Partly convertible debentures are divided into two portions, viz., convertible and non-convertible portion. The convertible portion is converted into equity shares of the company at the expiry of specified period. The non- convertible portion is redeemed at the expiry of the specified period in terms of the issue.

(d) Optionally convertible Debentures

An option is provided to the debenture holders at the maturity to get them converted into equity shares of the company are get them redeemed.

Basis of Negotiability

Debentures issued by a company may be negotiable or non-negotiable. There are following two types of debentures: -

(a) Bearer Debentures

These debentures are payable to bearer of the debentures and transferable by mere delivery. These debentures are also known as unregistered debentures.

(b) Registered Debentures

These debentures are not transferable by mere delivery of debenture certificate and shall be transferred as per the provisions of the Companies Act, by executing transfer deeds and the transfer registered by the company. Registered debentures are not negotiable instruments. A registered holder of a debenture means a person whose name appears both in the debenture certificate and in the register of debenture holders. Principal and interest amount, when due in respect of these debentures are payable to the registered holders thereof only.

Market Linked Debentures

Market-linked debt securities have an underlying principal component issued with market-linked returns obtained through exposures on exchange traded derivatives or MIBOR, GDP, inflation rate, underlying securities/indices etc. with coupon linked to a benchmark different from plain vanilla debt securities. The returns linked to equity markets are also called equity linked debt securities, stock linked debt securities, structured debt securities.

In view of the fact that such securities are different in their nature and their risk-return relationship, the following additional disclosures and requirements are specified in respect of issue and listing of structured debt securities/ market linked debt securities:

Debt securities which do not promise to return the principal amount in full at the end of the tenor of the instrument, i.e., 'principal non-protected' shall not be considered as debt securities under regulation 2(k) of SEBI NCS Regulations, 2021 and therefore will not be eligible for listing under the said regulations.

Eligibility criteria for issuers

As such securities expose the issuer to market risk, the issuer should have a minimum net worth of at least Rs. 100 crores at the time of issue.

Disclosure requirements

In addition to the disclosure requirements specified under SEBI NCS Regulations, 2021, the following disclosures shall be made in all offer documents for such securities:

a) Credit rating by any registered CRAs shall bear a prefix 'PP-MLD' denoting Principal Protected Market Linked Debt securities followed by the standardized rating symbols for long/ short term debt securities on the lines specified by the SEBI.

b) A detailed scenario analysis/ valuation matrix showing value of the security under different market conditions such as rising, stable and falling market conditions shall be disclosed in a table along with a suitable graphic representation.

c) A risk factor shall be prominently displayed that such securities are subject to model risk, i.e., the securities are created on the basis of complex mathematical models involving multiple derivative exposures which may or may not be hedged and the actual behavior of the securities selected for hedging may significantly differ from the returns predicted by the mathematical models.

d) A risk factor shall be prominently displayed stating that in case of principal/ Capital Protected Market Linked Debt securities, the principal amount is subject to the credit risk of the issuer whereby the investor may or may not recover all or part of the funds in case of default by the issuer.

e) Where indicative returns/ interest rates are mentioned in the offer document in percentage terms, such figures shall be shown only on annualized basis.

f) It shall be disclosed therein that the latest and historical valuation for such securities shall be made available on the websites of the issuer and of the valuer appointed for the purpose.

g) All commissions by whatever name called, if any, paid by issuer to distributor for selling/ distribution of such securities to end investors shall be disclosed in the offer document.

h) Conditions for premature redemption of such securities, if any, shall be clearly disclosed in the offer document.

Difference between Market Linked Debentures (MLD) and Non-Convertible Debentures (NCD)

A NCD is a fixed-income security where the issuer assures to pay a fixed interest rate on the principal amount to the investor. Non-Convertible Debentures can't be converted into equity shares of the issuing company, as the name suggests, "*non-convertible*". It has a specified maturity period, after which the investor can redeem the principal amount and the accumulated interest. On the contrary, Market Linked Debentures are structured products linked to the performance of the market index or asset, like commodities, currencies and stocks. MLDs' return on investments is not fixed because it is linked to the underlying asset's performance. So, the returns on MLDs are generally higher than NCDs when the market performs well but can be negative or zero when the market isn't performing well.

BONDS - AN INTRODUCTION

A developed and robust corporate bond market is important for the purpose of a well-rounded development of the economy. It supplements the banking system by providing an alternative and stable source of finance to meet the requirements of the corporate sector to raise funds – significantly, the infrastructure sector - while aiding diversification of risk.

A crucial element of India's Capital Market is the Corporate Bond Market. Indian Capital market has played a pivotal role in development of Indian Economy over the years. As India surges ahead to become an economic power house, the Indian capital market is expected to play a greater role and remain in forefront in the days ahead. Persistent effort by Government and SEBI in the last few years enabled a nascent Corporate Bond Market to move in the direction of maturity.

A bond is a debt instrument in which an investor loans money to an entity (typically corporate or government) which borrows the funds for a defined period of time at a variable or fixed interest rate. Bonds are used by companies, municipalities, states and sovereign governments to raise money to finance a variety of projects and activities. This Owners of bonds are debt holders, or creditors, of the issuer.

> The bond holders are generally like creditors where a company is obliged to pay the amount. The amount is paid on the maturity of the bond period. Generally the duration of a bond ranges from 3 to 10 years.

Based on the maturity period, bonds are referred to as bills or short-term bonds and long-term bonds. Bonds have fixed face value, which is the amount to be returned to the investor upon maturity of the bond. During this period, the investors receive a regular payment of interest, semi-annually or annually, which is calculated as a certain percentage of the face value and known as a 'coupon payment.

What are Bonds?

A bond is a debt instrument requiring the issuer (also called the debtor or borrower) to repay to the lender/ investor the amount borrowed plus interest over a specified period of time.

For investors, bonds provide an investment option that give steady returns for a fixed period while for the issuer they are a source of low-cost funds for their investment needs.

Bonds are generally one of the safe investment options generally providing predictable income flows. Depending on the risk appetite, an investor can choose various risk instruments.

Role of Corporate bond markets

Corporate bond markets are an important part of the global capital markets and play a key role in financing the real economy. They act as the alternative to the banking channels. Hence, it is imperative to ensure fair, efficient and transparent functioning of these markets.

The total capital raised in primary markets during the financial year 2023-24 stood at Rs. 9.2 lakh crore, out of which funds raised through corporate bonds were around 8.6 lac crore. According to CRISIL, the outstanding corporate bond market in India is expected to double and shall reach Rs. 65-70 lakh crore by the year 2025. In April 2024, SEBI reduced the face value of a bond issued through private placement from Rs.1,00,000 to Rs.10,000, which is expected to bring in more individual investors to the bond markets.

Different Kinds of Bonds

Fixed-rate bonds: In Fixed Rate Bonds, the interest remains fixed throughout the tenure of the bond. Owing to a constant interest rate, fixed rate bonds are resistant to changes and fluctuations in the market.

Floating rate bonds (FRBs): Floating rate bonds have a fluctuating interest rate (coupons) as per the current market reference rate.

Inflation-Indexed Bonds: Bonds linked to inflation are called inflation linked bonds. The interest rate of Inflation linked bonds is generally lower than fixed rate bonds.

Perpetual Bonds: Bonds with no maturity dates are called perpetual bonds. Holders of perpetual bonds enjoy interest throughout.

Bonds with Call or Put Option: Callable bonds are high coupon paying securities that give the issuer the right to call back the bonds at a pre-agreed price and date. Puttable bonds give the bondholder the right to return the bond and ask for repayment of principal at a pre-agreed date before maturity. Since the benefit offered is for investors, these bonds pay lower returns.

Zero-Coupon Bonds: As the name implies, these bonds do not pay periodic coupons during their tenure. Though, these bonds are issued at a discount and repayable at the par value.

Convertible bond: The investors holding convertible bonds get the right to convert the bond to a predefined number of equity shares in the issuing company at a particular time from the tenure.

Green Bonds: These are bonds which are primarily raised for Green investments such as Solar power projects, Land rehabilitation, Sewage management etc.

Municipal bonds: These Bonds are issued by Municipal authorities to finance the infrastructure needs of cities.

Secured and unsecured bonds: Bonds whose issuance is backed by some fixed or a tangible asset is called secured bonds while those that are not backed by any asset are unsecured bonds.

G-Secs: Bonds issued by the sovereign authority to finance its fiscal and investment needs are called Government bonds. These are risk free instruments which serve as a base for pricing other bond issuances.

Various risks associated with Bond investment

Risk is an inherent part of investing. Generally, investors must take greater risks to achieve greater returns. The main risks of investing in bonds include:

- *Interest Rate Risk*: Rising interest rates are a key risk for bond investors. Generally, rising interest rates will result in falling bond prices, reflecting the ability of investors to obtain an attractive rate of interest on their money elsewhere.
- *Credit Risk*: This is the risk that an issuer will be unable to make interest or principal payments when they are due, and therefore default.
- *Inflation Risk*: Inflation reduces the purchasing power of a bond's future coupons and principal. As bonds tend not to offer extraordinarily high returns, they are particularly vulnerable when inflation rises.
- *Reinvestment Risk*: When interest rates are declining, investors may have to reinvest their coupon income and their principal at maturity at lower prevailing rates.
- *Liquidity Risk*: This is the risk that investor may have difficulty in finding a buyer when they want to sell and may be forced to sell at a significant discount to market value.

ONLINE BOND PLATFORM PROVIDERS

Securities and Exchange Board of India on November 14, 2022, notified the circular, 'Registration and regulatory framework for Online Bond Platform Providers ('OBPP') for regulating online bond trading platforms.

Meaning and Scope

"Online bond platform provider" (OBPP) means any person operating or providing an online bond platform and "online bond platform" means any electronic system, other than a recognised stock exchange or an electronic book provider platform, on which the debt securities which are listed or proposed to be listed, are offered and transacted.

A framework has been prescribed for entities operating/ desirous of operating as OBPPs under regulation 51A of the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 ('NCS Regulations'):

(a) Such entity shall be a company incorporated in India and register itself as a stock broker in the debt segment of the Stock Exchange(s);

(b) An entity acting as an OBPP shall offer only the following products or securities or services on its Online Bond Platform:

- Listed debt securities, listed municipal debt securities and listed securitised debt instruments;
- Debt securities, municipal debt securities and securitised debt instruments proposed to be listed through a public offering;
- Listed Government Securities, State Development Loans and Treasury Bills; and
- Listed Sovereign Gold Bonds.
- Other products or securities or services that are regulated by a financial sector regulator viz. SEBI, RBI, IRDAI or PFRDA.

In case of the products or securities or services mentioned above,

a. they may be offered by the entity either under a different tab on its online bond platform or on any other website/ platform.

b. they will be governed by the directions / stipulations of the respective financial sector regulator.

It is also reiterated that an entity acting as an Online Bond Platform Provider shall divest itself of offerings of other products or securities or services which are not permitted under the above-mentioned clause.

SEBI on November 14, 2022, notified the circular, 'Registration and regulatory framework for Online Bond Platform Providers ('OBPP') for regulating online bond trading platforms. Vide this circular it has been prescribed that any entity operating or desirous of operating an Online Bond Platform (OBP) ('entity') shall, after obtaining registration as a stock broker in the debt segment of Stock Exchange(s), apply to a recognized stock exchange to act as an Online Bond Platform Provider (OBPP) as specified under NCS Regulations. In its application, the entity shall ensure that the following requirements are met and confirmations / undertakings are provided:

- The entity has appointed a **Company Secretary** as a compliance officer;
- The entity has appointed at least two qualified key managerial personnel with experience of at least three years in the securities market;
- The entity has obtained a SEBI Complaints Redress System (SCORES) authentication and has put in place a well-defined mechanism to address grievances that may arise or likely arise while carrying out OBP operations;
- The entity owns, operates and maintains robust technology infrastructure with a high degree of reliability, availability, scalability and security in respect of its systems, data and network, appropriate to support its operations and manage the associated risks;
- The entity shall ensure compliance with the minimum disclosure requirements as specified by SEBI;
- The entity undertakes to ensure that its advertisements shall be in conformity with the Advertisement Code;

- The mechanism for the redress of the investor grievances shall be as specified in Chapter VII on "Investor Grievance Redressal" of Master Circular for Stock Brokers dated May 17, 2023 and as amended from time to time.
- Entity has a comprehensive risk management framework covering all aspects of its operations and shall ensure that risks associated with its operations are identified properly and managed prudently;
- The entity undertakes to establish appropriate safeguards and procedures to deal with exigencies like suspension or cessation of trading in debt securities, cancellation of orders or transactions by the investors and sellers, malfunctions or erroneous use of its systems by investors and sellers, or other unforeseen situations;
- The entity undertakes to identify and disclose on its OBP, all instances of conflict of interest, if any, arising from its transactions or dealings with related parties;
- The entity undertakes to maintain all data relating to its activities in an easily retrievable media and confidentiality and security of all data relating to its activities and strictly control access to such data;
- The entity shall, in addition to the information required to be submitted under various SEBI regulations, submit such information as may be required by the Stock Exchange(s) in relation to their operations.

Minimum Disclosure Requirements for each debt security offered for sale on the OBP

- Name of the Issuer, Security Name and ISIN
- Nature of instrument: Listed Secured/ Listed unsecured
- Seniority: Senior/ non-senior
- Original Mode of Issue and date of issue: Public issue/ Private Placement
- Rating of the Instrument – Outstanding Rating; date of rating; Rating agency; latest Rating rationale
- Face Value, Clean price and Dirty price
- Coupon: fixed/ floating, Rate /value, Frequency
- Date of maturity/ Tenor
- Name of Debenture trustee
- Yield: Current yield and yield to maturity; calculation of such yields
- Offer documents - Prospectus / Private Placement Memorandum
- Any other documents as may be specified by SEBI from time to time.

ELECTRONIC BOOK PROVIDER (EBP) MECHANISM

Corporate debt can be raised either through public issuances or private placement route.

Historically, the private placements of debt securities were usually negotiated by the issuers directly by issuers with investors such as Qualified Institutional Buyers (QIBs) /HNIs or placed through arrangers over-the-telephone market and then listed on stock exchanges. It is usually post listing that many investors get to know about the more granular details of the issue. Thus, this mechanism lacked transparency, was time consuming and hence not an efficient way to discover price.

Primary Issuance of Debt Securities - EBP Mechanism

In order to streamline the issuance procedure in the year 2016, SEBI placed a consultation paper dated December 04,2015 for discussion on the EBP platform. After taking into account the comments of stakeholders including stock exchanges, SEBI vide circular dated April 21, 2016 introduced a framework for issuance of debt securities on private placement basis which are subsequently proposed to be listed through an Electronic Book Provider (EBP) platform with an aim to provide an efficient way of price discovery and more transparency by disseminating bidding data. The framework was subsequently reviewed by SEBI in the year 2018 and 2021.

EBP platform is a web-based portal for online bidding and allotment of debt securities on private placement basis in primary market. The requirements for primary issuance of Debt Securities are as under:

1. **Eligible participants on the EBP Platform**

   a) QIBs as defined under Regulation 2(ss) of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (hereinafter referred to SEBI ICDR Regulations, 2018).

   b) Any non-QIB, who/ which has been authorized by the issuer, to participate in a particular issue on the EBP Platform.

2. **Issues of securities through the EBP platform**

   (i) A private placement of debt securities and NCRPS as per the provisions of SEBI NCS Regulations, 2021 and municipal debt securities as per provisions of SEBI (Issue and Listing Municipal Debts Securities) Regulations, 2015 if it is:

      a) a single issue, inclusive of green shoe option, if any, of Rs. 20 crore or more;

      b) a shelf issue, consisting of multiple tranches, which cumulatively amounts to Rs. 20 crore or more, in a financial year; and

      c) a subsequent issue, where aggregate of all previous issues by an issuer in a financial year equals or exceeds Rs. 20 crore.

3. An issuer, if desirous, may choose to access EBP platform for private placement of securitised debt instruments or security receipts or CPs or CDs, and issuers constituted as REITs, SM REITs and InvITs may also access the EBP platform for private placement of units of REITs, SM REITs and InvITs.

4. Issuers of debt securities, NCRPS and municipal debt securities on private placement basis of issue size less than Rs. 20 crore may also choose to access the EBP platform for such issuances.

5. **The obligations of issuers**

   a) The issuer shall ensure compliance with all requisite laws, rules, regulations, etc. with respect to private placement of securities including ensuring compliance with Section 42 of the Companies Act, 2013.

      Provided that, the issuer, shall include the number of non-QIB eligible participants, on whose behalf arranger(s) is making bids in a particular issue, for the purposes of compliance with the provisions of Section 42 of the Companies Act, 2013 and other relevant statutes.

   b) The Issuer shall provide the Placement Memorandum and term sheet (i.e. summary of important terms and conditions related to an issue) to the EBP at least two working days prior to the issue opening date.

      However, the issuer issuing the securities for the first time through EBP platform shall provide the above information at least 3 working days prior to the issue to the opening date.

c) The Placement Memorandum and the term sheet, *inter-alia,* discloses the following:

i. Details of size of the issue and green shoe portion, if any.

However, the green shoe portion shall not exceed five times the base issue size.

Provided further, that issuer shall be required to disclose in the offer document, issue-wise green shoe option exercised vis-a-vis the base issue size and green shoe portion as specified in issues undertaken in the previous financial year.

ii. Interest rate parameter - Zero coupon, fixed coupon or floating coupon.

iii. Bid opening and closing date.

iv. Minimum Bid Lot.

v. Manner of bidding in the issue i.e. open bidding or closed bidding.

vi. Manner of allotment in the issue i.e. uniform yield allotment or multiple yield allotment.

vii. Manner of settlement in the issue i.e. through clearing corporation or through escrow bank account of issuer.

viii. Settlement cycle i.e. T+1 or T+2 day.

d) The issuer may choose to disclose estimated cut-off yield to the EBP, however the same has to be disclosed at least one hour prior to opening of the bidding for the issue.

e) Subsequent to closure of the issue, the issuer shall ensure following details of the issue are provided on the EBP platform:

Table 1: Details of allotment in private placement

Details of Investors to whom allotment has been made			
Name	**QIB/ Non-QIB**	**Category i.e. Scheduled Commercial Banks, MF, Insurance Company, Pension Fund, Provident Fund, FPI, PFI, Corporate, Others**	**Amount invested in Rs. crore**

6. Participants:

a) Participants, prior to entering into the bidding process shall be required to enroll with EBP. Such enrollment of a participant on an EBP will be onetime exercise and shall be valid till the time such enrolment is annulled or rescinded.

b) The KYC verification and enrolment of the eligible participants on the EBP platform shall be done in the following manner:

i. KYC verification shall be undertaken by obtaining/ utilizing existing KYCs of clients from KYC Registration Agencies (KRAs) registered with SEBI or on the basis of the guidelines as prescribed by SEBI from time to time.

ii. For QIB investors bidding directly or through arranger(s), KYCs and enrolment shall be done by the EBP.

iii. For non-QIB investors bidding directly, KYCs shall be done by the issuer and enrolment shall be done by the EBP.

iv. For non-QIB investors, which are bidding through arranger(s), KYC and enrolment on EBP shall be ensured by arranger(s).

c) EBPs shall ensure that all eligible participants have access to the Placement Memorandum (PM), term sheet and other issue specific information available with them.

d) Each eligible participant shall provide confirmation to the EBP that it is not using any software, algorithm, Bots or other automation tools, which would give unfair access for placing bids on the EBP platform.

e) Each EBP shall ensure that it does not provide any preferential access to any bidder on a selective basis.

f) An eligible participant cannot bid for an amount more than Rs. 100 crore or 5% of the base issue size, whichever is lower, through arranger(s) on the EBP platform. However, Foreign Portfolio Investors may bid through their custodians.

g) An arranger can bid, on behalf of multiple participants, subject to the limits for each participant, as mentioned above.

h) For bids made by an arranger for any particular issue, such arranger shall disclose the following to the EBP at the time of bidding:

   i. Specify that whether the bid is:

      a. a proprietary bid; or

      b. a client bid i.e. entered on behalf of an eligible participant; or

      c. a consolidated bid i.e. an aggregate bid consisting of proprietary bid and Client bids.

   ii. For consolidated bid, arranger shall disclose breakup between proprietary bid and client bid(s). Further, for client bids, the following shall be disclosed:

      a. Names of such eligible participants;

      b. Category (i.e. QIB or non-QIB); and

      c. Quantum of bid of each eligible participant.

7. Bidding, allotment and settlement process:

a) Bidding timings and period:

   i. In order to ensure operational uniformity across various EBP platforms, the bidding on the EBP platform shall take place between 9 a.m. to 5 p.m. only, on the working days of the recognized stock exchanges.

   ii. The bidding window shall be open for the period as specified by the issuer in the bidding announcement; however, the same shall be open for at least one hour.

   iii. An issuer can provide details of the eligible participant(s) for a particular issue, to the EBP, not later than one hour before the bidding start time.

b) Bidding announcement:

   i. Issuer shall make the bidding announcement on EBP at least one working day before initiating the bidding process.

   ii. Bidding announcement shall be accompanied with details of bid opening and closing time, and any other details as required by the EBP from time to time.

iii. Any change in bidding time and/ or date by the issuer shall be intimated to the EBP, ensuring that such announcement is made within the operating hours of the EBP, at least a day before the bidding date. However, such changes in bidding date or time shall be allowed for a maximum of two times.

c) The bidding process on EBP platform shall be on an anonymous order driven system.

d) Bid shall be made by way of entering bid in:

i. Price; or

ii. Coupon (in %), up to four decimal places; or

iii. Spread in basis points (bps).

Further, the bid amount shall be specified in Rupees (INR).

e) Bidding process shall be based on the following:

i. Coupon specified by issuer: The face value and coupon remaining constant, bids/ quotes shall be placed by the bidders in terms of price.

ii. Coupon/ spread discovered during bidding: The face value remaining constant, bids/ quotes shall be placed by the bidders in terms of coupon/ spread.

f) Investors may place multiple bids in an issue.

g) Modification or cancellation of the bids shall be allowed i.e. bidder can cancel or modify the bids made in an issue, subject to the following:

i. such cancellation/ modification in the bids can be made only during the bidding period;

ii. no cancellation of bids shall be permitted in the last 10 minutes of the bidding period; and

iii. in the last 10 minutes of the bidding period, only revision allowed would be for:

a. downward revision of coupon/ spread or upward modification of price; and/ or

b. upward revision in terms of the bid size.

h) The bid placed in the system shall have an audit trail which includes bidder's identification details, time stamp and unique order number. Further against such bids, the EBP shall provide an acknowledgement.

i) All the bids made in a particular issue shall be disclosed on the EBP platform, in the following format:

Table 2: Details of cumulative demand received on EBP platform

Coupon/price/ spread	*Amount demand at that particular coupon/ price/ spread (in Rs. crore)*	*Cumulative amount demand (in Rs. crore)*

For issues with open bidding, the aforesaid information shall be disseminated on a real time basis; however, for issues with closed bidding, the information shall be disseminated after closure of bidding.

j) Allotment and settlement amount for the bidders shall be based on the following:

i. *Coupon specified by issuer:* All bids shall be arranged as per 'price time priority'.

a. In case of *'uniform yield allotment'*, allotment and settlement value shall be based on the cut-off price determined in the bidding process.

b. In case of '*multiple yield allotment'*, allotment and settlement value shall be based on the price quoted by each bidder/ allottee in the bidding process.

ii. *Coupon discovered during bidding*: All bids shall be arranged as per 'yield time priority'.

a. In case of *'uniform yield allotment'*, allotment and settlement value shall be based on the face value.

b. In case of *'multiple yield allotment'*, allotment and settlement value shall be based on the price adjusted as per the coupon/ spread quoted by each bidder/ allottee in the bidding process.

iii. If there are two or more bids at cut off coupon/ price/ spread, then allotment shall be done on *'pro-rata'* basis.

8. Anchor portion within the base issue size:

a) Issuer shall have an option to avail an '*anchor portion'* within the base issue size, subject to the below mentioned conditions:

i. Issuer shall have the discretion to select the anchor investor(s) for the anchor portion.

ii. The quantum of allocation(s) to the anchor investor(s) shall be at the discretion of the issuer, subject to total allocation to the anchor(s) not exceeding the base issue size, as per thresholds mentioned below:

Instrument Rating	Anchor Portion (%) of base size
AAA/ AA+/AA/AA-	Not exceeding 30%
A+/A-	Not exceeding 40%
Others	Not exceeding 50%

iii. There shall be no bidding for anchor portion on the EBP platform.

iv. If the issuer opts for anchor portion, the same shall be suitably disclosed in the placement memorandum and the term sheet with the relevant quantum.

v. Issuer shall disclose details of the anchor investor(s) and the corresponding quantum allocated, to the EBP, along with the Placement Memorandum and the term sheet. Such anchor investors shall provide electronic confirmation on the EBP platform of their participation by T+1 day. Amount not confirmed by any such investor shall be added back to the base issue size.

vi. The settlement amount for the anchor investor(s) shall be determined on the basis of the following:

a. Coupon specified by the issuer:

Uniform yield allotment: The 'cut-off' price determined in the bidding process (in case of issues with anchor portion, it will imply total issue size less the anchor portion).

Multiple yield allotment: Face value of the security.

However, in case of re-issuance, the '*cut-off*' price determined in the bidding process shall be applicable on the anchor investor(s).

b. Coupon/ spread determined in the bidding process:

Uniform yield or multiple yield allotment: Face value of the security

b) The remaining portion of the issue (i.e. the non-anchor portion within the base issue size and the green shoe portion), shall be open for bidding by the eligible participants at the chosen time slot on the EBP platform. The anchor investor(s) may also participate in the said portion if identified as eligible participant(s) by the issuer.

9. Pay-in obligations:

a) Pay-in towards the allotment of securities shall be done from the account of the bidder, to whom allocation is to be made. For bids made by the arranger on behalf of eligible participant(s), pay-in towards allotment of securities shall be made from the account of such eligible participants.

b) Pay-in of funds through escrow bank account of issuer: The pay-in of funds towards an issue on EBP shall be permitted either through clearing corporations of stock exchanges or through the escrow bank account of an issuer. An issuer, in its PM, shall disclose the manner of pay-in of funds so chosen and details thereof. The process of pay-in of funds by investors and pay-out to issuer can be done on either T+1 or T+2 day, where T day is the issue day, and the same shall be disclosed by the issuer in the PM.

c) In case of non-fulfillment of pay-in obligations by allottees and anchor investor(s), such allottees and anchor investor(s) shall be debarred from accessing the bidding platform across all EBPs for a period of thirty days from the date of such default.

d) In case of three instances of non-fulfillment of pay-in obligations, across all EBPs, by client(s) for whom an arranger has bid, then such arranger shall be debarred from accessing the bidding platform on any EBP, for a period of seven days from the date of the such third or subsequent default.

e) Pay in shall be done through the clearing corporations of stock exchanges, as per their operating guidelines, or through an escrow bank account of the issuer, as mentioned below.

However, where the issuer has selected the escrow bank account as the mechanism for pay-in, EBP, pursuant to successful closure of issue, shall share the allocation details with the Registrar to an Issue, associated with the issue.

f) Process flow of settlement, where funds pay-in is to be made to escrow bank account of issuer:

i. Successful bidders, in an issue, will make pay-in of funds towards the allocation made to them, in the escrow bank account within the timelines, as provided by the issuer in the PM/ IM. The funds pay-in by the successful bidders will be made only from the bank account(s), which have been provided/ updated in the EBP system. Further, pay-in received from any other bank account will lead to cancellation of bid and consequent debarment of the investor from accessing EBP platform for 30 days.

ii. Escrow bank, pursuant to receipt of funds will provide a confirmation to the RTA, associated with the issue, about receipt of funds along with details including name of bank account holder, bank account number and the quantum of funds received.

iii. RTA, will then reconcile the information received from escrow bank with the details as provided by EBP and after reconciliation RTA shall intimate to the issuer about receipt of funds. Subsequently, issuer will initiate the process of corporate action through the RTA to Depository.

iv. RTA, after passing on the instructions for corporate action to the depositories, will issue instruction to the escrow bank to release money to the issuers bank account.

10. Withdrawal of offer by an issuer:

a) An issuer, at its discretion, may withdraw from the issue process at any time; however, subsequent to such withdrawal, the issuer shall not be allowed to access any of the EBP platforms for a period of seven days from the date of such withdrawal. A withdrawal from the issue process shall imply withdrawal of the total issue including anchor portion.

b) If an issuer withdraws from the issue because of any of the reasons as outlined below, the restrictions mentioned in the above paragraph shall not be applicable:

i. issuer is unable to receive the bids up to the base issue size; or

ii. bidder has defaulted on payment towards the allotment, within stipulated timeframe, due to which the issuer is unable to fulfill the base issue size; or

iii. cut-off yield (i.e. the highest yield at which a bid is accepted) in the issue is higher than the estimated cut-off yield (i.e. the yield estimated by the issuer, prior to opening of issue) disclosed to the EBP, where the base issue size is fully subscribed.

c) Disclosure of estimated cut-off yield on the EBP platform to the eligible participants, pursuant to closure of issue, shall be at the discretion of the issuer.

d) In case an issuer withdraws issues on the EBP platform because of the cut-off yield being higher than the estimated cut-off yield, the EBP shall mandatorily disclose the estimated cut-off yield to the eligible participants.

11. Responsibilities of various entities involved in the process:

a) Issuer shall:

i. open an escrow bank account/ have an escrow bank account jointly with a RTA, where the role of the RTA in operating such bank account shall be limited to the responsibilities as provided under this circular;

ii. provide the details of escrow bank account in which pay-in of funds has to be made and the timelines by which such pay-in shall be done by the successful bidders; and

iii. effect corporate action for credit of securities to the successful bidders, after receiving confirmation from the RTA about receipt of funds.

b) RTA shall:

i. undertake reconciliation between information received from the escrow Bank and EBP. Further, after reconciliation, shall intimate the issuer about the receipt of funds and shortfall, if any, and the reasons thereof;

ii. issue instructions to the escrow bank account for the release of funds, after passing on the instructions for corporate action to the depositories; and

iii. intimate to the EBP, upon closure of the issue, the status of the issue i.e. successful or withdrawn, details of defaulting investors etc.

12. Obligations and duties of EBP:

a) An EBP shall:

i. provide an on-line platform for placing bids;

ii. have necessary infrastructure like adequate office space, equipment, risk management capabilities, manpower and other information technology infrastructure to effectively discharge the activities of an EBP;

iii. ensure that the PM, term sheet and other issue related information is available to the eligible participants on its platform immediately on receipt of the same from the issuer;

iv. have adequate backup, disaster management and recovery systems; and

v. ensure safety, secrecy, integrity and retrievability of data.

b) EBPs shall ensure that the prescribed details regarding the issuance is updated on its website by end of T-day for issue closing upto 1 p.m. on T-day any buy 1 p.m. on T+1 day for the remaining issues.

c) EBPs shall together ensure that the operational procedure is standardized across all EBP platforms and the details of such operational procedure are disclosed on their websites.

d) Where an issuer has disclosed estimated cut-off yield to the EBP, the EBP shall ensure its electronic audit trail and secrecy. However, in case issuers withdraw issues on the EBP because of the cut off yield being higher than the estimated cut off yield, the EBP shall mandatorily disclose the estimated cut off yield in its platform.

e) EBPs shall ensure coordination amongst themselves and also with depositories so as to ensure that the cooling off period for issuers and debarment period for investors is adhered to.

f) EBPs shall ensure that bidding is done in the manner as specified.

g) The EBP shall be responsible for accurate, timely and secured bidding process of the electronic bid by the bidders.

h) The EBP shall provide a facility to the eligible participants to define the limits/ range, within which quotes may be placed, from its user interface, to avoid 'fat finger' errors.

i) The EBP shall be responsible for addressing investor grievances arising from bidding process.

13. CISA Audit of EBP Platform:

The EBP platform so provided by the EBP shall be subject to audit by a CISA at least once a year.

Benefits of EBP Mechanism

The EBP mechanism offers a lot of benefits to various stakeholders, including the following:

- Transparent process for price discovery through anonymous bidding
- Dissemination of bidding data on anonymous basis to the market which is absent till now
- Facility to do multiple bidding at different yields
- Institutional investors can also participate on behalf of arrangers/ sub arrangers
- Allotment data to be made available on the website of the EBP website which would bring required transparency in the secondary market of such private placements.

EBP has helped in developing an institutional market for corporate bonds wherein all QIBs (i.e. which are institutional investors) can participate after one-time registration, therefore gives an equal access to participation on all issuances to all such institutional participants. Further, details of proposed issuances (by any issuer) is disclosed before the start of bidding, in order to enable them to enable participants to choose their investments options in advance. Further, bidding and allotment is done in a transparent manner and appropriate disclosures viz. market price, amount etc. are available to all investors after successful closure of the bid. This has resulted in not only reduction in cost but also timelines for both investors and issuers.

SECONDARY MARKET FOR DEBT SECURITIES: REQUEST FOR QUOTE (RFQ) PLATFORM

RFQ is an electronic platform to enable sophisticated, multi-lateral negotiations to take place on a centralized online trading platform with straight through processing of clearing and settlement to complete a trade.

'Request for Quote' (RFQ) is a platform for interaction amongst the market participants who wish to negotiate transactions amongst themselves. This platform is a participant-to-participant model where an initiator may request other participants for a quote in corporate bonds, securitized debt instruments, municipal debt securities, Government securities, State development loans, Treasury bills, Commercial papers and Certificates of deposit or any other security as specified by Exchange from time to time. This platform effectively automates or provides an electronic form of transacting in OTC deals. The RFQ platform shall provide users a range of options to seek a quote and to respond to a quote, while keeping an audit trail of all the interactions i.e. quoted yield, mutually agreed price, deal terms etc. This may bring pre-trade transparency for over- the-counter transactions in eligible securities.

Secondary market trades in corporate bond are predominantly an OTC market, driven by institutional investors. Therefore, unlike trading in equity shares where buy and sell orders are matched on electronic order books, corporate bonds are traded over the counter. Prices are negotiated off-line, bilaterally and reported / cleared on a DVP-1 (Delivery vs Payment- 1) basis.

Robust price discovery in corporate bonds remains a challenge, even internationally. Enhancing and coalescing the fragmented liquidity of corporate bonds is a felt need of the market participants. One way in which this could possibly be achieved is through an electronic platform that enables sophisticated, multi-lateral negotiations to take place i.e. an enhanced 'Request for Quote (RFQ)' kind of arrangement. Negotiations that currently take place offline and bilaterally would have to be done on an electronic platform, with straight through processing of clearing and settlement to complete the trade. This is expected to lead to more transparency, centralization and pooling of investor interest and hopefully, a more efficient and liquid market.

In February 2020, pursuant to approvals from SEBI, both National Stock Exchange of India Limited and BSE Limited launched RFQ platforms, as an extension of their existing trade execution and settlement platforms,to bring in transparency in "Over the Counter"deals which were negotiated bilaterally. RFQ platform has been developed by BSE and NSE which acts as a single interface for price givers as well as price takers in the corporate bond market from a diverse range of clients which will act as a catalyst to better price discovery. RFQ using request for quote protocol shall provide participants a range of options to seek a quote and to respond to a quote, while keeping an audit trail of all interactions i.e. quoted yield, mutually agreed price, deal terms etc. A participant may request other participants for a quote for eligible securities. Ever since its introduction, it has seen traction from market players.

1. **Basic features of the RFQ platform**

    1.1. The RFQ platform is a system or interface for inviting and/ or giving quotes on an electronic platform.

1.2. A participant who seeks quote(s) is termed as an Initiator and a participant who acts/ responds to the quote requests of the Initiator is termed as a Responder.

1.3. A participant may request other participants for a quote for eligible securities.

1.4. The Initiator has the option to place quote(s) by disclosing its name or anonymously.

1.5. The quote can be placed to an identified counterparty (i.e. '*One to One'* (OTO) mode) or to all the participants (i.e. '*One to Many'* (OTM) mode).

1.6. The platform provides the participants a range of options to seek a quote and to respond to a quote, while keeping an audit trail of all interactions i.e. quoted yield, mutually agreed price, deal terms etc.

1.7. The quotes will be bilaterally negotiated between the counterparties, based on specified parameters. The acceptance of a quote by a participant will be considered as mutual agreement between the parties for the given deal.

2. Securities eligible for being traded on the RFQ platform

2.1. Non-convertible securities;

2.2. Securitised Debt Instruments;

2.3. Municipal Debt Securities;

2.4. Commercial Paper;

2.5. Certificate of Deposit;

2.6. Government Securities;

2.7. State development Loans;

2.8. Treasury Bills; and

2.9. Any other instrument, as may be specified by Stock Exchanges in consultation with SEBI.

3. Mandatory trades on RFQ platform

In February 2020, the RFQ platform was introduced as a '*participant-based'* model wherein all regulated entities, listed bodies corporate, institutional investors and all India financial institutions were eligible to register, access and transact. To enhance liquidity on the RFQ platforms of the stock exchanges, SEBI has, *inter alia*, mandated registered Mutual Funds, AIFs and Portfolio Management Services, to undertake a specified percentage of their total secondary market trades in Corporate Bonds through RFQ platform of stock exchanges. IRDAI has also prescribed similar stipulations for Insurers.

4. Permitting Stock Brokers on RFQ platform

SEBI has allowed stock brokers registered under the debt segment of the Stock Exchange(s) to place/ seek bids on the RFQ platform on behalf of client(s), in addition to the existing option of placing bids in a proprietary capacity.

The RFQ model will provide market participants with better price discovery and make information available near real-time to all the participants. This is expected to lead to more transparency, centralization and pooling of investor interest and hopefully, a more efficient and liquid market.

5. **Yield to Price computation**

   In order to simplify the process of yield to price computation for non-convertible securities, cash flow dates regarding payment of interest/ dividend/ redemption for the securities traded on RFQ platform for the purpose for yield to price computation shall not be adjusted for day count convention and shall accordingly be based on the due date of payment as per the cash flow schedule and not as per the date of payment.

GROWING IMPORTANCE OF THE ROLE OF COMPANY SECRETARY IN ENTITIES THAT HAVE LISTED CORPORATE BONDS

Over the years, the role of a Company Secretary has developed and increased into much more than fulfilling the basic statutory requirements like maintaining the company's minute books, advising the board of directors relating to the legal and financial risks of the company and ensuring that the company complies with statutory regulations. This in turn has served to direct company's focus on effectiveness.

A Company Secretary is a vital link between the company and its Board of Directors, shareholders, government and regulatory authorities and all other stakeholders. A Company Secretary can play an important role in fulfilling the role as a governance professional for companies with listed debt securities.

Given all the provisions above and other roles and responsibilities, it would be appropriate to say that company secretaries acting as compliance officers are responsible for ensuring that the organisational processes comply with needed laws and regulations. Any risk of violation of applicable laws and regulations can expose the company to financial and reputational losses.

Hence, Company Secretaries can add real value to their role and increase their impact by bringing commercial acumen, strategic understanding and softer people skills in addition to their already much sought after legal and governance knowledge.

Therefore, in nutshell, the Company Secretary monitors, manages the information updates and conducts regular assessment to ensure that company remains abreast of the regulatory standards.

SUSTAINABLE FINANCE

SEBI is actively involved in promoting sustainable financing in India. Towards this objective, SEBI has defined the term green bonds and has attempted to encourage mobilization of sustainable finance. The issuance of Green Debt Securities exclusively covers the financing projects in areas such as renewable and sustainable energy, low carbon transport modes, sustainable land use, water and waste management, climate change adaptation, energy efficiency, bio diversity conservation, etc.

Green Debt Securities

SEBI has recently redefined '*green debt security'*. A few circulars were issued on disclosure requirements and other obligations for issuers of green bonds as well as on greenwashing. Recently, on May 4, 2023, SEBI also issued the requirements for issuers of transition bonds.

Accordingly, Regulation 2(1)(q) of NCS Regulations, defines green debt security as under:

"*Green debt security" means a debt security issued for raising funds subject to the conditions as may be specified by SEBI from time to time, to be utilised for project(s) and/ or asset(s) falling under any of the following categories:*

i. renewable and sustainable energy including wind, bioenergy, other sources of energy which use clean technology,

ii. clean transportation including mass/public transportation,

iii. climate change adaptation including efforts to make infrastructure more resilient to impacts of climate change and information support systems such as climate observation and early warning systems,

iv. energy efficiency including efficient and green buildings,

v. sustainable waste management including recycling, waste to energy, efficient disposal of wastage,

vi. sustainable land use including sustainable forestry and agriculture, afforestation,

vii. biodiversity conservation,

viii. pollution prevention and control (including reduction of air emissions, greenhouse gas control, soil remediation, waste prevention, waste reduction, waste recycling and energy efficient or emission efficient waste to energy) and sectors mentioned under the India Cooling Action Plan launched by the Ministry of Environment, Forest and Climate Change,

ix. circular economy adapted products, production technologies and processes (such as the design and introduction of reusable, recyclable and refurbished materials, components and products, circular tools and services) and/or eco efficient products,

x. blue bonds which comprise of funds raised for sustainable water management including clean water and water recycling, and sustainable maritime sector including sustainable shipping, sustainable fishing, fully traceable sustainable seafood, ocean energy and ocean mapping,

xi. yellow bonds which comprise of funds raised for solar energy generation and the upstream industries and downstream industries associated with it,

xii. transition bonds which comprise of funds raised for transitioning to a more sustainable form of operations, in line with India's Intended Nationally Determined Contributions, and

Explanation: Intended Nationally Determined Contributions (INDCs) refer to the climate targets determined by India under the Paris Agreement at the Conference of Parties 21 in 2015, and at the Conference of Parties 26 in 2021, as revised from time to time.

xiii. any other category, as may be specified by the SEBI from time to time.

DISCLOSURE REQUIREMENTS FOR ISSUE AND LISTING OF GREEN DEBT SECURITIES

SEBI vide its circular has prescribed the disclosure requirement and responsibilities of an issuer of green debt securities.

Initial Disclosure Requirements

1. **An issuer desirous of issuing green debt securities shall make the following additional disclosures in the offer document for public issues / private placements:**

1.1 A statement on environmental sustainability objectives of the issue of green debt securities;

1.2 Brief details of decision-making process followed/proposed for determining the eligibility of project(s) and/or asset(s), for which the proceeds are being raised through issuance of green debt securities, such as:

a) process followed/ to be followed for determining how the project(s) and/or asset(s) fit within the eligible green projects categories as defined under Regulation 2 (1) (q) of NCS Regulations,

b) the criteria making the project(s) and/ or asset(s) eligible for using the green debt securities proceeds; and

c) details of taxonomies, green standards or certifications both Indian and global, if any referenced and the alignment of projects with said taxonomies, related eligibility criteria, and exclusion criteria, if applicable.

d) Details of the alignment of the objective of the issue with the India's Intended Nationally Determined Contributions in case of the proceeds raised though issuance of transition bonds

1.3 Details of the system/procedures to be employed for tracking the deployment of the proceeds of the issue.

1.4 Details of the project(s) and/or asset(s) or areas where the issuer, proposes to utilise the proceeds of the issue of green debt securities, including towards refinancing of existing green project(s) and/or asset(s), if any.

1.5 Details of an indicative estimate of distribution of proceeds raised though issuance of green debt security between financing and refinancing of project(s) and/ or asset(s); if applicable.

1.6 Details of the intended types of temporary placement of the unallocated and unutilised net proceeds from the issue of green debt securities.

1.7 Details related to the perceived social and environmental risks and proposed mitigation plan associated with the project(s) proposed to be financed/ refinanced through the proceeds from the issue of green debt securities.

1.8 The issuer shall appoint an independent third party reviewer/ certifier, for reviewing/certifying the processes including project evaluation and selection criteria, project categories eligible for financing by green debt securities, etc.

The said requirement of appointing a third party reviewer/ certifier is applicable on a *'comply or explain'* basis for a period of two years. *'Comply or explain'* for the purpose of the above, shall mean that the issuer shall endeavour to comply with the provisions and achieve full compliance by two years from the date of issuance of the circular. In case the entity is not able to achieve full compliance with the provisions till such time, the issuer shall, in its annual report, explain the reasons for such non-compliance/ partial compliance and the steps initiated to achieve full compliance.

Continuous Disclosure Requirements

2. An issuer who has listed green debt securities, shall provide following Additional Disclosures Requirement along with its annual report and financial results:

2.1 Utilisation of the proceeds of the issue, as per the tracking done by the issuer using the internal process as disclosed in offer document. Utilisation of the proceeds shall be verified by the report of an external auditor, to verify the internal tracking method and the allocation of funds towards the project(s) and/or asset(s), from the proceeds of green debt securities.

2.2 Details of unutilized proceeds including the temporary placement/utilization of unallocated and unutilized proceeds from each ISIN of green debt security issued by the issuer.

2.3 The following additional disclosures shall be made in the Annual Report:

a) List of project(s) and/or asset(s) to which proceeds of the Green Debt Securities have been allocated/invested including a brief description of such project(s) and/or asset(s) and the amounts disbursed.

b) Qualitative performance indicators and, where feasible, quantitative performance measures of the environmental impact of the project(s) and/or asset(s). If the quantitative benefits/ impact cannot be ascertained, then the said fact may be appropriately disclosed along with the reasons for non-ascertainment of the benefits/impact on the environment

c) Methods and the key underlying assumptions used in preparation of the performance indicators and metrics;

d) Details of the deployment of the mitigation plan (as disclosed in the offer documents) for the perceived social and environmental risks

2.4 Impact Reporting: Information, on a project-by-project basis, pertaining to reporting of the environmental impact of the projects financed by the green debt securities. Reporting standards or taxonomies followed by the issuer with regard to reporting of environmental impact, if any, shall also be disclosed.

2.5 Disclosures of major elements of Business Responsibility and Sustainability Reporting (BRSR) – Principle 6 pertaining to Environment.

Appointment of a Third Party Reviewer/certifier

3. An issuer shall appoint a third party reviewer/certifier for a green debt security for the following:

3.1 Post-issue management of the use of proceeds from the green debt security,

3.2 Verification of the internal tracking and impact reporting.

The said requirement of appointing a third party reviewer/ certifier is applicable on a '*comply or explain'* basis for a period of two years. *'Comply or explain'* for the purpose of the above, shall mean that the issuer shall endeavour to comply with the provisions and achieve full compliance by two years from the date of issuance of the circular. In case the entity is not able to achieve full compliance with the provisions till such time, the issuer shall in its annual report, explain the reasons for such non-compliance/ partial compliance and the steps initiated to achieve full compliance.

Responsibilities of the issuer

4. An issuer of green debt securities shall:

4.1 maintain a decision-making process which it uses to determine the continuing eligibility of the project(s) and/or asset(s). This includes, without limitation statement on the environmental objectives of the green debt securities and a process to determine whether the project(s) and/or asset(s) meet the eligibility requirements;

4.2 ensure that all project(s) and/or asset(s) funded by the proceeds of green debt securities, meet the documented objectives of green debt securities;

4.3 utilise the proceeds only for the stated purpose, as disclosed in the offer document; and

4.4 ensure compliance with the Chapter IX-A of SEBI Circular dated May 23, 2024 on *"Dos and don'ts relating to green debt securities to avoid occurrences of greenwashing"*.

Green Bonds and Greenwashing

Recently, SEBI revised its green bond framework, applicable for green bond issues after April 1, 2023. Pursuant to the review of the green bond regulatory framework, the following changes have been brought in by SEBI:

- *Expanding the scope of 'Green Debt Securities' by revising the definition through the of SEBI (Issue and Listing of Non-Convertible Securities) Amendment Regulations, 2023;*
- *Enhancement of disclosure requirements and mandating third-party reviewers through amendments to existing Chapter IX of the Operational Circular; and*
- *Guidance on avoidance of green-washing through introduction of Chapter IX-A to the existing Operational Circular.*

While there are no universally accepted taxonomies on greenwashing, the generally accepted definition of 'Greenwashing' is, *'making false, misleading, unsubstantiated, or otherwise incomplete claims about the sustainability of a product, service, or business operation'*.

As part of its green bond framework, SEBI has also released a list of '*Dos and don'ts on Greenwashing',* vide Master Circular dated May 22, 2024. SEBI is one of the few regulators to issue such a list and it is expected to act as a strong deterrent to the deceptive practice.

To address the concerns of market participants, regarding greenwashing, an issuer of green debt securities shall ensure the following to avoid its occurence:

(i) While raising funds for transition towards a greener pathway, it shall continuously monitor to check whether the path undertaken towards more sustainable form of operations is resulting in reduction of the adverse environmental impact and contributing towards sustainable economy, as envisaged in the offer document.

(ii) It shall not utilize funds raised through green bonds for purposes that would not fall under the definition of *'green debt security'* under the NCS Regulations.

(iii) In case any such instances mentioned in (ii) above come to light regarding the green debt securities already issued, it shall disclose the same to the investors and, if required, by majority of debenture holders, undertake early redemption of such debt securities.

(iv) It shall not use misleading labels, hide trade-offs or cherry pick data from research to highlight green practices while obscuring others that are unfavourable in this behalf.

(v) It shall maintain highest standards associated with issue of green debt security while adhering to the rating assigned to it.

(vi) It shall quantify the negative externalities associated with utilization of the funds raised through green debt security.

(vii) It shall not make untrue claims giving false impression of certification by a third-party entity.

Transition Bonds - Additional requirements for issuers

Since transition bonds are green debt securities as per the NCS Regulations, SEBI felt a need to ensure that the funds raised for transition finance through transition bonds are indeed used for the purpose. Accordingly, certain stipulations additionally have been brought in by SEBI for issuers of transition bonds.

1. On February 2, 2023, the revised definition of *'green debt security'* was notified in the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021. On May 22, 2024, SEBI vide its Mater Circular

issued the revised disclosure requirements for such issuances. [See Regulation 2(1)(q) of the SEBI NCS Regulations, 2021]

2. As mentioned earlier, *'Transition bonds'* is one of the sub categories of the revised definition of '*green debt security'.* As per the SEBI (Issue and Listing of Non-Convertible Securities), transition bonds comprise of *"funds raised for transitioning to a more sustainable form of operations, in line with India's Intended Nationally Determined Contributions."*

3. Transition finance market is moving from operations that are carbon intensive to carbon neutral. For transition, a significant helping hand through funding is required for carbon-intensive sectors to decarbonize. SEBI believes that transition bonds find their use in this space.

4. In order to facilitate transparency and informed decision making amongst the investors in the transition bonds and to ensure that the funds raised through transition bonds are not being misallocated, SEBI decided to prescribe certain additional requirements for issuance and listing of *transition bonds*, as follows:

   SEBI brought a circular on May 04, 2023, requiring an issuer desirous of issuing transition bonds to make the following additional disclosures:

   - **Disclosure in the offer document for public issues /private placements of such transition bonds:**

     a. To differentiate transition bonds from other categories of green debt security, Issuer of transition bonds shall use a denotation '***GB-T'***. The denotation shall be disclosed in the offer documents on the cover page and in *type of instrumen*t field in the term sheet.

     b. Transition Plan, which shall contain the following:

        (i) Details of interim targets / milestones along with an indicative timeline for achieving the targets.

        (interim targets should also reflect the indicative figure regarding how much emissions the issuer is envisaging to reduce)

        (ii) Brief of the project implementation strategy

        (iii) Details regarding the usage of technology for the project implementation

        (iv) Mechanism to oversee the utilization of the funds raised through transition bonds and the implementation of the transition plan. Issuers may form a committee to oversee the implementation and ensure timely completion of the defined targets.

   - **Disclosure in the Centralised Database for corporate bonds:**

     An issuer shall disclose the denotation in the Centralized Database for corporate bonds/ debentures by filling the denotation i.e. **GB-T** in sub point 6 i.e. *Others* of point 10. i.e. *Type of Instrument* of Annex-XIV-A to Chapter XIV (Centralized Database for corporate bonds/ debentures) of the Operational Circular dated August 10, 2021 (and as amended from time to time).

     The Depositories shall update the denotation i.e. **GB-T** as prefix in "*instrument details"* field in Centralized Database for corporate bonds/ debentures.

   - **Disclosure to Stock Exchanges, in case of a revision in the transition plan:**

     An Issuer of transition bonds, during the year, shall disclose the revised transition plan along with an explanation for any such revision to the already disclosed plan; if applicable.

- **Disclosure in the Annual report:**

  The Issuer, shall disclose the transition plan along with a brief on the progress of the implementation of the transition plan.

Municipal Bonds

The importance of infrastructure especially urban infrastructure and the role of entities tasked to create that infrastructure in India cannot be overstated. The funding requirement of municipalities is expected to increase given the pace of reforms being witnessed in the country. The current sources of revenues in the form of Tax & Non-tax and Grants from state/ central government are felt to be insufficient for the enormous scale of infrastructure development and upgradation required to meet the growth aims at various levels (State/ Centre).

SEBI has issued the SEBI (Issue and Listing of Municipal Debt Securities) Regulations, 2015 ('ILDMS Regulations').

In accordance with these Regulations, "municipal debt securities" shall mean non-convertible debt securities which create or acknowledge indebtedness, and include debenture, bonds and such other securities of an issuer and "municipality" shall mean an institution of self-government constituted under Article 243Q of the Constitution of India.

Municipal bonds are a good alternative source of finance to fund projects undertaken by Municipal Corporations. In India, the Municipal Debt market is in a nascent stage. SEBI is taking steps to increase awareness through such events. Since 2017 upto March 2025, seventeen issues of Municipal Bonds have been made by twelve Municipal Corporations in the country, raising almost Rs. 2789 Cr. The funds raised through these bonds have been used for various developmental projects like liquid waste management projects, water supply projects, tertiary sewage treatment plants, residential projects etc. A few municipalities have also issued green bonds.

Unless otherwise provided in these Regulations, An issuer making an offer of municipal debt securities shall satisfy the conditions of theset SEBI Municipal Bond Regulations as on the date of filing of the draft offer document for preliminary public issue or private placement.

These regulations, inter-alia, deal with:

- the eligibility requirement for public issue of municipal debt securities,
- listing requirements for both public issues and private placement,
- conditions for trading of debt securities,
- obligations of intermediaries and issuers etc.

An issuer under ILMDS may issue a green debt security if it falls within the definition of "green debt security", as per Regulation 2(1)(q) of the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 (NCS Regulations). Such issuer, shall, in addition to the requirements prescribed under the ILMDS Regulations and circulars issued thereunder, comply with the provisions for 'green debt security', as specified under the NCS Regulations and circulars issued thereunder.

Amounts raised through municipal bonds*

The following table gives a snapshot of the amounts raised through Municipal bonds recently:

Name of Municipality	*Date of Issue*	*Amount of Issue (Rs. in cr.)*	*Coupon (%)*
Pune Municipal Corporation	June 20, 2017	200	7.59
Greater Hyderabad Municipal Corporation	Feb 16, 2018	200	8.9
Indore Municipal Corporation	June 28, 2018	139.9	9.25
Greater Hyderabad Municipal Corporation	Aug 14, 2018	195	9.38
Bhopal Municipal Corporation	Sept 25, 2018	175	9.55
Greater Vishakhapatnam Municipal Corporation	Dec 21, 2018	80	10
Ahmedabad Municipal Corporation	Jan 11, 2019	200	8.7
Surat Municipal Corporation	Feb 27,2019	200	8.68
Greater Hyderabad Municipal Corporation	August 20, 2019	100	10.23
Lucknow Municipal Corporation	November 13, 2020	200	8.5
Ghaziabad Nagar Nigam	March 13, 2021	150	8.1
Vadodara Municipal Corporation	March 24, 2022	100	7.15
Indore Municipal Corporation	February 20, 2023	244	8.25
Pimpri Chinchwad Municipal Corporation	July 28, 2023	200	8.15
Ahmedabad Municipal Corporation	February 07, 2024	200	7.9
Vadodara Municipal Corporation	March 05, 2024	100	7.9
Rajkot Municipal Corporation	October 21, 2024	100	7.9

The issue by Indore Municipal Corporation is the first municipal bond issue under the green bond framework of SEBI.

Introduction of an information database by SEBI for Municipal Bond issuers through a QR Code

At a SEBI outreach programme on Municipal Bonds and Municipal Finance in January 2023, an Information Database including a repository of information pertaining to Municipal Bonds was launched on the SEBI website. The database is intended not merely to serve as a guide but also to create awareness about municipal debt securities. The Information database can also be accessed by way of a Quick Response Code (QR Code) that is provided in the press release.

The information database contains a wide range of information such as:

- *Statistics and regulations, circulars, guidance note and Frequently Asked Questions issued by SEBI in respect of Municipal Debt Securities;*

** For information only.*

- *Checklists for pre-listing requirements and sample letters and certificates from various intermediaries to be obtained by an Issuer who plans to tap the Municipal Bond Market;*
- *Templates for agreements between various stakeholders; and*
- *Indicative Due Diligence Questionnaire for Merchant Bankers*.

This Information database is expected to be useful to many stakeholders including the Municipal Corporations, Stock Exchanges, Credit Rating Agencies, Merchant Bankers, Debenture Trustees, Lawyers, NGOs and Institutional investors.

COMPLIANCES AS PER SEBI NCS REGULATIONS

An issue of non-convertible securities (private placement proposed to be listed or a public issue) is governed by the SEBI NCS Regulations and the Master Circular dated May 22, 2024. The SEBI NCS Regulations prescribes a host of requirements to be complied with at the time of issuance and listing of non-convertible securities and the obligation for ensuring the same lies on the lead manager (in case of public issue)/ compliance officer (in case of private placement). Currently, majority of the issues of non- convertible securities are private placements as against public issues.

Issue related Compliances [Regulations 5-23]

In particular, for private placements of listed Non-convertible Securities, the Company Secretary shall ensure that the regulatory provisions contained in the NCS Regulations are complied with by the Issuer Company. The major provisions are briefly enumerated below.

The Issuer shall:

- make an application to one or more stock exchange(s) and obtain an in-principle approval for listing of its Non-convertible Securities;
- comply with the conditions relating to the issue of International Securities Identification Number;
- enter into an arrangement with a depository for dematerialization of the Non-convertible Securities;
- appoint a Debenture Trustee and enter into a Debenture Trust Deed;
- appoint a Registrar to the Issue;
- obtain a credit rating from at least one Credit Rating Agency, and disclose the same in the offer document;
- create a recovery expense fund by depositing an amount equal to 0.01% of the issue size subject to maximum of Rs. 25 lakhs per issuer;
- pay regulatory fees to SEBI through the stock exchange ;
- make all payments on working days;
- follow the Actual/ Actual day count convention for calculation of interest/ dividend payments ;
- create a Debenture Redemption Reserve or Capital Redemption Reserve in accordance with the relevant provisions of the Companies Act, 2013;
- create and maintain security, in case of secured non-convertible securities; and
- comply with the guidelines for ‘Security and Covenant Monitoring’ using Distributed Ledger Technology (DLT).

- Ensure compliances with reference to Electronic Book Provider (EBP) Mechanism in case the issue is on private placement and is of the size of Rs.50 crore or more.

Further, the Company Secretary shall ensure that the Issuer satisfies the eligibility conditions viz. none of the promoters or directors of the company are wilful defaulters, fugitive economic offender, have been debarred or disqualified from being appointed or continuing as directors of companies.

The Company Secretary also ensures that the listed entities comply with the requirements prescribed for large corporates.

Issuers without track record

As per SEBI NCS Regulations, issuers (other than unlisted Real Estate Investment Trust (REITs) and InvITs) who have been in existence for less than 3 years have been facilitated to tap the bond market, provided:

a. Issuance of their debt securities is made only on a private placement basis;

b. The issue is made on the EBP platform irrespective of the issue size; and

c. The issue is open for subscription only to QIBs.

This is aimed to enable Special Purpose Vehicles created for specific infrastructure purposes/ NBFCs/ listed REITs/ listed InvITs and other companies who propose to list debt securities purely on private placement basis but who do not have a three-year existence, to list their debt securities even without three years' financials. All other requirements under the SEBI NCS Regulations and operating stipulations of the Electronic Book Provider mechanism continue to apply to such issuers. In such cases, the role of the Company Secretary assumes paramount importance. The Company Secretary undertakes necessary due diligence and the ensures compliance with the regulatory requirements.

Specific obligations with respect to treatment of applicants [Regulation 23]

The NCS Regulations require that the Issuer shall:

- apply for Securities and Exchange Board of India Complaints Redress System (SCORES) authentication.
- treat all applicants to an issue of non-convertible securities in a fair and equitable manner as per the procedures as may be specified by the Board.
- not employ any device, scheme, or artifice to defraud in connection with issue or subscription or distribution of non-convertible securities which are listed or proposed to be listed on the recognized stock exchange.
- In case of a public issue, the issuer shall provide all required information/ documents to the lead managers for conducting the due diligence, in the form and manner as may be specified by the SEBI.
- The issuer shall ensure that the secured debt securities are secured by hundred percent security cover or higher security cover as per the terms of the offer document and/or Debenture Trust Deed, sufficient to discharge the principal amount and the interest thereon at all times for the issued debt securities.
- If an issuer is a company, it shall ensure that its Articles of Association require its Board of Directors to appoint the person nominated by the debenture trustee(s) in terms of clause (e) of sub-regulation (1) of regulation 15 of the SEBI (Debenture Trustees) Regulations, 1993 as a director on its Board of Directors.
- The issuer shall fix a record date for the purposes of payment of interest, dividend and payment of redemption or repayment amount or for such other purposes as specified by the SEBI. Such record date shall be fixed at fifteen days prior to the due date of payment interest or dividend, repayment of principal or any other corporate actions.

Disclosures in the Offer Document [Regulations 27, 28 and 45]

Disclosures are paramount for issue of any listed securities to ensure safety of the investors' funds. While a Merchant Banker is compulsorily appointed in case of a public issue of non-convertible securities, which performs a critical role of ensuring due disclosures; for private placements, appointment of a merchant banker being optional, the role of the Company Secretary assumes significant importance in ensuring due disclosures.

The Company Secretary is required to ensure that the offer document contains all material, true, fair and adequate disclosures which are necessary for the subscribers of the debt securities and non-convertible redeemable preference shares to take an informed investment decision and shall not omit/ include any material fact which may make the statements made therein, in light of the circumstances under which they are made, misleading or untrue. The Company Secretary shall also ensure that the audited financial statements contained in the placement memorandum and tranche placement memorandum are not more than six months old as computed from the later of date of filing placement memorandum or the issue opening date.

Details of Compliance Officer who is also the Company Secretary of the issuer has to be necessarily disclosed on the front page of the offer document viz. name and contact particulars including postal and email address, telephone number. Such disclosure is essential for creating awareness and accessibility for the investors and underscores the importance of the Company Secretary in such issuances.

Advertisements for Public Issues [Regulation 30]

The Company Secretary should ensure that the advertisement by the issuer for the public issue is truthful, fair and clear and shall not contain a statement, promise or forecast which is untrue or misleading; it shall solicit investment only on the basis of information contained in the offer document.

Incentives [Regulation 31]

The Company Secretary shall ensure that no person connected with the issue offers any incentive, whether direct or indirect, in any manner, whether in cash or kind or services or otherwise to any person for making an application in the issue, except for fees or commission for services rendered in relation to the issue.

DEPOSITS

Corporates also have access to another market called the Inter Corporate Deposits (ICD) market. An ICD is an unsecured loan extended by one corporate to another. Existing mainly as a refuge for low rated corporates, this market allows corporates with surplus funds to lend to other corporates facing shortage of funds. Another aspect of this market is that the better-rated corporates can borrow from the banking system and lend in this market to make speculative profits. As the cost of funds for a corporate in much higher than that of a bank, thus, the rates in this market are higher than those in the other markets. ICDs are unsecured, and hence the risk inherent is high. The ICD market is an unorganized market with very less information available publicly about transaction details.

PUBLIC DEPOSITS

Introduction

Bank deposits consist of money that is placed by investors in banks and financial institutions. Deposits can be made in savings accounts and pure Deposit accounts. They are also known as fixed deposits as the interest and term of the deposits are fixed. A depositor can withdraw the amount at the end of the tenure of the deposit or on demand, as per the terms of the deposit. Since deposits are taken from the public at large, they are also known as public deposits. The cost and procurement of public deposits is cheaper and easier, respectively, than other forms of sources of finance. Generally public deposits, from the bank's or financial institution's point of view, are a source of short / medium term finance.

Provisions of the Companies Act, 2013

The provisions concerning deposits are covered under Sections 73 to 76 of the Companies Act, 2013, which are to be read with the prescribed Rules i.e. the Companies (Acceptance of Deposits) Rules, 2014. As per the Companies Act, 2013, a deposit is any money that is received, either by means of a deposit or a loan or any other form as may be prescribed, but does not include certain classes of transactions. Companies may accept deposits from both, members and the general public as per the provisions of the Companies Act, 2013.

Under Section 2 (31) of the Companies Act, 2013, "deposit" includes any receipt of money by way of deposit or loan or in any other form by a company, but does not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India. Under the rule 2(1)(c) of the Companies (Acceptance of Deposits) Rules, 2014, deposit has been granularly defined as *any receipt of money by way of deposit or loan or in any other form by a company, but does not include the following amounts*:

- Received from the Central Government or a State Government, or any such source where the repayment will be guaranteed by the State or the Centre.
- Received from foreign banks or international banks, foreign governments, multilateral financial institutions subject to the provisions of FEMA, 1999.
- Received by way of financial assistance or loan from Public Financial Institutions notified by the Central Government or Scheduled Banks or Insurance Companies.
- Received as a loan or facility from any banking company or the State Bank of India or any of its subsidiaries.
- Received by a company from any other company.
- Received against the issue of commercial paper or any other instruments issued in accordance with the RBI guidelines.
- Received against an offer made towards the subscription of securities, by way of share application money or advance towards allotment. The money shall be considered as a deposit provided *the company fails to allot such securities within 60 days and after the expiry of the aforesaid 60 days, the money that is received has still not been refunded in the next 15 days.*
- Received from an employee of the company not exceeding his annual salary in the nature of non-interest bearing security deposit.
- Received amount that is non-interest bearing in nature or held in trust.
- Received from a director or a relative of a director who provides a declaration stating that the amount is not given out of borrowings or a loan or a deposit from any person.
- Raised by way of issue of debentures or bonds secured by a first charge or any other way.
- Brought in by the promoters as a loan, unsecured in nature, in pursuance with the stipulation of bank or lending financial institution.
- Accepted by a Nidhi Company as per the provisions of Sec 406 of the Act.
- Received in the course/for the purpose of business as an advance:-

    a) Received in connection with consideration for an immovable property under an agreement.

b) Received for the supply of capital goods under long term projects.

c) For the supply of goods/provision of services as long as the advance is appropriated against the supply of goods/provision of services within 365 days of accepting the same.

d) Received as a security deposit for the performance of a contract.

e) Towards consideration for providing future services in the form of a warranty or maintenance contract as per written agreement or arrangement.

f) Received and as allowed by any sectoral regulator or in accordance with directions of Central or State Government.

g) For subscription towards publication, whether in print or in electronic to be adjusted against receipt of such publications.

- Received by way of subscription in respect of a chit under the Chit Fund Act, 1982.
- Received by the company under any collective investment scheme in compliance with regulations framed by SEBI.
- An amount of twenty five lakh rupees or more received by a start-up company, by way of a convertible note (convertible into equity shares or repayable within a period not exceeding ten years from the date of issue) in a single tranche, from a person.

Eligibility of a company to accept Deposits

Rule 2(1)(e) of the Companies (Acceptance of Deposits) Rules, 2014 states that a public company having a net worth of not less than one hundred crore rupees or a turnover of not less than five hundred crore rupees and which has obtained the prior consent of the company in general meeting by means of a special resolution and also filed the said resolution with the Registrar of Companies and where applicable, with the Reserve Bank of India before making any invitation to the Public for acceptance of Deposits can accept deposits.

However, such company which is accepting deposits within the limits specified under clause (c) of sub-section (1) of Section 180, may accept deposits by means of an ordinary resolution.

Non-applicability of Section 73

However, section 73 categorically states that the above provisions will not apply to:

- Any banking company.
- Non Banking Financial Companies as per the RBI Act 1934.
- Any other company notified by the Central Government in consultation with the RBI.

Conditions for Acceptance of Deposits (Sec. 73)

There are a few conditions that have to be fulfilled in order for a company to accept deposits. The following is the procedure to be followed by a company to accept deposits:

- A resolution has to be passed by shareholders in a General Meeting.
- The members shall be informed about the following:

a) Financial statements of the company

b) Credit rating obtained

c) Total number of depositors

d) Amount due to the depositors with regard to deposits collected in the past by the company

- File a copy of the above information and the statements with the Registrar at least 30 days prior to the issue of the circular.
- 20% of the total amount of deposits maturing in the following financial year to be deposited with a Scheduled bank in a separate account, *"Deposit Repayment Reserve Account"* before the 30th of April, of every year.
- The company shall certify the fact that it has not defaulted on the repayment of the deposits or any payment of interest on such deposits, whether those deposits were accepted before or after the commencement of the Act.
- In case there has been a default in the past and the company has made good the same, a period of five years should have passed since the default has been made good.
- A security has to be provided for secured deposits; others will be treated as unsecured deposits.

Tenure of deposits:

The Rules also say that the tenure of deposits shall be less than 6 months or more than 36 months from the date of acceptance or renewal of such deposit.

For more information about Deposits, the students may refer Lesson 6 of Company Law & Practice Paper of Executive Programme.

NON-BANKING FINANCIAL COMPANIES (NBFCs)

Introduction

NBFCs are important to the Indian economy. NBFCs reach the nook and corner of the country and have been pivotal in the financial inclusion in India - from personal to vehicle finance loans, gold to microfinance loans and what not. They have promoted credit growth in the unorganised, un-banked, and under-banked sections of the economy. The relevance of NBFCs as providers of commercial credit increased significantly in the 2010s, especially since the banking sector began experiencing acute asset quality stress after 2015. NBFCs thus primarily operate in niche segments where they can overcome their funding cost disadvantage and serve a useful purpose through other capabilities such as more efficient sourcing of customers, prompt provision of services and specialized sector expertise. NBFCs not only complement but also act as substitutes for banks by widening the ambit of and access to financial services. As of March 2024, around 10,000 NBFCs were registered with RBI, with an asset size of almost Rs.50 lakh crore.

NBFC - Definition

As per Section 45 I(f) of Reserve Bank of India Act, 1934, "**Non-Banking Financial Company**" means:

1. a financial institution which is a company;
2. a non-banking institution which is a company, and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;
3. such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify;

What is a Non-Banking Financial Company (NBFC)?

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/ securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.

A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in instalments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

Major Difference between Banks and NBFCs

NBFCs lend and make investments and hence their activities are akin to that of banks; however there are a few differences as given below:

i. NBFC cannot accept demand deposits;

ii. NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself;

iii. deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks.

Registration as NBFC

A company incorporated under the Companies Act, 2013 and desirous of commencing business of non-banking financial institution as defined under Section 45 I(a) of the RBI Act, 1934 should comply with the following:

i. it should be a company registered under Section 3 of the Companies Act, 2013

ii. it should have a minimum net owned fund of ₹10 crore (earlier ₹ 2 crore)

RBI has specified a glide path to achieve the revised Net Owned Fund (NOF) requirements for the existing NBFCs as provided in the table below:

NBFCs	*Current Net owned Fund*	*To be achieved by March 31, 2025*	*To be achieved by March 31, 2027*
NBFC-ICC	₹2 crores	₹5 crores	₹10 crores
NBFC-MFI	₹5 crores (₹2 crore in NE Region)	₹7 crores (₹5 crore in NE Region)	₹10 crores
NBFC-Factors	₹5 crores	₹7 crores	₹10 crores

Section 45-IA of the Reserve Bank of India Act, 1934 governs the registration and maintaining minimum Net Owned Funds requirement of NBFCs. The relevant provisions are as under:

Non-banking financial company shall not commence or carry on the business of a non-banking financial institution without:

1. obtaining a certificate of registration; and

2. having the net owned fund of twenty-five lakh rupees or such other amount, not exceeding hundred crore rupees, as the Bank may, by notification in the Official Gazette, specify:

However, the Bank may notify different amounts of net owned fund for different categories of non-banking financial companies.

Certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration.

Principal Business

Financial activity as principal business is when a company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income. A company which fulfils both these criteria will be registered as NBFC by RBI. The term 'principal business' is not defined by the Reserve Bank of India Act. The Reserve Bank has defined it so as to ensure that only companies predominantly engaged in financial activity get registered with it and are regulated and supervised by it.

Investigation powers of RBI vis-à-vis NBFCs

- Insertion of Section 45-ID by the Finance Act, 2019 gives the power to RBI, if satisfied, in the public interest or to prevent affairs of NBFC in detrimental manner, to remove from office a director (by whatever name called) of such company other than Government owned NBFC after giving opportunity of being heard.
- Further, RBI also has the powers by virtue of section 45-IE, to supersede the Board of Directors of NBFC other than Government Company.
- RBI also has the powers to provide for resolution of NBFC in the public interest
- RBI can also call for information from group companies and if required cause an inspection or audit to be made of group companies.
- RBI also has powers to take action against auditors of NBFCs as per Section 45 MAA of the RBI Act, 1934.

Classification of NBFCs

On the basis of activities, NBFCs can be classified as under:

- *Investment and Credit Company (NBFC-ICC)* – Conducting primarily Investing, Lending and Asset Finance activities, other specialized classifications.
- *Micro-finance Company (NBFC-MFI)* – Conducting the principal business of providing micro finance.
- *Infrastructure Finance Company (NBFC-IFC)* – Conducting the principal business of providing infrastructure finance through loans.
- *Factoring Company (NBFC-Factor)* – Conducting the principal business of factoring.
- *Housing Finance Companies (NBFC-HFC)* – Engaged in the principal business of Housing Finance.
- Core Investment Company (Systemically Important if Asset Size above Rs. 100 Cr.) (CIC).
- *Account Aggregators (NBFC-AA)* – Conducting the activity of account aggregation.
- *Peer to Peer Lending Platforms (NBFC-P2P)* – Conducting the business of a peer to peer lending platform, majorly IT driven.

- *Infrastructure Debt Fund NBFC (IDF-NBFC)* – It facilitates the flow of long term debt into infrastructure projects.
- Mortgage Guarantee Companies (MGC).

Classification of NBFCs based on supervision

Recently, RBI has classified NBFCs into four layers, like banks, for supervision, particularly risk based supervision. The layers are explained as under:

a. **Base layer (NBFC-BL)**

The base layer will be equivalent to the existing non-deposit taking non-systemically important NBFCs (NBFC-NDs) Systemically important, non-deposit taking NBFCs below the asset size of Rs. 1,000 crore (except those necessarily featuring in the middle layer) will be part of NBFC-BL. It will specifically include:

- NBFC-P2P (NBFC-Peer to Peer lending platform);
- NBFC-AA (NBFC-Account Aggregator);
- NOFHC (Non-Operative Financial Holding Company); and
- NBFCs without public funds and customer interface.

While higher level of prudential regulations will not be applicable to such entities, there will be an increase in the transparency requirements through additional disclosures and improved governance standards.

b. **Middle layer (NBFC-ML)**

The middle layer will be equivalent to the existing deposit taking NBFCs (NBFC-D) and systemically important non-deposit taking NBFCs (NBFC-ND-SI). It will specifically include the SPD (i.e. Standalone Primary Dealers) and IDF (Infrastructure Debt Funds) (which will always remain in the middle layer). It will also include NBFC-D, irrespective of their asset size, NBFC-ND-SI with asset size greater than Rs. 1,000 crore, CIC, IFC and HFCs. Government owned NBFCs will not be placed in the upper layer, till further notice, and accordingly, will be placed in NBFC-BL or NBFC-ML. There will be a higher level of regulatory supervision in this layer, which aims to plug the areas of regulatory arbitrage between banks and NBFCs.

c. **Upper layer**

The upper layer has been conceived as a new category of NBFCs, in which a chosen few, systemically significant NBFCs would be specifically identified by RBI through parametric analysis of certain quantitative and qualitative criteria, which will be reviewed periodically. Accordingly, entities that meet the specified criteria will move from the middle layer to the upper layer of the scale-based framework. The top 10 eligible NBFCs in terms of their asset size will always reside in the upper layer, irrespective of any other factor. Higher prudential regulations and intensive supervision will be applicable for such entities proportionate to their systemic significance.

d. **Top layer**

The top layer would ideally remain empty and NBFCs will be slotted into this layer from the upper layer of the scale-based framework at the discretion of RBI if it is of the opinion that the entity is contributing significantly to the systemic risk. Such entities would be required to comply with significantly higher regulatory and supervisory requirements.

Recent RBI reforms on risk based supervision

The RBI reforms to enhance risk based supervision of NBFCs that were effective from October 1, 2022 are as under:

1. **Re-Classification of Non-Banking Financial Companies**

   Categorising NBFCs into various categories such as NBFC- Infrastructure Investment Company, Core Investment Company, Microfinance Institution, Systemically Important/ Non-Systemically Important, Deposit taking/Non-deposit taking etc.

   - Layer Based Classification into four layers – Base Layer, Middle Layer, Upper Layer, and Top Layer;
   - Classification in terms of Asset Size, Perceived Riskiness involved;
   - Various activities undertaken by NBFCs are considered for classification.

2. **Ceiling on Subscription through IPO**

   RBI has advised NBFCs to apply the ceiling of ₹ 1 crore per borrower for financing subscription to Initial Public Offer (IPO). However, NBFCs can fix more conservative limits.

3. **Enhanced Governance**

   RBI has amended and uniformed governance structure that will apply layer wise, as follows:

   - The governance over different layer will vary and depends on the meeting of thresholds by NBFCs;
   - Additional Disclosure Requirements for Upper and Middle Layer NBFCs are prescribed;
   - Constitution of Internal Committees and Assessments - Risk Management Committee (RMC): The NBFC shall form a RMC either at the Board or Executive level for evaluating the overall risks faced by the NBFC including liquidity risk and such Committee shall report to the Board.

4. **Directors to have bank / NBFC experience**

   At least one of the directors shall have relevant experience of having worked in a bank/ NBFC, considering the need for professional expertise in managing the affairs of the NBFCs.

5. **Loans to Directors and Senior Officers**

   NBFCs shall put in place a Board Approved Policy for granting loans to the Directors, Senior Officers, and Relatives of Directors and to entities where directors or their relatives have a major shareholding.

6. **Additional Disclosure Requirements**

   Base Layer NBFCs are required to make certain additional disclosure in Annual Financial Statements such as Related Party Transactions, Exposure to Real Estate Sector, Exposure to Capital Market, Sectoral Exposure, etc.

7. **Internal Capital Adequacy Assessment Process**

   NBFCs are now required to assess their capital in proportion to risk to the business in same way as done by Commercial Banks under Master Circular – Basel III Capital Regulations prescribes.

   - This is similar to Commercial Banks

- This ensures adequate Capital to support all risks in the business of NBFC
- This assists NBFCs to develop and use better Internal Risk Management Techniques.

8. Core Financial Service Solution

NBFCs shall maintain core financial service solution:

- Akin to Core Banking Solution adopted by Banks
- The Solution is required to be adopted by NBFC Middle Layer and Upper Layer with 10 or more Fixed Point Service Delivery Unit
- Implementation of the Solution has to be quarterly reported to RBI
- This is required for Seamless customer interface in digital offerings and transactions.

Provisioning Norms

The RBI provisioning norms for Standard Assets as well as Non-Performing Assets for NBFCs (Scale-Based Regulation) are as follows:

<table>
<tr><th>Provisioning for NBFC-ND-SI and NBFC-D</th><th>Provisioning for NBFC-ND-NSI</th><th colspan="2">Treatment for secured portion</th></tr>
<tr><td>Standard Assets</td><td>At the end of each year: 0.40%</td><td>At the end of each year: 0.25%</td><td>NA</td></tr>
<tr><td>Sub- standard assets</td><td>10% of the outstanding amount if it remains outstanding for a period of 12 months.</td><td>10% of the outstanding amount if it remains outstanding for a period of 18 months.</td><td>No specific provisions regarding Security</td></tr>
<tr><td>Doubtful Assets</td><td>100% provision to the extent to which the advance is not covered by the realizable value of the security Note: Asset will be considered doubtful if it remains substandard for 12 months</td><td>100% provision to the extent to which the advance is not covered by the realizable value of the security Note: Asset will be considered doubtful if it remains substandard for 18 months</td><td>To the extent of loan which is covered by estimated realizable value of securities, the following provisioning is required - based on the period the asset (the underlying loan) has remained doubtful
<table>
<tr><th>Period for which Considered Doubtful</th><th>% of Provision against estimated realizable value of securities</th></tr>
<tr><td>Up to - one year</td><td>20</td></tr>
<tr><td>One - three year</td><td>30</td></tr>
<tr><td>More than three years</td><td>50</td></tr>
</table></td></tr>
</table>

Provisioning for NBFC-ND-SI and NBFC-D	***Provisioning for NBFC-ND-NSI***	***Treatment for secured portion***	
Loss Assets	100% Write off in the books (Same treatment for the Interest)	100% Write off in the books (Same treatment for the Interest)	NA

"***Standard asset***" means the asset in respect of which, no default in repayment of principal or payment of interest is perceived and which does not disclose any problem nor carries more than normal risk attached to the business

Non-performing asset" (referred as "NPA"): Lease Rental and Hire-Purchase Assets shall become NPA if overdue for 3 months (12 months for NBFC-ND-NSI) for the financial year ending March 31, 2018 and thereafter Assets other than Lease Rental and Hire-Purchase Assets shall become NPA if overdue for 3 months (6 months for NBFC-ND-NSI) for the financial year ending March 31, 2018 and thereafter. (NBFC-ND-SI means a systemically important non-deposit taking non-banking finance company.)

NPA norms for NBFCs

The NPA norms for NBFCs have been changed by RBI as under:

NPA Norms	***Timeline***
>150 Days overdue	By March 31, 2024
>120 Days overdue	By March 31, 2025
> 90 Days overdue	By March 31, 2026

Corporate Governance norms for NBFCs

1. Extent of the Directions

RBI has come out with the Non-Banking Financial Companies – Corporate Governance (Reserve Bank) Directions, 2015, which apply to every non-deposit accepting Non-Banking Financial Company with asset size of Rs.500 crore and above (NBFCs-ND-SI), as per its last audited balance sheet, and all deposit accepting Non-Banking Financial Companies (NBFCs-D), henceforth called as Applicable NBFCs.

2. Non applicability

The provisions of these Directions shall not apply to a Systemically Important Core Investment Company as defined in the Core Investment Companies (Reserve Bank) Directions, 2011.

3. Constitution of Committees of the Board

(a) Audit Committee

i. All Applicable NBFCs shall constitute an Audit Committee, consisting of not less than three members of its Board of Directors.

Explanation I **:** The Audit Committee constituted by a non-banking financial company as required under Section 177 of the Companies Act, 2013 shall be the Audit Committee for the purposes of this paragraph.

Explanation II**:** The Audit Committee constituted under this paragraph shall have the same powers, functions and duties as laid down in Section 177 of the Companies Act, 2013.

ii. The Audit Committee must ensure that an Information System Audit of the internal systems and processes is conducted at least once in two years to assess operational risks faced by the NBFCs.

(b) Nomination Committee

All Applicable NBFCs shall form a Nomination Committee to ensure 'fit and proper' status of proposed/ existing directors.

Explanation I **:** The Nomination Committee constituted under this paragraph shall have the same powers, functions and duties as laid down in Section 178 of the Companies Act, 2013.

(c) Risk Management Committee

To manage the integrated risk, all Applicable NBFCs shall form a Risk Management Committee, besides the Asset Liability Management Committee.

4. Fit and Proper Criteria

(1) All Applicable NBFCs shall

- ensure that a policy is put in place with the approval of the Board of Directors for ascertaining the fit and proper criteria of the directors at the time of appointment, and on a continuing basis.
- obtain a declaration and undertaking from the directors giving additional information on the directors. The declaration and undertaking shall be on the lines specified by RBI.
- obtain a Deed of Covenant signed by the directors.
- furnish to the Reserve Bank a quarterly statement on change of directors, and a certificate from the Managing Director of the NBFC that fit and proper criteria in selection of the directors has been followed.

The statement must reach the Regional Office of the Reserve Bank within 15 days of the close of the respective quarter. The statement submitted by NBFCs for the quarter ending March 31, should be certified by the auditors.

However, the Bank, if it deems fit and in public interest, reserves the right to examine the fit and proper criteria of directors of any non-banking financial company irrespective of the asset size of such non-banking financial company.

5. Disclosure and transparency

(a) All applicable NBFCs shall put up to the Board of Directors, at regular intervals, as may be prescribed by the Board in this regard, the following:

i. the progress made in putting in place a progressive risk management system and risk management policy and strategy followed by the NBFC;

ii. conformity with corporate governance standards viz., in composition of various committees, their role and functions, periodicity of the meetings and compliance with coverage and review functions, etc.

(b) All applicable NBFCs shall also disclose the following in their Annual Financial Statements, with effect from March 31, 2015:

i. registration/ licence/ authorisation, by whatever name called, obtained from other financial sector regulators;

ii. ratings assigned by credit rating agencies and migration of ratings during the year;

iii. penalties, if any, levied by any regulator;

iv. information namely, area, country of operation and joint venture partners with regard to Joint ventures and overseas subsidiaries and

v. Asset-Liability profile, extent of financing of parent company products, NPAs and movement of NPAs, details of all off-balance sheet exposures, structured products issued by them as also securitization/ assignment transactions and other disclosures.

6. Rotation of partners of the Statutory Auditors Audit Firm

All Applicable NBFCs shall rotate the partner/s of the Chartered Accountant firm conducting the audit, every three years so that same partner does not conduct audit of the company continuously for more than a period of three years. However, the partner so rotated will be eligible for conducting the audit of the NBFC after an interval of three years, if the NBFC, so decides. NBFCs shall incorporate appropriate terms in the letter of appointment of the firm of auditors and ensure its compliance.

7. Framing of Internal Guidelines

All applicable NBFCs shall frame their internal guidelines on corporate governance with the approval of the Board of Directors, enhancing the scope of the guidelines without sacrificing the spirit underlying the above guidelines and it shall be published on the company's web-site, if any, for the information of various stakeholders.

8. Recent RBI diktat on cash disbursements:

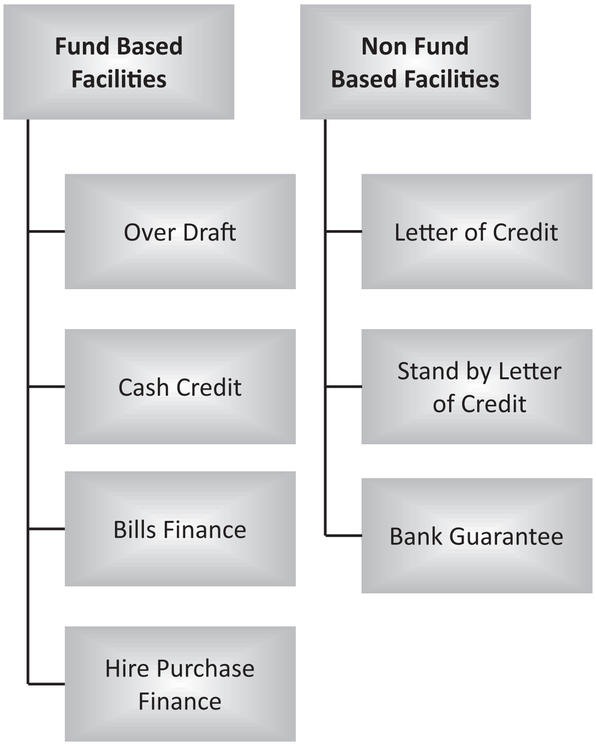
The Reserve Bank of India (RBI) has, in May 2024, directed non-bank finance companies to follow the IT Act (Section 269 SS) strictly for cash payouts. Thus NBFCs must stick to cap of Rs 20,000 while disbursing cash loans. This is likely to stop large payouts to those borrowing against cash transactions, particularly gold loans.

BANK FINANCE- MOST COMMON WAY OF FUNDING FOR CORPORATES

Banking Regulation Act, 1949 classifies bank finance into secured loans and unsecured loans. Secured loan means loans granted by the banks on the backing of some tangible security, while Unsecured loan is one for which the banker has to rely upon the personal security of the borrower. Unsecured advances are not popular in India as they impose a huge risk of money loss in case of default by the borrower. Most of the bank advances are secured ones. Only a small portion of about 11% to 15% of the total bank advance is unsecured that usually take form of Overdrafts and Cash Credit Facilities.

Bank's finance their customers not only in the form of loans, but through other types of credit facilities also. The other types of bank finance are tailor made to suit the needs of customers. The loans and advances wherein immediate flow of funds is available to borrowers, are called funds based facility. In non-fund based facilities like issuance of letter of guarantee, letter of credit etc., banks get income in the form of fee for making available the facility and there is no immediate outflow of funds from bank. Some of the credit facilities which are different from loans are described here-under:

Credit Facilities provided by the Banks



CREDIT FACILITIES PROVIDED BY THE BANKS

Fund Based Facilities and Non Fund Based Facilities

In Funded (Fund based) facility, there is cash outflow right from the initial stage. The examples of funded facility are Term Loan, Cash Credit and Bill Purchased or bill discounting. When a term loan is disbursed, cash credit facility is sanctioned or a bill is purchased or discounted cash flow takes place. The income earned by the banks when they extend funded facilities to the borrowers, is accounted under income head interest (in case of term loans and cash credits) and discount (in case of bill discounting facility).

In Non-funded (Non-fund based) facility, initially there is no cash outflow, later on there may or may not be cash outflow. The examples of non-fun based facility are Bank Guarantees (BGs) including deferred payment guarantees and Letter of Credit (LCs). When BG or LC is issued, there is no cash out flow. However latter on if the guarantee is invoked by the beneficiary, the bank will have to make the payment under the guarantee at times even if there is no balance in the account of customer. Similarly when bills negotiated under LC are due for payment the bank may have to honour the same at times by creating forced loan in the account of the buyer on whose behalf Letter of Credit is issued. The income earned by banks while issuing bank guarantees or LCs is accounted under the income head "commission". Non-Fund based credit facilities to non-borrowers of the bank.

Banks can grant non-funded facilities including partial credit enhancement to customers, not availing fund based facility from any bank in India under following conditions :

1. Banks are to ensure that the borrower has not availed any fund based facility from any bank operating in India. At the time of granting non-funded facilities, bank to obtain declaration from the customer about the non- funded credit facilities already enjoyed by them from other banks.
2. Banks are to undertake similar credit appraisal as for fund based facilities.
3. Credit information relating to such facility shall be mandatorily be furnished to the Credit Information Companies.

FUND BASED FACILITIES

Overdrafts

After bank loans, Overdrafts is the most common way of availing credit facilities from the bank. Overdraft means allowing the customer to draw cheques over and above credit balance in the account. Bank overdraft is line of credit that overs the transaction if the Bank Account balance drops below zero. Overdraft is normally allowed to Current Account customers and in exceptional cases Savings bank account holders are also allowed to overdraw their account. High rate of interest is charged on daily debit balance of overdraft account as these are clean advances .i.e. banks do not have any securities to sell back if these facilities are not repaid. There are two types of overdraft accounts as prevalent in Banks i.e. (i) Temporary overdraft or clean overdraft and (ii) Secured overdraft. Temporary overdrafts are allowed purely on personal credit worthiness of the customer concerned and it is availed by the customer to meet some urgent commitments on rare occasions. Allowing a customer to draw against his cheques sent in clearing - known as "against clearing" also falls under this category. Secured overdraft is allowed up to a certain limit against some tangible security like bank deposits, LIC policies, National Saving Certificates shares and other similar assets. Secured overdraft is most popular with traders as lesser operating cost, simple application and document formalities are involved in this facility.

Cash Credit Account (CC A/C)

A cash credit facility is a short-term finance to a borrower company, having a tenure of up to one year which can be renewed for further period by the bank on the basis of projected sales and satisfactory operation in the account during the period of finance. Cash credit facility is extended in two forms viz. Open Cash Credit and Key Cash Credit. Open Cash credit account is a running account just like a current account where the borrower is allowed to maintain debit balance in the account up to a sanctioned limit or drawing power whichever is lower.

The Cash Credit facility is offered to a borrowers normally either against pledge (Key Cash Credit) or hypothecation of stocks of raw materials, semi-finished goods and/or finished goods and Book Debts (Receivables). In the case of Key Cash Credit, the borrower lodges the stocks in his godown and the key of the godown will be handed over to the bank. By this process, the goods lodged in the godown are pledged to the bank and the bank will allow the customer to draw funds against the value of the goods less its safety margin. This is known as Drawing Power. The pledged goods are allowed to be removed by the borrower on remitting into his CC account the amount equivalent to value of the goods. The bank would release further funds to the borrower within the Drawing Power (DP)/sanctioned limit on borrower depositing (pledging) more stock in the godown. Therefore, such facility is called Key Cash Credit/Cash Credit limits are also sanctioned to a borrower against security of term deposits, LIC policies, NSCs or Gold Jewels. This type of limit is offered mainly to traders who find it difficult to maintain stock register and submitting periodic stock statements When the security for the CC facility is jewels, life policies, NSC, Term Deposits; there is no need to submit periodic stock statements. In case of manufacturing units this facility is required for purchase of raw materials, processing and converting them into finished goods. In case of traders, the limit is allowed for purchase of goods which they deal.

Bills Finance

Bills finance is short term and self-liquidating finance in nature. The bills can be classified as Demand Bills and Usance Bills. Demand Bill is purchased and Usance bill is discounted by the banks. The credits available to the seller against the bills drawn under Letter of Credit either on sight draft or usance draft are called bills negotiated by the banks. The advantage of bills finance is that the seller of goods (borrower) gets immediate money from the bank for the goods sold by him irrespective of whether it is a purchase, discount or negotiation by the bank. The 'Demand Bills' can be documentary or clean. Usually, banks accept only documentary bills for purchase. However, clean bills from good parties also purchased by the banks which have a clean repayment record.

The 'Documentary Bills' may be drawn by a Seller of Goods ('Drawer') on D/P (Delivery against payment) or D/A (Delivery against Acceptance) terms. In case of D/P terms the documents of title to goods are delivered to the buyer of the goods (drawee) against payment of bill amount. In case of D/A bills, the documents to the title of goods are to be delivered to the drawee (Buyer) against acceptance of bills. These types of bills are called "Usance Bills' which means bills are maturing on a future date and payment will be made on due date. In case of 'Usance Bills' bills become clean after it is delivered to drawee on acceptance.

Therefore, banks take into consideration the credit worthiness not only of the borrower but also of the drawee.

Leasing Finance

A lease is a contract between the owner (lessor) and the user (lessee). There are various types of leases viz. operating lease, finance lease etc. In terms of lease agreement the lessor pays money to the supplier who in turn delivers the article to the lessee. The lessee (hirer of the article) makes periodical payment to the lessor. At the end of lease period the asset is restored to the lessor. Commercial banks in India have been financing the activities of leasing companies, by providing overdraft/ Cash credit account/Demand loan against fully paid new machinery or equipment by hypothecation of security. The repayment should be from rentals of machinery/ equipment leased out and similar other ways. The maximum period of repayment is five years or the economic life of the equipment whichever is lower. The bank is allowed to periodical inspection of the asset. Lease contracts are only for productive purpose and not for consumer durable.

Hire-Purchase Finance

Hire-Purchase transactions are very similar to leasing transactions. In the Hire-purchase finance takes place predominantly in automobile sector. Like Leasing Finance, the ownership of the vehicle continues to remain with the Leasing Company till the agreement period ends. However, at the end of the stipulated period, the hirer (lessee) has options either to return the asset to leasing company while terminating the agreement or purchase the asset upon terms set out in the hire-purchase agreement. Since hire-purchase finance takes place predominantly in automobile sector, banks have started direct finance to transport operator as the nature of advance being classified as priority sector lending. By and large most banks finance vehicles under Hypothecation arrangement instead of Hire-Purchase.

Difference between Hire-Purchase and Hypothecation

For a long time, Hypothecation was not defined legally in India, until it was defined by SARFAESI Act in 2002. It is a charge on any movable asset/property of a borrower for which bank has extended its finance. It is an equitable charge on the assets in favour of the financing bank where the asset is owned by the borrower as well as possession is with him on behalf of the bank. If a borrower fails to repay the finance extended for the movable asset the bank can repossess the asset with the consent of the borrower. If the borrower surrenders the asset to the bank, bank has a legal right to sell the asset without the intervention of the court and adjust the proceeds towards the loan dues. Under SARFAESI Act bank also has got the right to sell the movable asset of a defaulted borrower without the intervention of a court subject to following rules laid down in this regard.

Under Hire Purchase Agreement, as explained above the ownership of the financed assets remains with the lender till it is purchased by the borrower at the end of the hire purchase period as per agreed terms between the financing agency and the borrower. Under Hire Purchase the financing entity may get the benefit of depreciation as well as ownership of the asset financed.

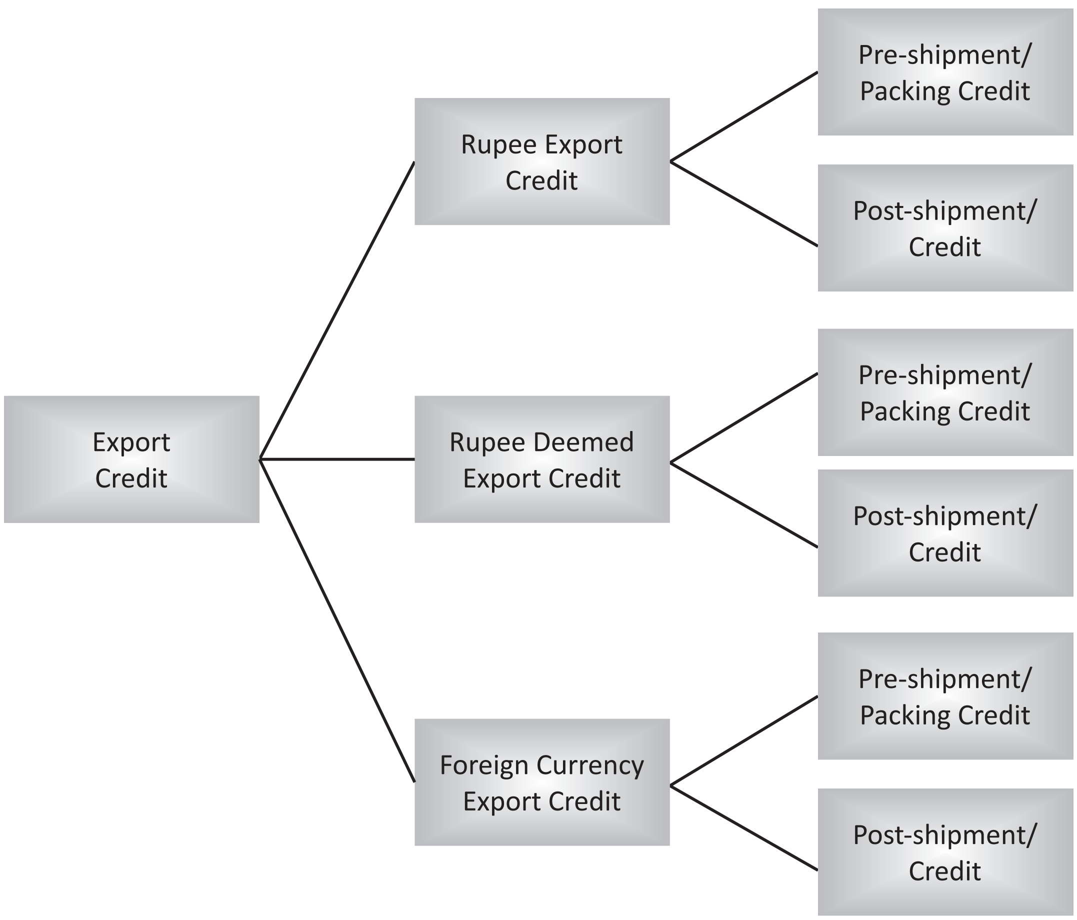
Banks cannot take advantage of Hire Purchase Arrangement, as ownership aspect of the asset will result in violating permitted line of activity under the banking license granted by RBI.

For example, if a bank finances a public transport vehicle under Hire Purchase, it implies that the bank as the owner of the public transport vehicle, is involved in the business of public transportation which is against permitted activities under the Banking license. Also, in a Hire Purchase arrangement, if an accident takes place, bank will be a party to the claim suit filed by the injured passengers which will involve monetary loss and as well as damage to the image of the bank.

CREDIT FACILITIES (FUND BASED) GRANTED TO THE EXPORTERS BY BANKS

In order to encourage exports and to help exporters financially, RBI introduced Export Credit scheme in the year 1967. As on date, Exporters can avail credit for their export activities either in Rupees or in Foreign Currency as per their choice and subject to RBI directions in this regard.

The broad financing schemes available for exporters are shown in the below diagram:



RUPEE EXPORT CREDIT

A finance facility for the exporters, available in Indian currency in the following two forms:

Pre-shipment/Packing Credit

A short-term advance/loan given to an exporter for procuring, processing, manufacturing/packing goods prior to shipping such goods. Such export credit can be given for working capital purposes also. Banks are at liberty to decide the tenor of such loans (which are usually up to three/six months or in exceptional cases nine months) depending upon individual cases. These loans are given at concessional interest rates. If these loans are not adjusted by submission of export documents within 360 days, banks will charge normal rate of interest on such loans/advances instead of concessional rates. Pre-shipment advances are to be repaid out of finance made available at Post-shipment stage or from eligible resources of the exporting customer as per RBI directions.

Example: Pre-shipment credit

XYZ Limited, an Exporter of cotton readymade garments in India, has secured a firm export order from UK to supply 100,000 cotton shirts of a particular size. For executing this order the Indian exporter would require to buy raw cloth, get the cloth cut, stitched, ironed, check all shirts for any defects to rectify, labled, packed and shipped. The finance needed for this entire cycle by the exporter is called Pre-shipment finance/Packing credit.

Post-shipment Credit

This is again a short-term advance/loan given to an exporter after shipment of goods to the date of realization of proceeds of exported goods. Such credit facility granted to an exporter has to be repaid out of the proceeds of goods exported or from eligible resources of the exporter as permitted by RBI directions. The period of such advance/loan will be as specified by Foreign Exchange Dealers Association of India (FEDAI).

Example:

Taking the pre-shipment example of XYZ Limited mentioned above, once XYZ Limited has shipped the goods they can present the Shipping documents along with commercial documents of the transaction to their bankers for availing Post-shipment credit. XYZ's bank can grant them post-shipment credit in any of the following ways :

1. By purchase/discounting/negotiation of Export bills.
2. By providing an advance against the export bills given for collection.
3. By providing an advance against export incentives receivable from Government of India.

The loan amount of the post-shipment will be used by XYZ's bank to close the Pre-shipment advance/loan granted to the company earlier.

The post-shipment advance granted by XYZ Limited's banker will be closed out of the export proceeds that will be received by the Bank from the importer's Bank in UK subsequently.

Rupee Deemed Export Credit

A deemed export transaction is one in which goods are supplied to a project in India itself which are funded by International/ Multilateral agencies or where goods are supplied to units in SEZs or foreign shipping companies calling on Indian ports, Supply of goods to foreign tourists etc., such that the proceeds of such goods supplied will be paid in foreign currencies. Such transactions are treated as prima facie Export transactions and enjoy incentives and other concessions given to normal export transactions.

Pre-shipment and Post-shipment credit facilities granted to Rupee Deemed Export Credit transactions are similar to finance/credit extended under Rupee Export credit - Pre-shipment as well as Post-shipment as described herein. However in Deemed Export transactions the date of supply to the projects/SEZ units/ foreign tourists is taken as date of export. Also the value of the transaction will be based on Free on Rails (FOR) basis instead of usual Free on Board (FOB) basis, usually associated with export transactions.

FOREIGN CURRENCY EXPORT CREDIT

A short-term working capital finance facility available to exporters in Foreign Currency in the following manner:

Pre-shipment credit in Foreign Currency (PCFC)

The objective of PCFC facility is to provide an additional source of finance at internationally competitive rates to Indian exporters. Normally this is facility is applicable to Cash Exports where the "payment for goods is received prior to the export".

An exporter can avail PCFC in any of the following ways:

1. Avail pre-shipment credit in Rupees and convert the same in Foreign currency at the discretion of financing bank.
2. Avail pre-shipment credit in Foreign currency and discount/rediscount export bills in Foreign currency under Export Bill Rediscounting Scheme (EBR).
3. Avail Pre-shipment credit in Rupees and post-shipment credit either in Rupees or in foreign currency by discounting/re-discounting export bills under EBR.

PCFC is normally available for a maximum period of 360 days. Further extension is subject to the financing bank's terms and conditions. PCFC is liquidated by discounting or re-discounting of Export bills under EBR scheme at the post-shipment stage. PCFC is also allowed for Deemed Exports subject to a maximum period of 30 days or up to the date of payment by project authorities whichever is earlier.

PCF is also subject to the overall directions of RBI from time to time in this regard.

Post-shipment Credit in Foreign Currency (PSCFC)

Banks are permitted to extend PSCFC facility to their export customers, (by utilizing their foreign exchange resources held by them or availed by them from foreign banks by way of line of credit in foreign currency etc.) through discounting the usance export bills received from their customers who have availed PCFC or otherwise by rediscounting these bills with foreign banks.

Normally the PSCFC scheme covers export bills of usance period up to 180 days from the date of shipping. If a customer is eligible to draw bills beyond a usance period of 180 days, PSCFC facility is allowed to be provided beyond the period of 180 days too.

Banks can rediscount the export bills abroad and square up the PSCFC.

IMPORT FINANCE

Apart from the usual financing methods of short term credit facilities, import finance can also be availed by importers in India through Buyers credit, Suppliers Credit as well as through External Commercial Borrowings ('ECB'). A brief overview of the same is as under:

Buyers' Credit	Suppliers' Credit
Buyers' credit refers to loans for payment of imports into India arranged by the importer from overseas bank or financial institution.	Suppliers' credit relates to the credit for imports into India extended by the overseas supplier.

Buyers' Credit	Suppliers' Credit
Imports should be as permissible under the extant Foreign Trade Policy of the Director General of Foreign Trade (DGFT).	In this case too, imports should be as permissible under the extant Foreign Trade Policy of the DGFT.
For the overseas exporter the transaction becomes cash	The importer pays an agreed amount of down payment and the balance amounts are paid in instalments over a deferred period.
Since the facility is provided by an overseas bank the interest rates may be slightly high.	Since the facility is provided by the supplier itself, interest rates are comparatively low.

LOAN AGAINST SECURITIES

Banks and financial institutions come up with innovative ways to fulfill the monetary requirements of every individual as per their credit worthiness and paying capacity. One step in this direction has been Loan against Securities, popularly referred to as LAS. Under "Loan against Securities", loan is advanced to a customer against pledge of securities or simply put loan against insurance policy, mutual funds, NSC and other securities. The list of approved securities against which LAS can be advanced varies from bank to bank, but primarily the following are considered to be approved securities against which LAS could be given.

1. Non-Convertible Debentures
2. Mutual Fund Units
3. NABARD Bonds
4. Dematerialised Shares
5. National Saving Certificates/Kissan Vikas Patra (Accepted only in Demat form)
6. Insurance Policies.

By pledging the securities held by the borrower, a loan against Securities is provided by a bank or a financial institution as an overdraft facility. The value of the overdraft limit that is advanced is determined on the basis of the securities that are pledged. The rate of interest is calculated only on the amount withdrawn and only for the period of utilization.

> ***Example***
>
> Zen Limited is in need of funds for its upcoming project and wishes to consider the facility of LAS. The company approaches the bank and pledges shares worth Rs. 10,00,000 held by it in Ten Limited, with the help of its Depository.
>
> Depository creates a pledge on said shares in the favor of the bank and the bank disburses the payment to Zen Ltd.
>
> The pledge was created for 1 year. At the end of this tenure Zen Ltd. will repay the loan to the bank along with the interest, at the rate as decided and intimated by the bank at the time of disbursement, and the bank will release the shares to Zen Ltd.

The advantageous part of pledging your securities is one that the borrower is able to get steady cash easily at the time of need and secondly the borrower need not be devoid of the benefits as a shareholder. This means that the borrower enjoys the rights of receiving dividends and bonuses along with gaining from the price movements in the shares. This facility is ideal to meet short- term financial needs and the interest rates are lesser than that in a personal loan.

Features of Loan against Securities

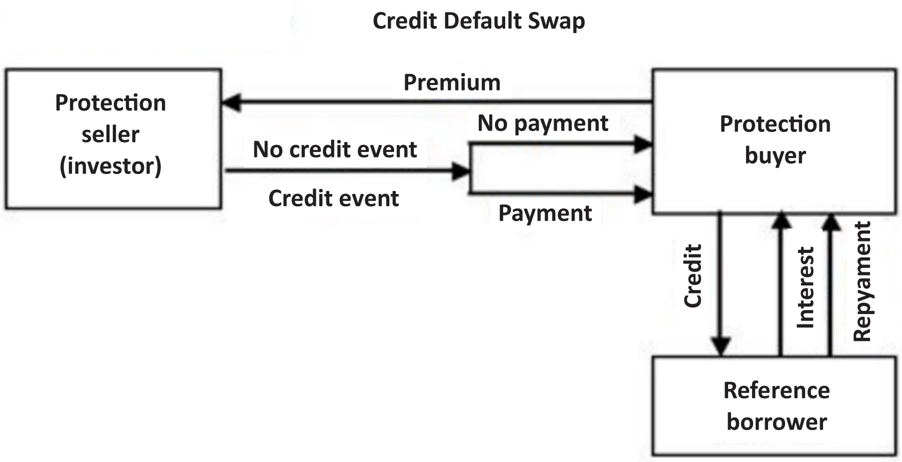
1. **Secured Loan -** Loan against securities is a secured loan as the bonds, shares, debentures or mutual funds owned by the borrower are kept as collateral security when this loan is advanced.
2. **Tenure -** The tenure of loan against securities is generally one year.

3. **Rate of Interest -** Generally, interest rates at which loan against securities is advanced varies from 12%–15% per annum.
4. **Processing Fees -** Banks and financial institutions usually charge approximately 2% as processing fees.
5. **Loan Amount -** The loan amount for which the borrower may be eligible depends upon the type of security that is being offered. For example, in case equity shares are offered then the amount that is eligible would be 50% of the value of such shares.
6. **Prepayment Charges -** There are generally no prepayment charges.

Credit Default Swap (CDS)

A Credit default swap (CDS) is credit derivative contract in which one counterparty (protection seller) commits to compensate the other counterparty (protection buyer) for the loss in the value of an underlying debt instrument resulting from a credit event with respect to a reference entity and in return, the protection buyer makes periodic payments (premium) to the protection seller until the maturity of the contract or the credit event, whichever is earlier.

A pictorial representation of CDS is as follows:



Benefit of CDS

Credit Default Swaps (CDS) on corporate bonds provide market participants a tool to transfer and manage credit risk in an effective manner through redistribution of risk. CDS, as a risk management product offer participant the ability to hive / hedge credit risk and also assume credit risk which otherwise may not be possible. Since CDS has benefits like enhancing investment and borrowing opportunities and reducing transaction costs while allowing risk-transfers, such products would increase investors' interest in corporate bonds and would be beneficial to the development of the corporate bond market in India.

Major differences between the old 2013 CDS Guidelines of RBI and the new 2022 directions of RBI

Particulars	*RBI CDS Guidelines, 2013*	*RBI CDS Directions, 2022*
Permitted Users	Permitted only non-retail users including Banks, NBFCs, MFs, Insurance companies, Listed corporates, and FIIs. The Guidelines did not differentiate between retail and non-retail users.	Allows both retail and non-retail users. Non-retail users to include any corporate with a minimum net worth of Rs.500 crores (listing criteria removed). Both resident in India and non-resident allowed to participate in the market.

Particulars	*RBI CDS Guidelines, 2013*	*RBI CDS Directions, 2022*
Retail Participation Restrictions	Retail Participation Not Permitted.	Allows retail users to undertake transactions in permitted credit derivatives for hedging underlying credit risk only.
Non Retail Participation Restrictions	Not allowed to maintain naked CDS protection i.e. CDS purchase position without having an eligible underlying reference obligations.	Non- retail users allowed to undertake CDS transactions for both hedging and other (trading) purposes.
Reference Entities and Obligations	Reference entity shall be a resident legal entity that is eligible to issue any of the debt instruments below ● CPs, CDs and non-convertible NCDs of original maturity up to one year ● Rated Rupee-denominated corporate bonds, both listed and unlisted ● Unrated rupee-denominated corporate bonds issued by infrastructure companies	Similar set of eligible instruments; however, clear restrictions placed on the usage of the following structured products as reference obligations: 1. ABS 2. MBS 3. Credit enhanced or guaranteed bonds 4. Convertible bonds 5. Bonds with embedded call / put options Loans continue to be ineligible for use as reference obligation. Clearly permits only single-name CDS contracts, i.e. the CDS contracts should have only one reference entity.
Market Makers	Commercial Banks, standalone Primary Dealers (PDs), Non-Banking Financial Companies (NBFCs) having sound financials and good track record in providing credit facilities and any other institution specifically permitted by the Reserve Bank.	Compared to the 2013 guidelines, HFCs (specifically) and institutions like NABARD, SIDBI, EXIM Bank, NHB etc. are now allowed act as market makers. In addition, norms around CRAR, NPA levels have been removed from both banks as well as NBFCs. While banks are not required to obtain any specific approval from the RBI, NBFCs and PDs will have to obtain specific approval from RBI.
Clearing and Settlement	Parties to CDS contract to upfront determine the procedure and method of settlement. Participants allowed to opt for any of the three settlement methods - cash/ physical/auction – provided the CDS contract envisages the said settlement methodology. For non-retail users, physical settlement is mandatory. Auction settlement allowed to be conducted in cases deemed fit by the Determination Committee. In case of auction-based settlement, physical settlement will take place at a price decided through auction.	All Exchange traded CDS contracts will need to be guaranteed cash settled both for retail as well as non-retail participants/users. FIMMDA, in consultation with market participants and based on international best practices, shall devise standard master agreement/s for the Indian CDS market which shall include credit event definitions and settlement procedures.

LOAN AGAINST PROPERTIES

Similar to loans against securities, this is a loan, banks grant against property owned by the prospective borrower. Banks take the property as security and based on the valuation of the property, they extend a loan, net of the margin fixed by them.

The types of Property against which LAP can be availed can range from owned residential properties g, self-occupied property, owned and rented property, owned land, owned commercial property, owned but rented out commercial property. The proceeds from these are used by borrowers for personal, business and consumption purposes. After due appraisal Banks sanction generally anywhere between 50% to 65% of the value of borrower's property. Banks offer repayment period of 10 to 15 years at competitive interest rates. For sanctioning loans against properties banks insist on creating a mortgage in their favour.

DISCOUNTING

Commercial bills are basically negotiable instruments accepted by buyers for goods or services obtained by them on credit. Such bills being bills of exchange can be kept upto the due maturity date and encashed by the seller or may be endorsed to a third party in payment of dues owing to the latter.

The most common practice is that the seller who gets the accepted bills of exchange discounts it with the Bank or financial institution or a bill discounting house and collects the money (less the interest charged for the discounting).

Commercial bills are basically negotiable instruments accepted by buyers for goods or services obtained by them on credit.

The biggest advantage of this facility to the seller is to get the cash released fast on the trade bill drawn which would otherwise be locked in the invoices and hence a better way to get an unsecured business loan.

The volume of bills both inland and foreign, which are discounted accounted, forms a substantial part of the total scheduled commercial bank credit. Over the years this is coming down. The Reserve Bank has been attempting to develop a market for commercial bills. The bill market scheme was introduced in 1942 and a new scheme called Bill Rediscount Scheme with several new features was introduced in November, 1970. Under the latter scheme the RBI rediscount bills at the bank rates or at rates specified by it at its discretion. Since the rediscounting facility has been made restrictive, it is generally available on a discretionary basis.

The difficulties which stand in the way of bill market development are, the incidence of stamp duty, shortage of stamp paper, reluctance of buyers to accept bills, predominance of cash credit system of lending and the administrative work involved in handling documents of title to goods. To be freely negotiable and marketable, the bills should be first class bills i.e. those accepted by companies having good reputation. Alternatively, the bills accepted by companies should be co-accepted by banks as a kind of guarantee. In the absence of these criteria, bill market has not developed in India as the volume of first class bills is very small.

Forfaiting

Forfaiting is a mechanism through which exporters can avail finance by discounting their medium term/long term export receivables with an intermediary called forfaiter. Long term receivable can be as long as 10 years where as medium term can be anywhere between three to five years. Thus, receivables on deferred basis evidenced by export bills and commercial documents can be forfeited.

Forfaiting is done on a without recourse basis i.e. if the importer fails to pay, the forfaiter cannot recover the dues from the exporter for whom he has discounted the export receivable. Of course, a forfaiter covers this risk by getting the export documents co-accepted by an importer's bank/ reputable bank from the importer's country.

A brief overview of general working mechanism of Forfaiting is as follows:

A foreign importer and an Indian exporter meet an finalize the transaction between them by entering in to a contract.

↓

Thereafter the exporter readies goods and ships the same to the importer as per contract terms.

↓

Exporter simultaneously prepares set of export documents (which are in a standardized formats of the forfeiter).

↓

Before hand, the foreign importer agrees to get the co-acceptance the export documents sent by the Indian importer, from his bank/reputed bank in his country as agreed between him and the exporter – this known as "availed" document.

↓

Once the co-accepted documents reach the exporter he hands over the same to the forfeiter 'forfait' the same – i.e., discount the same, "without recourse" basis to him.

↓

The 'forfaiter' discounts the same and credits the amount of the bill after deducting his charges such as Commitment Fee, Discount and Documentation Fee.

↓

The forfeiter thereafter sends the export documents to the importer's bank/co-accepted bank for reimbursement on maturity date of the bill.

Forfaiting is an approved method of export financing by RBI. EXIM Bank in India has been authorised to facilitate the forfaiting transactions. The advantage for the exporter is that he can convert the credit sale in to cash sale without recourse to him or his banker.

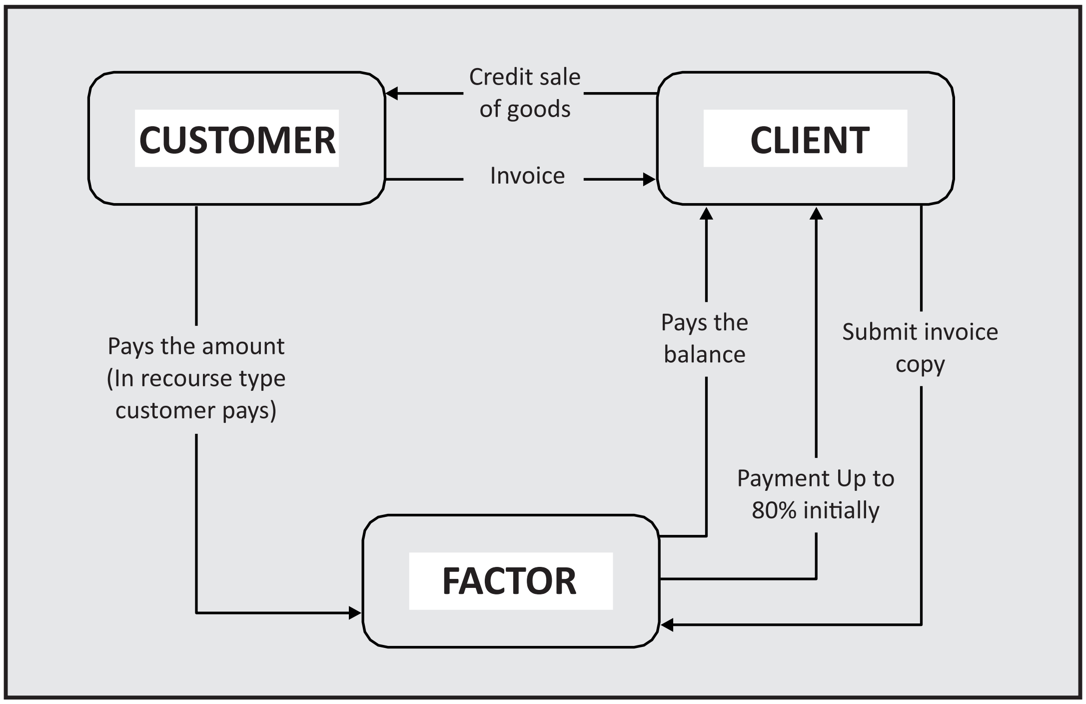
FACTORING

Factoring is a financial transaction where an entity sells its receivables to a third party called a 'factor', at discounted prices. Factoring is a financial option for the management of receivables. In simple definition it is the conversion of credit sales into cash. In factoring, a financial institution (factor) buys the accounts receivable of a company (Client) and pays up to 80% (rarely up to 90%) of the amount immediately on formation of agreement.

Examples

Factoring against goods purchased, factoring for construction services (usually for government contracts where the government body is capable of paying back the debt in the stipulated period of factoring. Contractors submit invoices to get cash instantly), factoring against medical insurance etc.

Factoring company pays the remaining amount (Balance 20%-finance cost-operating cost) to the client when the customer pays the debt. Collection of debt from the customer is done either by the factor or the client depending upon the type of factoring. The account receivable in factoring can either be for a product or service.



Parties in Factoring

The factoring transaction involves three parties:

– The Seller, who has produced the goods/services and raised the invoice.

– The Buyer, the consumer of goods/services and the party to pay.

– The Factor, the financial institution that advances the portion of funds to the seller.

Factoring Process

The steps involved in factoring are listed below:

– The seller interacts with the funding specialist/broker and explains the funding needs.

– The broker prepares a preliminary client profile form and submits to the appropriate funder for consideration.

– Once both parties agree that factoring is possible, the broker puts the seller in direct contact with the funder to ask/answer any additional questions and to negotiate a customized factoring agreement, which will meet the needs of all concerned.

– At this point, the seller may be asked to remit a fee with formal application to cover the legal research costs, which will be incurred during "due diligence". This is the process by which the buyer's credit worthiness is evaluated through background checks, using national database services.

– During the next several days, the under completes the "due diligence" process on the seller, further verifies invoices and acknowledges any liens, UCC filings, judgments or other recorded encumbrances on the seller's accounts receivables.

– The seller is advised of the facility and is asked to advise the buyers of the Factor by letter and submit an acknowledged copy of the same to the Factor for records.

– A detailed sanction letter is given to the seller and their acceptance on the same taken, with the Required signatories.

– Sanction terms must contain the following:

  - All facilities covered under the sanction.
  - The period for which the sanction is valid.
  - When the facility comes into effect (e.g. if facility is dated 1/12/120, it can state that invoices raised from or after 15/12/20 only would be Factored).
  - Who are the authorized signatories for signing invoices for factoring?
  - The limits.
  - The seller has to advise the buyer of the Factoring agreement.
  - Copy of such advice acknowledged by the buyer should be submitted to the Factor. Buyer's consent is not required to decide on the Factor.

– The discounting rates, charges fixed.

– In case of discounts given by the seller to the buyer, which value would be financed by the factor (since the factored amount should never exceed the amount actually payable by buyer).

– Usually within 7 to 10 days of the initial contact with the factor, agreements are signed, customers are notified, UCC forms filed and the first advance is forwarded to the company. This advance can vary between 70 - 80% of the face value of the invoices being factored. In the construction industry, the advances may be in the range of 60 - 70%. The remaining amount is called the "reserve" which is held by the factor until the invoices are paid. The factor then deducts his fee and returns the remaining funds to the seller.

– The seller performs services or delivers products, thus creating an invoice.

– The seller sends or faxes a copy of the invoice directly to the factor.

– The funder verifies the invoice and the advance is sent to the seller as per the agreement with the factor. In certain cases, the funder wires the funds to the seller's account for an additional fee.

– The buyer pays the factor. The factor then returns any remaining reserve, minus the fee, which has been predetermined in the negotiated agreement.

Advantages to the Seller

The Seller gets funds immediately after the sale is effected and on presentation of accepted sales invoices and Promissory notes. Major part of paper work and correspondence is taken care of by the factor. The follow-up, for recovery of funds, is done mainly by the factor. The Interest rates are not as high as normal discounting. There is an increased cash flow to meet payroll. There is an Immediate funding arrangement, no additional debt is incurred on balance sheet. Other assets are not encumbered and approval is not based on seller's credit rating.

Types of Factoring

Non-Recourse or Full Factoring

Under this type of factoring the bank takes all the risk and bear all the loss in case of debts becoming bad debts.

Recourse Factoring

Under this type of factoring the bank purchases the receivables on the condition that any loss arising out or bad debts will be borne by the company which has taken factoring.

Maturity Factoring

Under this type of factoring bank does not give any advance to the company rather bank collects it from customers and pays to the company either on the date of collection from the customers or on a guaranteed payment date.

Advance Factoring

Under advance factoring arrangement the factor provides an advance against the uncollected and non-due receivables to the firm.

Undisclosed Factoring

Under this type of factoring, the customer is not informed of the factoring arrangement. The firm may collect dues from the customer on its own or instruct to make remit once at some other address.

Invoice Discounting

Under this type of factoring the bank provide an advance to the company against the account receivables and in turn charges interest rate from the company for the payment which bank has given to the company.

Difference between Forfaiting and Factoring

- Factoring applies to domestic and international trade both, whereas forfaiting is limited to international trade.
- While factoring focuses on accounts receivables, forfaiting also covers negotiable instruments such as promissory notes and bills of exchange.
- Factoring deals with short-term receivables, whereas forfaiting is for medium and long-term receivables.
- Factoring usually provides 80-90% of the accounts receivable, whereas forfaiting can in some cases provide up to 100%.
- Factoring is normally for ordinary products or services, whereas forfaiting is for capital goods.
- Factoring can be recourse or non-recourse, whereas forfaiting is almost always non-recourse.
- Factoring supports the seller, whereas forfaiting supports both the buyer (importer) and the seller (exporter).

WORKING CAPITAL FINANCE

Main objective of running any industry is earning profits. An industry will require funds to acquire “Fixed assets” like land, building, plant, machinery, equipments, vehicles, tools etc., & also to run the business i.e. its day to day operations.

Funds required for day to-day working like for purchase of raw materials/ stores/ fuel, for employment of labour, for power charges etc., for storing finishing goods till they are sold out & for financing the sales by way of sundry debtors/ receivables, are financed through working capital limit.

Capital or funds required for an industry can therefore be bifurcated as fixed capital & working capital. Working capital in this context is the excess of current assets over current liabilities. The excess of current assets over current liabilities is treated as net working capital or liquid surplus & represents that portion of the working capital which has been provided from the long term source.

Thus, Working Capital Requirement is dependent on :

(a) The volume of activity (viz. level of operations i.e. Production & sales)

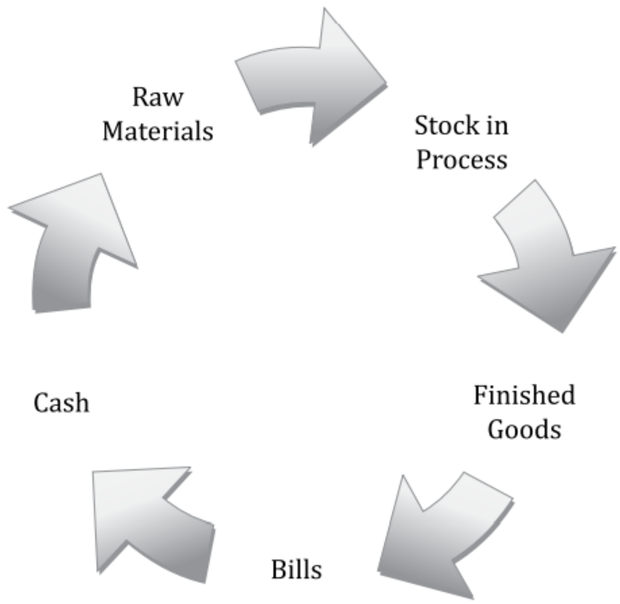
(b) The activity carried on viz. manufacturing process, product, production programme, the materials & marketing mix.

Various methods of accessing Working Capital requirements of a business:

1. **Operating Cycle Method:** Any manufacturing activity is characterized by a cycle of operations consisting of purchase of raw materials for cash, converting these into finished goods & realizing cash by sale of these finished goods.

   The time gap between cash outlay & cash realization by sale of finished goods & realization of sundry debtors is known as the length of the operating cycle.

   Operating cycle is also called the cash-to-cash cycle & indicates how cash is converted into raw material, stocks in process, finished goods, bills (receivables) & finally back to cash. Working capital is the total cash that is circulating in this cycle. Therefore, working capital can be turned over or redeployed after completing the cycle.



a) The operating cycle consists of:

- Time taken to acquire raw materials & average period for which they are in store;
- Conversion process time;
- Average period for which finished goods are in store; and
- Average collection period of receivables (Sundry Debtors).

2. **Turnover Method (Nayak Committee)** : This method of assessing working capital requirement of a firm is given by "Nayak Committee". The committee headed by Mr. P.R. Nayak examined the adequacy of institutional credit to SSI sector and gave its recommendations which are as under:

   Under this method, bank credit for working capital purposes for borrowers requiring fund based limits up to Rs. 5 crore for Small Scale Industries borrowers and Rs. 2 crore in case of other borrowers, may be assessed at minimum of 25% of the projected annual turnover of which should be provided by the borrower (i.e. minimum margin of 5% of the annual turnover to be provided by the borrower) and balance 4/5th (i.e. 20% of the annual turnover) can be extended by way of working capital finance.

   The projected turnover or output value may be interpreted as projected gross sales which will include excise duty also.

   Since the bank finance is only intended to support the need based requirement of a borrower, if the available Net Working Capital (net long term surplus funds) is more than 5%of the turnover the former should be reckoned for assessing the extent of bank finance.

3. **Maximum Permissible Banking Finance Method (Tandon Committee)** : A committee headed by Mr. P.L. Tandon, ex-chairman of PNB, was constituted with view to suggest improvement in the existing ash credit system. It submitted its report on guidelines for follow up of credit in August 1974, suggesting three methods of lending as follows:

   - ***1st Method of Lending:*** 75% of the working capital gap (Working Capital Gap= Total current assets-Total current liabilities other than bank borrowings) is financed by the bank and the balance 25% of the Working Capital Gap considered as margin is to come out of long term source i.e. owned funds and term borrowings.

   - ***2nd Method offending:*** Bank will finance maximum up to 75% of total current assets (TCA) and borrower has to provide a minimum of 25% of total current assets as the margin out of long term sources. This will give a minimum current ratio of 1.33:1.

   - ***3rd Method of Lending:*** This is same as 2nd method of lending, but excluding core current assets from total assets and the core current assets are financed out of long term funds of the company. The term 'core current assets' refers to the absolute minimum level of investment in current assets, which is required at all times to carry out minimum level of business activity.

4. **Chore Committee** : The RBI constituted, in April 1979, a working group under the chairmanship of Shri K.B Chore, to review the system of cash credit with the particular reference to the gap between sanctioned limit and the extent of their utilization. It was also asked to suggest alternative type of credit facilities which would ensure greater credit discipline and enable the banks to relate the credit limits to increase in output or other productive activities.

   The committee recommended assessment of working capital requirements have to be mandatorily assessed based on 2nd method of lending suggested by Tandon Committee except for sick/Units under rehabilitation.

5. **Cash Budget System** : In case of tea, sugar, construction companies, film industries and service sector requirement of finance may be at the peak during certain months while the sale proceeds may be realised throughout the year to repay the outstanding in the account. Therefore, credit limits are fixed on the basis of projected monthly cash budgets to be received before beginning of the season.

SECTION–II
INDIAN NON FUND BASED

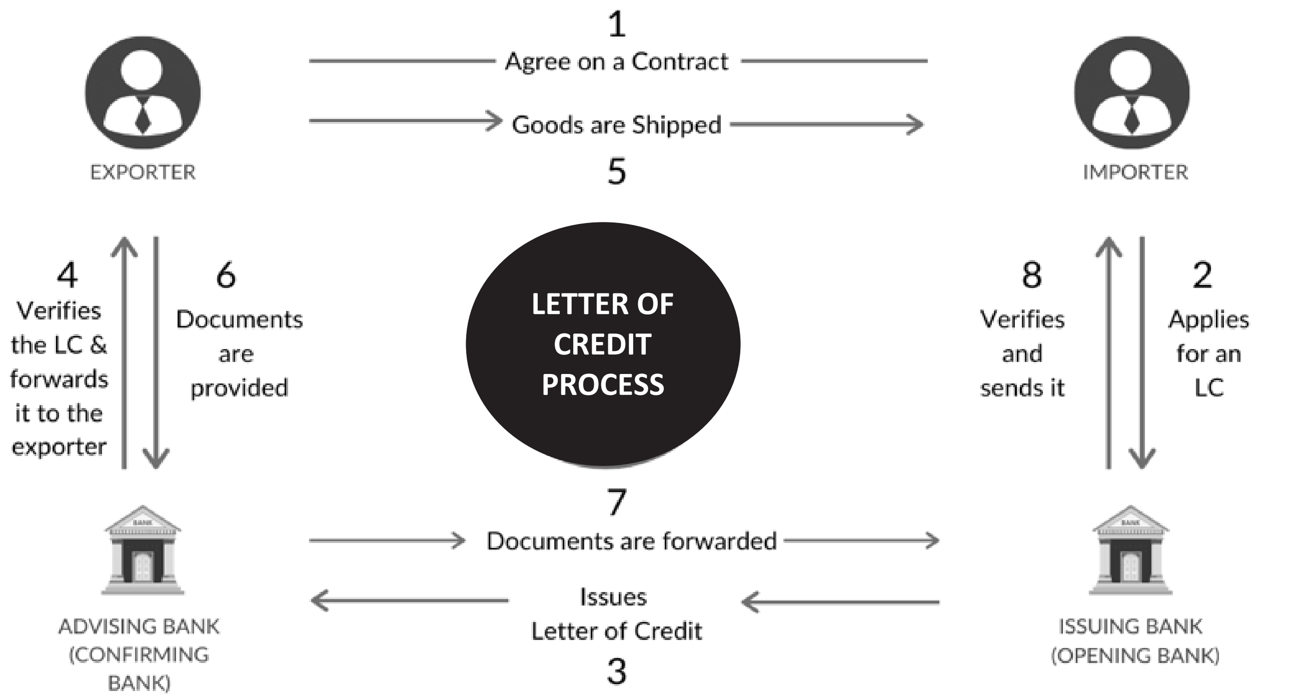
NON-FUND BASED FACILITIES

Letter of Credit

A letter of credit is a document from a bank that guarantees payment. It is an undertaking/ commitment by the bank, advising/informing the beneficiary that the documents under a letter of credit would be honoured, if the beneficiary (exporter) submits all the required documents as per the terms and conditions of the letter of credit.

A Letter of Credit is issued by a bank at the request of its customer (importer / buyer) in favor of the beneficiary (exporter / seller).

Letter of Credit



Types of Letter of Credit

- **Sight Credit -** Under this letter of credit, documents are payable at sight/ upon presentation, i.e., Payment is made to the seller immediately (maximum within 7 days) after the required documents have been submitted.
- **Acceptance Credit/ Time Credit -** The Bills of Exchange which are drawn, payable after a period, are called usance bills. Under acceptance credit usance bills are accepted upon presentation and eventually honoured on due dates. The documents of title to goods (R/R, L/R, MTR, Bill of Lading etc.) are delivered to the applicant (importer / buyer) on acceptance of Bill of exchange drawn under LC by the Seller / exporter. To that extent these LCs are unsecured.
- **Revocable and Irrevocable Credit -** A revocable letter of credit is a credit, in which the terms and conditions of the credit can be amended/cancelled by the Issuing bank, any time and without prior notice to the beneficiaries. If the negotiating bank makes a payment to the beneficiaries prior to receiving notice of cancellation / amendments, it is obligatory for issuing bank to make payment to reimburse the negotiating bank. An irrevocable letter of credit is a credit, the terms and conditions

of which can neither be amended nor cancelled without the consent of the beneficiaries. Hence, the opening bank is bound by the commitments given in the letter of credit. If nothing is stated, the LC is treated as irrevocable.

- **Confirmed Credit -** Only Irrevocable letter of credit can be confirmed. A confirmed letter of credit is one when a banker other than the Issuing bank, adds its own confirmation to the credit. In case of confirmed letter of credits, the beneficiary's bank would forward the LC to the confirming banker with a request to add their confirmation. The liability of the confirming bank is same as the issuing bank.
- **Back-to-Back Letter of Credit -** Back-to-Back Letter of Credit is a negotiable instrument in which the seller gets a Letter of Credit from the buyer and the seller further transfers the Letter of Credit to its supplier. In simple words, the seller first gets the Letter of Credit from the buyer to ensure timely payment and further the same seller hands over the Letter of Credit to someone from whom he buys goods or materials. There are various advantages and disadvantages of Letter of Credit.

Example: Back-to-Back Letter of Credit

A pen manufacturer DNP Limited sells its product to Mr. Pankaj. In return, Mr. Pankaj did not make the payment. Instead, he gave DNP Limited a Letter of Credit. This Letter of Credit is an assurance to DNP Limited that if Mr. Pankaj fails to make timely payment, DNP Limited can use the negotiable instrument to get its claim from the bank. To process the order of Mr. Pankaj, DNP Limited purchases raw material from its supplier, CS Limited. DNP Limited does not make any payment to it. Instead, it hands over the original Letter of Credit received from Mr. Pankaj after changing the beneficiary name with its intermediary bank. Now CS Limited is assured that it will receive the payment for the material purchased by DNP Limited. This transfer of Letter of Credit from one seller to another seller is Back-to- Back Letter of Credit (BBLC).

- **Transferable Credit -** While a letter of credit is not a negotiable instrument, the Bills of Exchange drawn under it are negotiable. A Transferable letter of credit is one in which a beneficiary can transfer his rights to third party / parties in whole or in part (in that case the unused portion can be transferred back to the original beneficiary). Such letter of credit should clearly indicate that it is a 'Transferable' letter of credit. Transferable Letter of Credit is transferrable only once.
- **Red Clause Letter of Credit -** Red clause letter of credit is an advance payment letter of credit. Under the red clause letter of credit, the issuing bank will make an advance payment to the exporter i.e. the seller before the seller ships the goods to the importer i.e. buyer. This is usually done to provide aid to the seller in the form of working capital to purchase raw material, processing and packaging of goods, etc. The advance payment will be done against documentary requirement under the red clause letter of credit. Generally, documents required are written undertaking and receipts.
- **Green Clause Letter of Credit -** Green clause letter of credit is an extension of red clause letter of credit. Which means it provides the advance not only for the purchase of raw materials, processing, and packaging of goods, etc. but also for pre-shipment warehousing at the port of origin and insurance expense. In usual cases, the advance under this letter of credit is granted only after the purchased goods are stored in bonded warehouses. This type of letter of credit is usually used in transactions related to commodity market such as wheat, rice, gold, etc
- **Standby Letter of Credit -** In certain countries there are restrictions to issue guarantees, as a substitute these countries use standby credit. In case the guaranteed service is not provided, the beneficiary can claim under the terms of the standby credit. In case of Standby letter of credits, the documents required are proof of non- performance or a simple claim form.

- **Revolving Credit -** Here the amount of drawings made would be reinstated and made available to the beneficiary again and again for further drawings during the currency of credit provided. At times an overall turnover cap is also stipulated.

PARTIES INVOLVED IN LETTER OF CREDIT FINANCE

Applicant	Issuing Bank	Advising Bank	Beneficiary	Negotiating Bank	Reimbursing Bank	Confirming Bank

1. **Applicant (The buyer/importer of goods):** This person has to make payment of letter of credit to the issuing bank if the documents are in accordance with the terms and conditions of LC.
2. **Issuing Bank:** Importer's or buyer's bank who lends its name or credit, is issuing Bank. It is liable for payment of LC in case the documents are received by it from the nominated or negotiating bank and the documents are in terms of letter of credit. This bank gets 5 days to check the documents.
3. **Advising Bank:** Issuing bank branch or correspondent in exporter country to whom the letter of credit is sent for onward transmission to the seller or beneficiary, after authentication of genuineness of the credit. Where it is unable to verify the authenticity, it can seek instructions from the opening bank or can advise the LC to the beneficiary, without any liability on its part. This bank has no obligation to negotiate the document.
4. **Beneficiary:** The party to whom the credit is addressed i.e. seller or the exporter or the supplier of the goods. It gets payment against documents as per LC from the nominated bank within validity period of negotiation maximum 21 days from date of shipment.
5. **Negotiating Bank:** The bank nominated by the issuing bank to negotiate the documents when submitted by the exporter or alternatively the bank to whom the beneficiary presents the documents for negotiation. It claims payment from the reimbursing bank or opening bank and gets 5 banking days to check the documents.
6. **Reimbursing Bank:** Third bank which repays, settle or funds the negotiating bank at the request of its principal, the issuing bank.
7. **Confirming Bank:** The bank adding confirmation to the credit, which undertakes the responsibility of payment by the issuing bank and on his failure, to pay. The confirmation, is added on request of the opening bank.

Documents handled under Letters of Credit

Documents play a crucial role in trade transactions. Documents are integral part of LCs. The banks involved in LC transactions deal only with documents and on the evidence of the correct and proper documents only the paying banks (opening bank/confirming bank) need to make payment. In view of these factors, banks have to be careful while handling documents/ LCs. At various stages, different banks (Negotiating bank {beneficiary's bank}, confirming bank, opening bank) have to verify whether all the required documents are submitted strictly as per the terms and conditions of credit.

The important documents handled under LCs are broadly classified as under:

(a) Bill of Exchange

Bill of exchange, is drawn by the beneficiary (exporter) on the LC issuing bank. When the bill of exchange is not drawn under a LC, the drawer of the bill of exchange (exporter), draws the bill of exchange on the drawee (importer). In such a case, the exporter takes credit risk on the importer, whereas, when the Bill of Exchange is drawn under LC, the credit risk for the exporter is not on the importer but on the LC issuing bank. Banks should be careful in ensuring that the Bill of Exchange is drawn strictly as per the terms and conditions of the credit.

Some others important aspects are:

(i) It should be drawn by the beneficiary on the opening bank.

(ii) It should clearly indicate the amount and other details.

(iii) Depending upon the LC terms a Bill of Exchange may be drawn as a sight bill or an usance bill.

(iv) It should clearly indicate the LC number.

(b) Commercial Invoice

This is another important document. Commercial invoice is prepared by the beneficiary, which contains

(i) relevant details about goods in terms of value, quantity, weights (gross/net), importer's name and address, LC number.

(ii) Commercial invoice should exactly reflect the description of the goods as mentioned in LC.

(iii) Another important requirement is that the commercial invoice should indicate the terms of sale contract (Inco terms) like FOB, C&F, CIF, etc.

(iv) Other required details like shipping marks, and any specific detail as per the LC terms should also be covered.

(c) Transport Documents (Documents of title to the goods)

When goods are shipped from one port to another port the transport document issued is called the bill of lading. Goods can be transported by means of airways, waterways, roadways and railways depending upon the situations. In case goods are transported by means of water ways, the document is called bill of lading (B/L), by airways it is known as airway bills (AWB) and by roadways called as lorry receipt (LR) and by railways it is known as railway receipt (RR). In case of a single transaction, when different modes are used to transport the goods from the beneficiary's country to the importer's destination, a single transport document can be used viz., Multi Modal Transport Document.

(d) Bill of Lading (B/L)

The B/L is the shipment document, evidencing the movement of goods from the port of acceptance (in exporter's country) to the port of destination (in importer's country). It is a receipt, signed and issued by the shipping company or authorized agent. It should be issued in sets (as per the terms of credit).

Other important features

As per the terms and conditions of the credit, a bill of lading should clearly indicate:

(i) the description of goods shipped, as indicated in the invoice;

(ii) conditions of goods "Clean" or otherwise (not in good condition/ shortage/damaged);

(iii) drawn to the order of the shipper, blank endorsed or in favour of the opening bank;

(iv) the gross and net weight;

(v) Freight payable or prepaid;

(vi) Port of acceptance and port of destination.

(e) Insurance Policy/ Certificate: This document is classified as a document to cover risk.

(a) It must be issued by the insurance company or their authorized agents;

(b) It should be issued in the same currency in which the LC has been issued;

(c) It should be issued to cover "All Risks";

(d) The date of issuance of the policy/ certificate should be on or before the date of issuance of the shipment, and should clearly indicate that the cover is available from the date of shipment;

(e) Unless otherwise specified, it should be issued for an amount of 110% of CIF value of goods;

(f) The description of the goods in the policy/certificate should be as per the terms of the credit;

(g) The other important details like the port of shipment, port of destination etc. needs to be clearly indicated.

(g) Other documents

As per the terms of LC, all required documents have to be submitted by the beneficiary. Documents like Certificate of Origin (issued by the Chamber of Commerce), indicates the origin of goods. The origin of goods should not be from any prohibited nations. Packing list, required certificates, etc. should be drawn as per the terms and conditions of the credit.

Standby Letter of Credit (SLOC)

A standby letter of credit (SLOC or SBLC), also known as a standby or LOC, is a lender's guarantee of payment to an interested third-party in the event the client defaults on an agreement. Standby letters of credit are formal documents that specify the duties and obligations of each party and serve as an act of good faith. The bank issuing the SLOC performs general underwriting duties to ensure the financial credibility of the party seeking the letter of credit. Then it sends a notification to the bank of the party requesting the letter of credit (typically a seller or creditor).

Example

A financial SLOC, the most common type, is typically used in international trade or other high-value purchase contracts where litigation or other non-payment actions may not be feasible. A financial SLOC guarantees payment to the beneficiary if contract requirements are unfulfilled. For example, an exporter sells goods to a foreign buyer who guarantees payment in 30 days. When no payment is received by the deadline, the exporter presents the SLOC to the buyer's bank to receive payment.

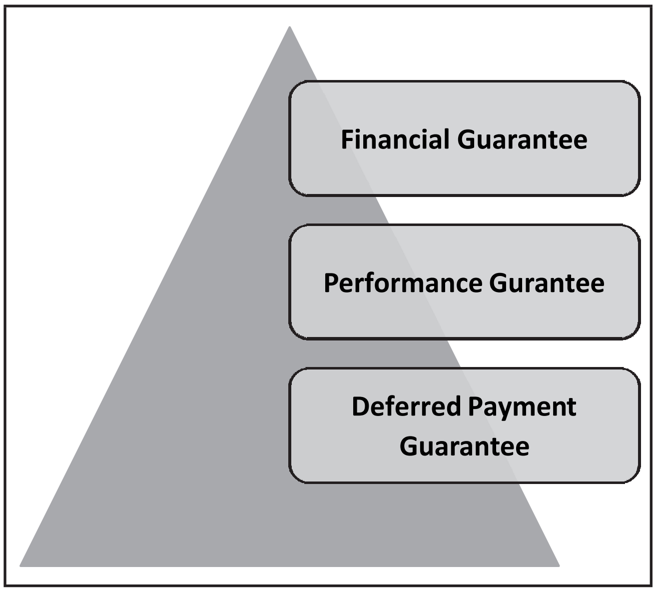
A performance SLOC ensures that time, cost, amount, quality of work, and other criteria are fulfilled in a manner acceptable to the client. The bank pays the beneficiary if any contractual obligations are unmet. For example, a contractor guarantees a construction project will be finished in 90 days. If work remains incomplete after the 90-day period, the client can present the SLOC to the contractor's bank and receive payment.

Standby letters of credit and bank guarantees are both methods of providing assurance to a vendor of payment on credit. A bank guarantee is a commitment by a bank to pay its client's obligation up to a certain amount, while standby letter of credit is a more formal document that details the obligations of both parties.

BANK GUARANTEE

Bank guarantees are part of non-fund based credit facilities provided by the bank to the customers. Bank issue bank guarantee on behalf of his client as a commitment to third party assuring her/ him to honour the claim against the guarantee in the event of the non- performance by the bank's customer. A Bank Guarantee is a legal contract which can be imposed by law. The banker as guarantor assures the third party (beneficiary) to pay him a certain sum of money on behalf of his customer, in case the customer fails to fulfill his commitment to the beneficiary.

Banks issue different types of guarantees, on behalf of their customers, as illustrated below:



- **Financial Guarantee:** The banker issues guarantee in favour of a government department against caution deposit or earnest money to be deposited by bank's client. At the request of his customer, in lieu of a caution deposit/ earnest money, the banker issues a guarantee in favour of the government department. This is an example of a Financial Guarantee. This type of guarantee helps the bank's customer to bid for the contract without depositing actual money. In case, the contractor does not take up the awarded contract, then the government department would invoke the guarantee and claim the money from the bank.

- **Performance Guarantee:** Performance Guarantees are issued by banks on behalf of their clients. In performance guarantee bank issue on behalf of his client to assure the third party to complete some work on time or as per the terms of contact between the parties. If the work is not completed as per the term of contract then the third party can request the bank to invoke the bank guarantee and make payment for default.

  Performance Bank Guarantees are issued guaranteeing due performance of contract or obligation of the Borrower under the contract. In the event of non-performance of obligation in terms of contract the bank assumes monetary liability up to the amount specified in the Guarantee.

  Purpose of issuing Performance Bank Guarantee

  i. Due performance of a specific contract undertaken by a customer in favour of Govt. bodies / Others - for e.g. supply of materials, Construction of Roads, Buildings Dams, Civil Work, etc.

  ii. To secure any claims by the buyer on the seller arising from default in delivery or performance of the terms of the contract (e.g. construction, assembly, execution).

  iii. Due performance of an equipment/project after completion for a specific period due to possible defects appearing after delivery during warranty period of the equipments.

  iv. Execution of Long Term Infrastructure Projects such as Seaports, Airports, Road Construction, Bridges, Sanitation and Sewerage Projects, Telecommunication Services, Construction of Educational Institutions and Hospitals, Generation/ Transmission/ Distribution of Power, etc.

- **Deferred Payment Guarantee:** It is clear from the name that under this guarantee, the banker guarantees payments of installments spread over a period of time.

Here, the banks undertake to make payment of instalments payable by the buyer of capital goods such as machinery, on long term credit given by the supplier. Normally advance payment of 10 to 15% of the price of the capital goods is made by the borrower (margin). The balance amount with interest is payable in installments spread over may be 1 to 5 years. The supplier accordingly draws bills due on different dates which are accepted by the borrower and further co-accepted by the banker or bank issues DPG. On every due date the buyer's bank makes payment of the bill to the supplier irrespective of there being balance in the buyer's (borrower's) account or not. Banks secure such guarantees by creating charge over the assets purchased.

On expiry of the validity period of the guarantee, a registered acknowledgement due notice is to be sent to the beneficiary indicating that the liability of the bank under said guarantee stands discharged. If no reply is received from the beneficiary in reasonable time the entry is reversed in books of account. If beneficiary invokes the guarantee, the amount claimed needs to be paid immediately without any delay for whatsoever the reason.

In this bank guarantee, the extent of monetary liability and the validity period should be specific. The limitation clause is inserted for this purpose. As such even when the period of liability is specified in the guarantee, the beneficiary can claim till the limitation period is alive. No bank guarantee should normally have a maturity period of more than 10 years. The bank should have a policy approved by the Board in case guarantee for more than 10 years is to be issued.

Difference between Letter of Credit and Bank Guarantee

A bank guarantee and a letter of credit are similar in many ways but they're two different things. Letters of credit ensure a transaction proceeds as planned, while bank guarantees reduce the loss if transaction does not go as planned.

Example

A purchases a machinery on a long-term credit basis and agrees to pay in installments on specified dates over a period of time. In terms of the contract of sale, B (the seller) draws Bills of Exchange on the customer for different maturities. These bills are accepted by A. The banker (guarantor) guarantees payment of these bills of exchange on the due date. In the event of default by A, the banker need to honour the claim to the seller (beneficiary).

A letter of credit, sometimes referred to as a documentary credit, acts as a promissory note from a bank. It represents an obligation taken on by a bank to make a payment once certain criteria are met.

Once these terms are completed and confirmed, the bank will transfer the funds. The letter of credit ensures the payment will be made as long as the services are performed.

Example

An Indian wholesaler receives an order from a US company. The wholesaler has no way of knowing whether the buyer can fulfill his payment obligations, and requests a letter of credit be provided in their contract. The purchasing company applies for a letter of credit at a bank where it already has funds (LOC). After the goods have been shipped, the bank would pay the wholesaler its due as long as the terms of the sales contract are met, such as delivery before a certain time or confirmation from the buyer that the goods were received undamaged. The letter of credit substitutes the bank's credit for that of its client, ensuring correct and timely payment.

Letters of credit are especially important in international trade due to the distance involved and potentially differing laws in the countries of the businesses involved. In these transactions, it is not always possible for the parties to meet in person. The bank issuing the letter of credit holds payment on behalf of the buyer until it receives confirmation that the goods in the transaction have been shipped.

While letters of credit are used mostly in international trade agreements, bank guarantees are often used in real estate contracts and infrastructure projects.

Bank guarantees represent a more significant contractual obligation for banks than letters of credit do. A bank guarantee, like a letter of credit, guarantees a sum of money to a beneficiary; however, unlike a letter of credit, the sum is only paid if the opposing party does not fulfill the stipulated obligations under the contract. This can be used to essentially insure a buyer or seller from loss or damage due to nonperformance by the other party in a contract.

Bank guarantees insure both parties in a contractual agreement from credit risk. For instance, a construction company and its cement supplier may enter into a new contract to build a mall. Both parties may have to issue bank guarantees to prove their financial stance and capability. In a case where the supplier fails to deliver cement within a specified time, the construction company would notify the bank, which then pays the company the amount specified in the bank guarantee.

Both bank guarantees and letters of credit work to reduce financial risk. The seller takes on less risk when a letter of credit or bank guarantee is active, and would be more likely to agree to the transaction. These agreements are particularly important and useful in what would otherwise be risky transactions for the seller, such as certain real estate and international trade contracts. Banks, since they are agreeing to take on risk, thoroughly screen buyers interested in one of these transactions. After the bank has determined that the buyer is a reasonable risk, a monetary limit is placed on the agreement. The bank agrees to be obligated up to, but not exceeding, the limit. This protects the bank by providing a specific threshold of risk.

APPRAISAL METHODOLOGY FOR DIFFERENT TYPE OF NON FUND BASED CREDIT PRODUCTS

Credit Appraisal

Credit Appraisal is a process to ascertain the risks associated with the extension of the credit facility. Appraisal of credit is generally carried by the Banks/financial institutions which are involved in providing financial funding to its customers. To ascertain the credit risk associated with every credit proposal appraisal is required. Credit worthiness of a borrower can be assessed by proper credit appraisal.

I. **Letter of Credit Limit:** Letter of credit (LC) is a method of settlement of payment of a trade transaction and is widely used to finance purchase of raw material, machinery etc. It contains a written undertaking by the bank on behalf of the purchaser to the seller to make payment of a stated amount on presentation of stipulated documents and fulfillment of all the terms and conditions incorporated therein. Letters of credit thus offers both parties to a trade transaction a degree of security. The seller can look forward to the issuing bank for payment instead of relying on the ability and willingness of the buyer to pay.

Assessment of Limit of Letter of Credit

Particular	
Annual Raw Material Consumption	A
Annual Raw Material Procurement through ILC/ FLC	B
Monthly Consumption	C

Usance	D
Lead Time	E
Total Time	F=D+E
LC Time Required	G=F*C

II. Bank Guarantee Limit: Appraisal of proposals for Bank guarantees is done with same diligence as in the case of fund-base limits. Whenever an application for the issue of bank guarantee is received, Bank examine & satisfy about the following aspects:

a) The need of the bank guarantee & whether it is related to the applicant's normal trade/business.

b) Whether the requirement is one time or on the regular basis.

c) The nature of bank guarantee i.e., financial or performance.

d) Applicant's financial strength/ capacity to meet the liability/ obligation under the bank guarantee in case of invocation.

e) Past record of the applicant in respect of bank guarantees issued earlier; e.g., instances of invocation of bank guarantees, the reasons thereof, the customer's response to the invocation, etc.

f) Present o/s on account of bank guarantees already issued.

g) Margin.

h) Collateral security offered.

Assessment of Limit of Bank Guarantee

Particulars	
Outstanding Bank Guarantee as per Audited Balance Sheet	A
Add: Bank Guarantee required during the period	B
Less: Estimated maturity or cancellation of Bank Guarantee during the period	C
Requirement of Bank Guarantee	D=A+B-C

LESSON ROUND-UP

- Keeping in view the larger complementary role that corporate bonds have to play along-side bank credit for financing economic activities, several policy measures have been taken by the Government and the Regulators to develop a vibrant corporate bond market.
- Debt markets are markets for the issuance, trading and settlement of various types and features of fixed income securities.
- Debenture is a document evidencing a debt or acknowledging it and any document which fulfills either of these conditions is a debenture. They can be either convertible or non convertible into equity shares at a later point in time.

- Debt securities, Non-convertible redeemable preference shares, Perpetual debt instruments, Perpetual Non-cumulative preference shares or similar non-equity regulatory capital instruments are collectively referred to as “non-convertible securities”.
- “Debt securities” means non-convertible debt securities with a fixed maturity period which create or acknowledge indebtedness and includes debentures, bonds or any other security whether constituting a charge on the assets/ properties or not, but excludes security receipts, securitized debt instruments, money market instruments regulated by the Reserve Bank of India, and bonds issued by the Government or such other bodies as may be specified by the SEBI.
- Corporates also have access to another market called the Inter Corporate Deposits (ICD) market. An ICD is an unsecured loan extended by one corporate to another. The ICD market is an unorganized market with very less information available publicly about transaction details.
- The cost and procurement of public deposits is cheaper and easier, respectively, than other forms of sources of finance. Generally public deposits, from the bank’s or financial institution’s point of view, are a source of short / medium term finance.
- A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/ securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.
- A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in instalments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).
- Bonds which are rupee denominated are called Masala Bonds which are becoming a very popular instrument.
- Banks also provide other types of finance including overdrafts and cash credit.
- Innovative methods of financing like Loan against shares are also available from Banks and financial institutions.
- Cash credit is the main method of lending by banks in India and accounts for about 70 percent of total bank credit. Under the system, the banker specifies a limit, called the cash credit limit, for each customer, upto which the customer is permitted to borrow against the security of tangible assets or guarantees.

GLOSSARY

Debenture Trustee: A trustee of a trust deed for securing any issue of debentures of a body corporate.

ISIN (International Securities Identification Number): A unique identification number allotted for each security in the depository system by SEBI.

CCA/c: Cash Credit Account

ODA/c: Over draft Account

DP: Drawing Power

D/P: Delivery Against Payment

D/A: Delivery Against Acceptance

CMA: Data Credit Monitoring Arrangement Data

GCC: Gulf Cooperation Council (GCC)

ROI: Return on investment

CIBIL: Credit Information Bureau (India) Limited

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation.)

1. Discuss the procedure to be followed for electronic book mechanism for issue of debt securities.
2. What do you mean by 'Green Debt Securities'? Explain.
3. QUE Jay Ltd. is planning to issue 1,00,000 non-convertible debentures at Rs. 10 each through a public offer. You are the Company Secretary of the company and have been asked by the Board to prepare a Guidance Note briefing on the following points:
   a) Provisions of Companies Act, 2013 applicable on such issue.
   b) Provisions of SEBI (Issue & Listing of Non- Convertible Securities) Regulations, 2021 as applicable.
4. Sunshine Ltd. is a company with the main objective of Waste Management & Recycling. Company wants to raise funds for financing its activities from the Indian Debt Market. What is your advice to the company?
5. Xeron Ltd. issued 1,52,000 non-convertible debentures in 2019, to be redeemed in 2022. At the time of redemption, the Board of the company wants to consider the roll-over option. Can they do so? If yes, what are the conditions involved?
6. What is factoring. What are the advantages of factoring to a seller?
7. What are the factors to be taken into account for credit appraisal?
8. Differentiate between the following:
   a. Bills Finance and Project Finance
   b. Bill Discounting and Cash Credit
   c. Factoring and Forfaiting
   d. Overdraft and Cash Credit account
   e. Buyers' credit and Suppliers credit.
9. Explain the Working Capital Assessment Method as under Maximum Permissible Banking Finance Method with the help of an example.
10. In the Board Meeting of Heaven Limited the directors were discussing on the advantages and disadvantages of Hire Purchase Financing. You are the Company Secretary of the company and was asked by the Board to prepare an Advisory Note, briefing the Board about what Hire Purchase Finance is and how it is different from Project Finance.

11. The following data pertains to XYZ Ltd:

	Rs.
Projected Sales	20,00,000
Creditors	3,00,000
Bank Borrowings	3,30,000
Current Assets	7,40,000

Access the Working Capital requirements of XYZ Ltd. using the method given by Nayak Committee.

LIST OF FURTHER READINGS

- The Companies Act, 2013 & the Companies (Share Capital and Debentures) Rules, 2014
- SEBI(Issue of Capital and Disclosure Requirements) Regulations, 2018
- SEBI(Issue and Listing of Non-Convertible Securities) Regulations, 2021
- SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("Listing Regulations")
- FAQs on Government Securities Market in India-A Primer available at https://www.rbi.org.in/Scripts/FAQView.aspx?Id=79
- FAQs on Banking available at https://www.rbi.org.in/Scripts/FAQDisplay.aspx?dId=49

OTHER REFERENCES

- https://www.sebi.gov.in/sebi_data/docfiles/2973_t.html
- https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1847812
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