Bonds and Debentures

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Different sources of debt

- Bonds
- Debentures
- Loans
- Deposits

Bonds

As per SEBI Glossary for Investor

- *A negotiable certificate evidencing indebtedness a debt security or IOU, issued by a company, municipality or government agency. A bond investor lends money to the issuer and, in exchange, the issuer promises to repay the loan amount on a specified maturity date. The issuer usually pays the bondholder periodic interest payments over the life of the loan*

Features of Bonds

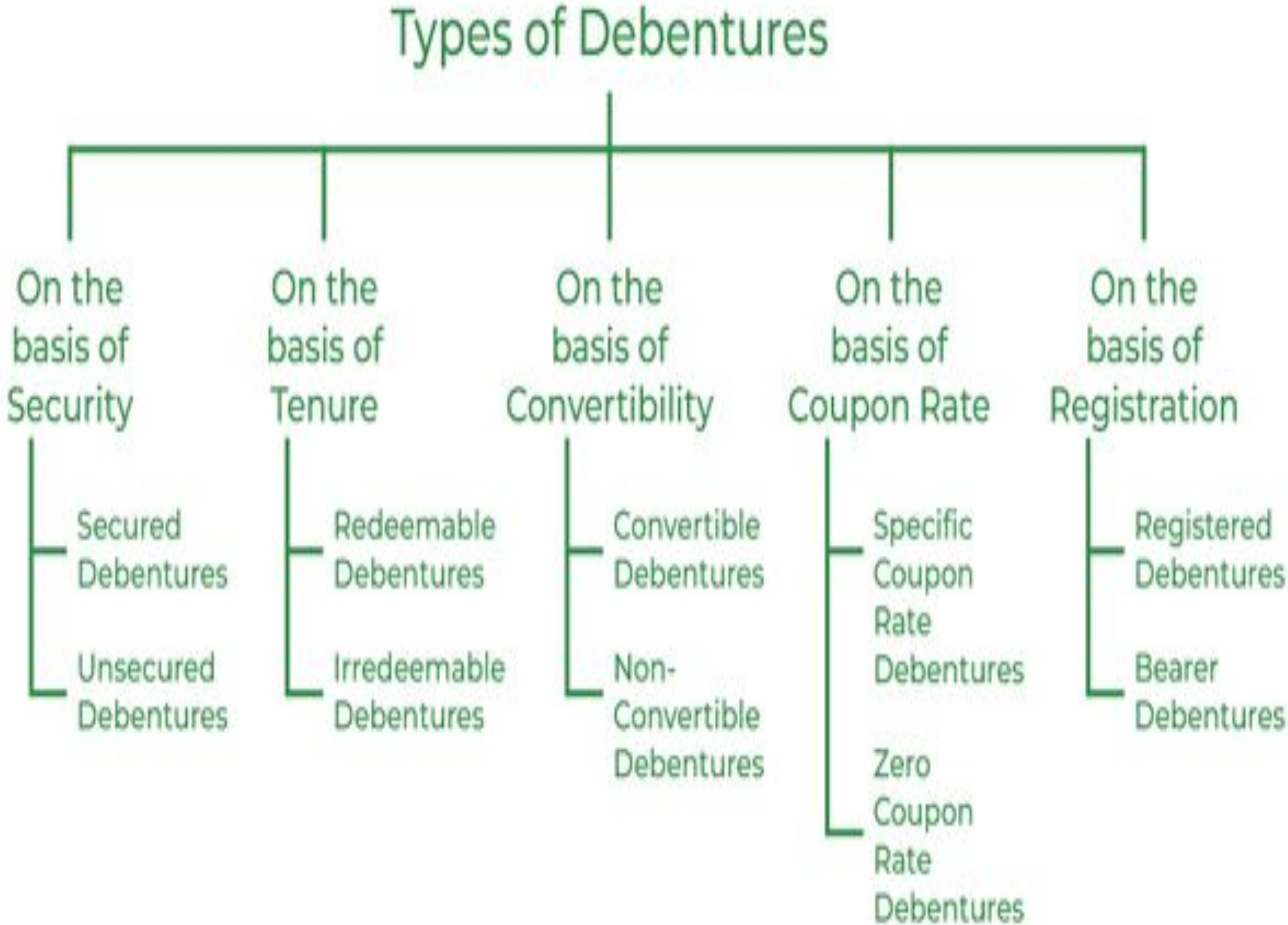
- The Face Value of Bonds connotes the principle value of the loan granted by the bondholder to the bond issuer.
- The Bond Holder is entitled to receive the periodic interest on the bond, the Interest attached to Bond is called as "Coupon"
- The Interest Calculated on a bond could be on a fixed rate basis or floating rate basis
- The Bond has a maturity period upon which the principal amount of the bond is repaid back to the holder of the instrument
- It is debt instrument which does not give any control rights to holders
- Bonds are rated by credit-rating agencies according to the financial strength

Types of Bonds

- On the Basis of Issuer
  - Government Bonds
  - Corporate Bonds
- On the basis of Interest rate
  - Fixed interest rate bonds
  - Floating interest rate bonds
  - Zero-Coupon Bonds
- On the Basis of Redemption
  - Perpetual Bonds
  - Callable and putable Bonds
  - Convertible bonds
  - Non-Convertible bonds
- On the Basis of Security or Collateral
  - Secured Bonds
  - Unsecured Bonds
- On the Basis of market adjustments
  - Inflation-Linked bonds
- On the Basis of Holding
  - Bearer bonds

Debentures

- The word 'debenture' has been derived from a Latin word 'debere' which means to borrow.
- Section 2(30) of the Companies Act, 2013 defines "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.


Types of Debentures
On the basis of Security
Secured Debentures
Unsecured Debentures
On the basis of Tenure
Redeemable Debentures
Irredeemable Debentures
On the basis of Convertibility
Convertible Debentures
Non-Convertible Debentures
On the basis of Coupon Rate
Specific Coupon Rate Debentures
Zero Coupon Rate Debentures
On the basis of Registration
Registered Debentures
Bearer Debentures

Debentures [Section 71]

- A Company may issue debentures with an option of convertibility at the time of redemption-Approved by SR.
- No Voting Rights in case of Debentures
- On issue of debenture, a Company shall create a Debenture Redemption Reserve (DRR) out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilized by the company except for the redemption of debentures.
- A company is required to pay interest and redeem the debentures in accordance with the terms and conditions of their issue.
- If there is any default in repayment of amount in the event of maturity or default in payment of the interest thereon then the Tribunal will be approached by the Debenture-holders or Debenture Trustee to take appropriate measures.

Conditions for issue of secured debentures

- Redemption Period : An issue of secured debentures may be made, provided the date of its redemption shall not exceed ten years from the date of issue.
- However, the following classes of companies may issue secured debentures for a period exceeding ten years but not exceeding thirty years,
  - Companies engaged in setting up of infrastructure projects;
  - 'Infrastructure Finance Companies' as defined in clause (viia) of sub direction (1) of direction 2 of Non-Banking Financial (Non-deposit accepting or holding) Companies Prudential Norms (Reserve Bank) Directions, 2007;
  - Infrastructure Debt Fund Non-Banking Financial Companies’ as defined in clause (b) of direction 3 of Infrastructure Debt Fund NonBanking Financial Companies (Reserve Bank) Directions, 2011;
  - Companies permitted by a Ministry or Department of the Central Government or by Reserve Bank of India or by the National Housing Bank or by any other statutory authority to issue debentures for a period exceeding ten years.
- Creation of Charge: Debentures shall be secured by the creation of a charge on the properties or assets of the company or its subsidiaries or its holding company or its associates companies, having a value which is sufficient for the due repayment of the amount of debentures and interest thereon.

Governing Framework for issue of Debentures

- The power to issue debentures can be exercised on behalf of the Company at a meeting of the Board under the provisions of Section 179 (3) of the Companies Act, 2013. Further Section 71 read with Rule 18 of the Companies (Share Capital and Debentures) Rules, deals with the provisions relating to the issuance of debentures.
- Debentures are Securities within the meaning of Section 2(81) of the Companies Act, 2013. Hence, for issue of Debentures, all procedures for issue of securities as mentioned in Section 23 will be applicable, which states the ways available for a Public Company and Private Company for issue of Securities.

Non-Covertible Debentures

- For issue of Non-Convertible Debentures on a private Placement basis by a private company, the provisions of Section 42 along with rules made thereunder will be applicable. A Public company can either make public issue of debentures or can make a Private Placement.

Convertible Debentures

- In case of debentures which are convertible either fully or partly into equity shares (whether compulsorily or optionally), Section 62 will be attracted by virtue of Explanation (ii) of Rule 13(1) of the Companies (Share Capital and Debentures) Rules, 2014, which explains the meaning of the word "shares or other securities" to include “fully convertible debentures, partly convertible debentures or any other securities, which would be convertible into or exchanged with equity shares at a later date”.
- Where the preferential offer of convertible debentures is made by a company whose share or other securities are listed on a recognized stock exchange, such preferential offer shall be made in accordance with the provisions of the Companies Act, 2013 and regulations made by the Securities and Exchange Board, and if they are not listed, the preferential offer shall be made in accordance with the provisions of Section 62 read with Rule 13 of the Companies(Share Capital & Debentures) Rules, 2014 along with the conditions laid down in Section 42 and Rule 14 of the Companies (Prospectus & Allotment of Securities) Rules, 2014.

Conditions for issue of debentures under Companies Act, 2013

- Section 71(4) read with Rule 18(7) of the Companies (Share Capital and Debentures) Rules, 2014 provides that the company shall create a Debenture Redemption Reserve for the purpose of redemption of debentures.

Method of Investment in DRR

- Every listed company (including listed NBFCs and Housing Finance Companies) in case of public issue of debentures and other unlisted company (other than unlisted NBFCs and Housing Finance Companies) shall on or before the 30th day of April in each year, in respect of debentures issued by the above-mentioned companies is required to invest or deposit at least 15 % of the amount of its debentures maturing during the year ending on 31st day of March of next year. The company may choose any of the below given methods:
  - In deposits with any scheduled bank, free ;
  - In unencumbered securities of the Central methods of deposits or from any charge or lien; Government or any State Government;
  - In unencumbered securities mentioned in sub-clauses (a) to (d) and (ee) of section 20 of the Indian Trusts Act, 1882;
  - In unencumbered bonds issued by any other company which is notified under sub-clause (f) of section 20 of the Indian Trusts Act, 1882;
- In case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non- convertible portion of debenture issue in accordance with Rule 18(7) of the Companies (Share Capital and Debentures) Rules, 2014.

Appointment of Debenture Trustee

- A Company cannot issue debentures to more than 500 people without appointing a debenture trustee, whose duty would be to protect the interest of Debenture Holders and redress their grievances.
- The company shall appoint the debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures and not later than sixty days after the allotment of the debentures, execute a debenture trust deed to protect the interest thereon.
- The security for the debentures by way of a charge or mortgage shall be created in favour of the debenture trustee on:-
  - any specific movable property of the company or its holding company or subsidiaries or associate companies or otherwise.
  - any specific immovable property wherever situate, or any interest therein.

Conditions for Appointment of Debenture Trustee

- The names of the debenture trustees shall be stated in letter of offer/Notices or other Communication sent to the debenture holders
- A written consent shall be obtained before appointment.
- A person shall not be appointed as a debenture trustee, if he:
  - beneficially holds shares or is promoter, director or key managerial personnel or any other officer or an employee of the company or its holding, subsidiary or associate company;
  - is beneficially entitled to receive any money otherwise than as remuneration payable to the debenture trustee or is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;
  - has furnished any guarantee in respect of the principal debts secured by the debentures or interest thereon or has any pecuniary relationship with the company amounting to two per cent or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;
  - is relative of any promoter or any person who is in the employment of the company as director or key managerial personnel.
- Any debenture trustee may be removed from office before the expiry of his term only if it is approved by the holders of not less than three fourth in value of the debentures outstanding, at their meeting.

Duties of Debentures Trustee

- satisfy himself that the letter of offer does not contain any matter which is inconsistent with the terms of the issue of debentures or with the trust deed.
- satisfy himself that the covenants in the trust deed are not prejudicial to the interest of the debenture holders;
- call for periodical status or performance reports from the company
- communicate promptly to the debenture holders defaults, if any, with regard to payment of interest or redemption of debentures and action taken by the trustee therefor
- ensure that the company does not commit any breach of the terms of issue of debentures or covenants of the trust deed and take such reasonable steps as may be necessary to remedy any such breach;
- inform the debenture holders immediately of any breach of the terms of issue of debentures or covenants of the trust deed;
- ensure the implementation of the conditions regarding creation of security for the debentures, if any, and debenture redemption reserve;
- ensure that the assets of the company issuing debentures and of the guarantors, if any, are sufficient to discharge the interest and principal amount at all times and that such assets are free from any other encumbrances except those which are specifically agreed to by the debenture holders;
- call for reports on the utilization of funds raised by the issue of debentures;

Liability of Debenture Trustee

- If case of default of Trustee to show the degree of care and due diligence required of him as a trustee. The Trust Deed Cannot Exempt his liability
- Any provision exempting the liability shall be void

Debenture Trust Deed

- It is a written instrument legally conveying property to a trustee often for the purpose of securing a loan or mortgage

Meetings of Debenture Holders by Debenture Trustee

The meeting of all the debenture holders shall be convened by the debenture trustee on-

- requisition in writing signed by debenture holders holding at least one-tenth in value of the debentures for the time being outstanding;
- the happening of any event, which constitutes a breach, default or which in the opinion of the debenture trustees affects the interest of the debenture holders