



Company Law Corner

ALL ABOUT DEBENTURES UNDER THE COMPANIES ACT, 2013

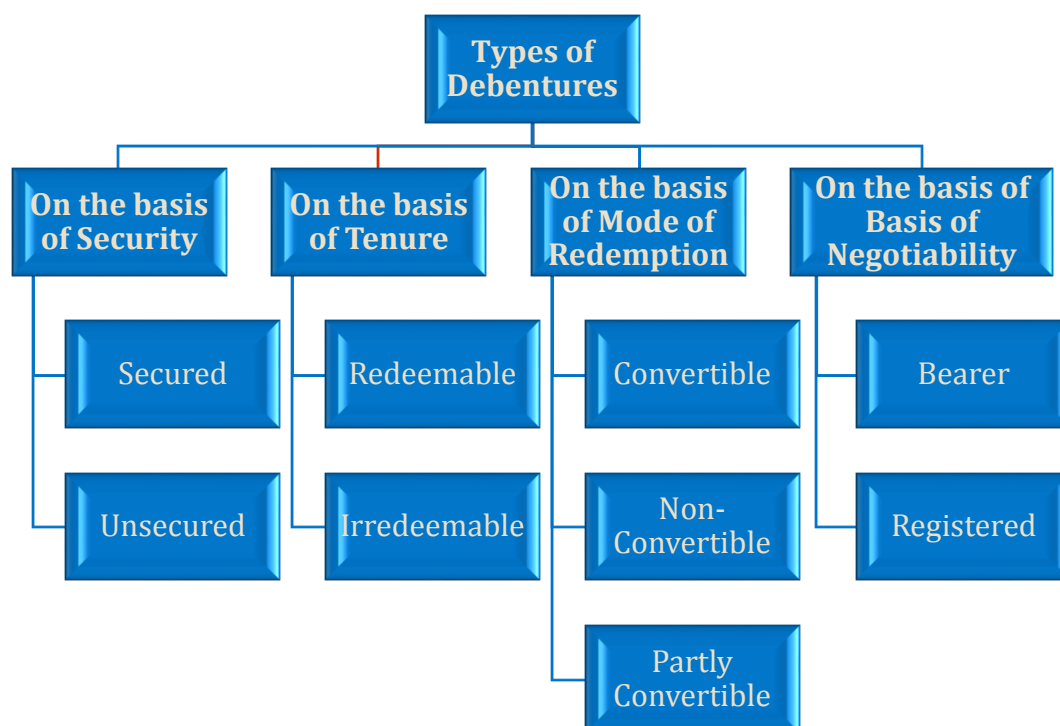
The word 'debenture' has been derived from a Latin word 'debere' which means to borrow.

Section 2(30) of the Companies Act, 2013 define "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.

However, the instruments referred to in Chapter III-D of the Reserve Bank of India Act, 1934 and such other instrument, as may be prescribed by the Central Government in consultation with the Reserve Bank of India, issued by a company, shall not be treated as debenture.

Thus, 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.

Types of Debentures



Security

- (a) **Secured Debentures** refer to those debentures where a charge is created on the assets of the company for the purpose of payment in case of default. A charge ranking Pari Passu with the first charge on any assets referred to in Schedule III of the Companies Act, 2013 excluding intangible assets of the company. 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.

Condition for Issue of Secured Debenture:

- **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,

- (i) Companies engaged in setting up of infrastructure projects;
- (ii) 'Infrastructure Finance Companies' as defined in clause (viiia) of sub direction (1) of direction 2 of Non-Banking Financial (Non-deposit accepting or holding) Companies Prudential Norms (Reserve Bank) Directions, 2007;
- (iii) Infrastructure Debt Fund Non-Banking Financial Companies' as defined in clause (b) of direction 3 of Infrastructure Debt Fund Non-Banking Financial Companies (Reserve Bank) Directions, 2011;
- (iv) 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.

- (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.

Tenure

- (c) **Redeemable Debentures** are those which are payable on the expiry of the specific period (Maximum period 10 years from the date of issue) either in lump sum or in instalments during the life time of the company. Debentures can be redeemed either at par or at premium.
- (d) **Irredeemable Debentures** are also known as Perpetual Debentures because the company does not give any undertaking for the repayment of money borrowed by issuing such debentures. These debentures are repayable on the winding-up of a company or on the expiry of a long period. They can legally be framed as payable to bearer.

Under the Companies Act, 2013, it is reiterated that in case of Redeemable Debentures the maximum period of redemption is 10 years from the date of issue, except certain specified companies infrastructure companies where the maximum redemption period can be exceeding ten years but not exceeding thirty years.

Mode of Redemption

These debentures are issued by a company on the basis of option provided to them for conversion of debenture in the equity shares of the company after a certain period. It may be classified in the following categories: —

- (e) **Convertible Debenture** These debentures are converted into equity shares of the company on the expiry of a specified period.
- (f) **Non-Convertible Debenture** debentures do not have any option to convert the same into equity shares and are redeemed at the expiry of specified period(s).

A Company can only issue Secured Non-Convertible Debentures (NCD's). In case of issue of NCD's by a Company not constituting a charge on the assets of the Company, it shall be mandatory for listing of the securities on the recognized stock exchange so that same does not come under the purview of deposits. (Rule 2 (1) (c) of Companies (Acceptance of Deposits), Rules, 2014.

- (g) **Partly Convertible Debenture** 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.

Basis of negotiability

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

- (h) **Bearer Debentures** These debentures are payable to bearer of the debentures and transferable by mere delivery. These debentures are also known as unregistered debentures.
- (i) **Registered Debentures** These debentures are not transferable by mere delivery of debenture certificates and shall be transferred as per the provisions of the Companies Act 2013, 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.

Mandatory Requirements

- Debentures cannot be issued with voting rights.
- 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 utilised 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.

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-Convertible Debenture

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 the Companies Act, 2013

Debenture Redemption Reserve

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. The company shall comply with the requirements with regard to Debenture Redemption Reserve (DRR) and investment or deposit of sum in respect of debentures maturing during the year ending on the 31st day of March of next year, in accordance with the conditions given below:-

Quantum of Debenture Redemption Reserve

S. No.	Classes of Company	Condition
1	All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies	No DRR for debentures issued by for both public as well as privately placed debentures
2	Financial Institutions (FIs) within the meaning of clause (72) of section 2 of the Companies Act, 2013	DRR shall be as applicable to NBFCs registered with RBI.
3	For NBFCs registered with the RBI under Section 45-IA of the RBI Act, 1934 and Housing finance companies registered with the National Housing Bank:	
3A	Listed NBFCs and Housing Finance Companies	No DRR required for debentures issued for both public as well as privately placed debentures
3B	Unlisted NBFCs and Housing Finance Companies	No DRR is required in case of privately placed Debentures
4A	Listed Companies	No DRR required for debentures issued for both public as well as privately placed debentures
4B	Unlisted companies	Adequacy of DRR shall be 10% of the value of outstanding debentures.

Method of investment in Debenture Redemption Reserve:

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:

- (i) in deposits with any scheduled bank, free ;
- (ii) in unencumbered securities of the Central methods of deposits or from any charge or lien; Government or any State Government;
- (iii) in unencumbered securities mentioned in sub-clauses (a) to (d) and (ee) of section 20 of the Indian Trusts Act, 1882;

- (iv) in unencumbered bonds issued by any other company which is notified under sub-clause (f) of section 20 of the Indian Trusts Act, 1882;

Provided that the amount remaining invested or deposited, as the case may be, shall not any time fall below fifteen percent. of the amount of the debentures maturing during the year ending on 31st day of March of that year.

The amount invested or deposited as above shall not be used for any purpose other than for redemption of debentures maturing during the year referred above.

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.

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.

Appointment of Debentures 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.

Charge/Mortgage in favour of Debenture Trustee

- The security for the debentures by way of a charge or mortgage shall be created in favour of the debenture trustee on:-
 - (i) any specific movable property of the company or its holding company or subsidiaries or associate companies or otherwise.
 - (ii) any specific immovable property wherever situate, or any interest therein.

However, in case of a non-banking financial company, the charge or mortgage under sub-clause (i) may be created on any movable property.

Further that in case of any issue of debentures by a Government company which is fully secured by the guarantee given by the Central Government or one or more State Government or by both, the requirement for creation of charge shall not apply.

In case of any loan taken by a subsidiary company from any bank or financial institution the charge or mortgage may also be created on the properties or assets of the holding company.

Conditions for Appointment of Debenture Trustee

- The company shall appoint debenture trustees under Section 71(5) of the Companies Act, 2013, after obeying with the following conditions, namely:-

- (a) The names of the debenture trustees shall be stated in letter of offer inviting subscription for debentures and also in all the subsequent notices or other communications sent to the debenture holders;
- (b) Before the appointment of Debenture Trustee or trustees, a written consent shall be obtained from such debenture trustee or trustees proposed to be appointed and a statement to that effect shall appear in the letter of offer issued for inviting the subscription of the debentures;
- (c) A person shall not be appointed as a debenture trustee, if he:
- ✓ beneficially holds shares in the company;
 - ✓ 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 moneys which are to be paid by the company otherwise than as remuneration payable to the debenture trustee;
 - ✓ 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;
 - ✓ 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.
- (d) The Board of directors may fill any casual vacancy in the office of the trustee but while any such vacancy continues, the remaining trustee or trustees, if any, may act.
- However, where such vacancy is caused by the resignation of the debenture trustee, the vacancy shall only be filled with the written consent of the majority of the debenture holders.
- (e) 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

- It shall be the duty of every debenture trustee to-
 - (a) 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;

- (b) satisfy himself that the covenants in the trust deed are not prejudicial to the interest of the debenture holders;
- (c) call for periodical status or performance reports from the company;
- (d) 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;
- (e) appoint a nominee director on the Board of the company in the event of-
 - ✓ two consecutive defaults in payment of interest to the debenture holders; or
 - ✓ default in creation of security for debentures; or
 - ✓ default in redemption of debentures
- (f) 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;
- (g) inform the debenture holders immediately of any breach of the terms of issue of debentures or covenants of the trust deed;
- (h) ensure the implementation of the conditions regarding creation of security for the debentures, if any, and debenture redemption reserve;
- (i) 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;
- (j) do such acts as are necessary in the event the security becomes enforceable;
- (k) call for reports on the utilization of funds raised by the issue of debentures;
- (l) take steps to convene a meeting of the holders of debentures as and when such meeting is required to be held;
- (m) ensure that the debentures have been converted or redeemed in accordance with the terms of the issue of debentures;
- (n) perform such acts as are necessary for the protection of the interest of the debenture holders and do all other acts as are necessary in order to resolve the grievances of the debenture holders.

Liability of Debenture Trustee

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.

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 3/4th in value of the total debentures at a meeting held for the purpose.

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.

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.

Meetings of Debenture Holders by Debenture Trustee

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

- (a) requisition in writing signed by debenture holders holding at least one-tenth in value of the debentures for the time being outstanding;
- (b) 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.

Debenture Trust Deed

Debenture Trust deed is a written instrument legally conveying property to a trustee often for the purpose of securing a loan or mortgage. It is the document creating and setting out the terms of a trust. It will usually contain the names of the trustees, the identity of the beneficiaries and the nature of the trust property, as well as the powers and duties of the trustees. It constitutes trustees charged with the duty of looking after the rights and interests of the debenture holders.

A trust deed in Form No. SH. 12 or as near thereto as possible shall be executed by the company issuing debentures in favour of the debenture trustees within three months of closure of the issue or offer.

A trust deed for securing any issue of debentures shall be open for inspection to any member or debenture holder of the company, in the same manner, to the same extent and on the payment of the same fees, as if it were the register of members of the company; and a copy of the trust deed shall be forwarded to any member or debenture holder of the company, at his request, within seven days of the making thereof, on payment of fee.

Non Applicability

Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014 is not applicable

- ✓ on any amount received by a company against issue of commercial paper or any other similar instrument issued in accordance with the guidelines or regulations or notification issued by the Reserve Bank of India. or

- ✓ in case of any offer of foreign currency convertible bonds or foreign currency bonds issued in accordance with the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 or regulations or directions issued by the Reserve Bank of India, the provisions of this rule shall not apply unless otherwise provided in such Scheme or regulations or directions.

Procedure for Issue of Debentures under the Companies Act, 2013

S. No.	Particulars	Time frame
1.	Obtain a valuation report from the registered valuer with respect to the Convertible Debentures to be issued. <i>In case of Non-Convertible Debenture, there is no dilution of share-holding in the share capital of the company, valuation of securities and justification of price are not applicable.</i>	
2.	Hold a meeting of Board: (i) To consider and approve issue of Debentures including the terms and conditions of issue. (ii) To identify the group of persons to whom debentures are proposed to be offered. (iii) To approve the offer letter (iv) To fix day, date and time and agenda for General Meeting for passing Special Resolution (v) To approve draft notice of General Meeting	
3.	In case of a Public Company, a copy of Board Resolution for issue of debentures with ROC is required to be filed by the company	File E-Form MGT-14 within 30 days of passing of Board Resolution
4.	Convene and hold Extra-Ordinary General Meeting to consider and approve the following items: – (i) Increase in the Borrowing power of the Board of Directors by passing Special Resolution, in case it exceeds the limit, in terms of Section 180(1)(c) (ii) Issue of Debentures	File E-Form MGT-14 along with explanatory statement within 30 days of passing of Special Resolution.
5.	Open a separate Bank Account in a scheduled bank for keeping monies received on the application.	

6.	Prepare the list of such persons to whom offer to subscribe debenture will be given in draft offer letter under PAS-4 .	
7.	Offer letter shall be accompanied by an application form serially numbered and addressed specifically to the person to whom the offer is made.	
8.	Dispatch of Letter of Offer to identified persons.	
9.	Maintain a complete record of persons to whom offer letter is sent in Form PAS-5 .	
10.	Receiving of Application Money through cheque or demand draft or other banking channel and not by cash. Keep the record of the bank account from where such payments for subscriptions have been received.	
11.	Convene Board meeting within a period of 60 days from the date of receipt of subscription money: <ul style="list-style-type: none"> a. to consider the allotment of Debentures b. Approval of draft agreement for Charge creation & authorizing the director for signing the same, if applicable. c. Approval of the draft of Debenture Trust Deed [SH-12], if applicable. d. Issue of Debentures Certificate and authorize two directors and a person to sign the same. 	Filing of CHG-9 within 30 days from the date of creation of charge in case of Secured Debenture. Filing Return of Allotment in PAS-3 within 15 days of allotment.
12.	Make necessary entries in the Register of Debenture holders in Form MGT-2 Make necessary entries in the Register of Charges in Form CHG-7; if applicable	<ul style="list-style-type: none"> • within 7 days of the Board Meeting in which allotment of debentures was approved • forthwith after the registration of creation of charge

13.	Issue of Debenture Certificate	Within 6 months from date of allotment of debentures
14.	Stamp Duty settlement as per provisions & rates of Stamp Act.	

Note : Board resolution under clause (c) of subsection (3) of section 179 would be adequate, in case of offer or invitation for non-convertible debentures, where the proposed amount to be raised through such offer or invitation does not exceed the limit as specified in clause (c) of Section 180(1).

Further, in case of offer or invitation for non-convertible debentures, where the proposed amount to be raised through such offer or invitation exceeds the limit as specified in clause (c) of sub-section (1) of section 180, it shall be sufficient if the company passes a previous special resolution only once in a year for all the offers or invitations for such debentures during the year.
