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**BORROWINGS**



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***Giving Wings to Corporates!***

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**PROFESSIONAL LIFE - ENDLESS POSSIBILITIES WITH  
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# CORPORATE BORROWINGS

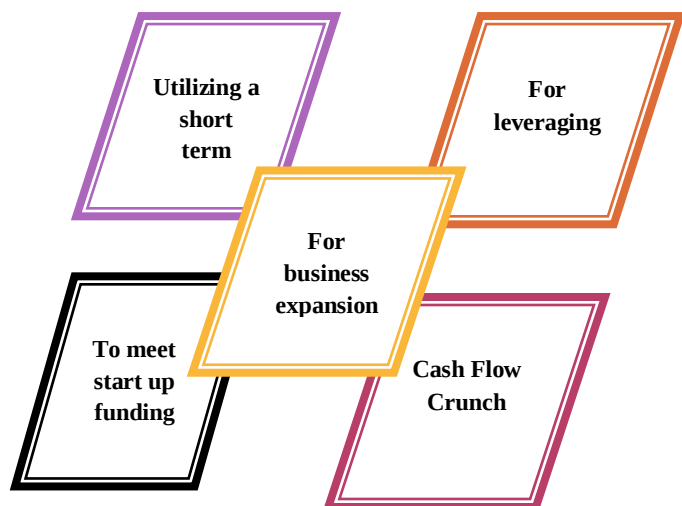
Debt is as old as economy. The anthropologist David Graeber argues in “*Debt: The First 5000 Years*” that trade starts with some sort of credit namely the promise to pay later for already handed over goods. Therefore credit and debt existed even before coins.

A debt is an obligation owed by one party (the debtor) to a second party, the creditor; usually this refers to assets granted by the creditor to the debtor. A debt is created when a creditor agrees to lend a sum of assets to a debtor. In finance, debt is a means of using anticipated future purchasing power in the present before it has actually been earned.

Debt allows people and organizations to do things that they would otherwise not be able, or allowed, to do.

Business borrow money for several reasons. A young business may borrow, when revenue is light or non-existent, to fund development or for sales and marketing. A mature business may need funds for various reasons such as to meet cash flow needs, expand operations or make an acquisition.

Some of the common reasons why corporates borrow are:



Coming to the regulatory framework, we are all aware that all companies registered under the Companies Act, 1956 are regulated by the said Act and any transaction to be undertaken by a company must be in compliance with the provisions of the Companies Act and the rules made there under. So is the case of borrowings. Borrowings are permitted both from domestic as well as foreign sources. In case of borrowings from foreign sources, Companies additionally need to comply with the requirements of the Foreign Exchange Management Act, 1999 and other rules and conditions stipulated by the Reserve Bank of India. We shall first focus on the provisions under the Companies Act, 1956.

To understand the provisions relating to borrowings under the Companies Act, borrowings can be categorized under three broad heads. These are –

**A. DEPOSITS      B. LOANS      C. DEBENTURES**

## ➤ DEPOSITS

Public deposits are an important and popular source of raising funds by companies. The term 'public deposit' implies any money received by a company from the public in the form of deposit or loan but excludes the money received in the form of shares and debentures and any amount specifically exempt in this regard. Public includes

general public, directors, employees and shareholders of the company. In India, this method of raising finance has gained a lot of importance because of the several advantages relating to public deposits:-

It is an easier method of gathering funds, especially during periods of credit pinch.

The administrative cost of deposits for the company is lower than that involved in the issue of shares and debentures. The procedure of inviting public deposits is also simpler and involves lesser formalities.

The rate of interest payable by the company on public deposits is lower than the interest on loans from banks and other financial institutions.

It helps the company to borrow funds from a larger segment of public and thus reduces the dependence of the company upon financial institutions.

It also enables the company to create contact with a large number of investors.

It ensures the availability of funds for a longer duration and provides flexibility to the financial structure of the company. There is no risk of over-capitalization and the deposits can be repaid when they are not required.

There is no dilution of shareholders' control as the depositors have no voting rights and cannot interfere with the internal management of the company.

Provisions relating to invitation, acceptance, renewal and repayment of deposits by companies are contained in Section 58A of the Companies Act, 1956. No company can invite and accept deposits except in the manner and subject to conditions prescribed by the Central Government in consultation with the Reserve Bank of India.

## MEANING OF THE TERM “DEPOSIT”

*“Deposit” means any deposit of money with, and includes any amount borrowed by, a company but shall not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India.*

**Companies (Acceptance of Deposits) Rules, 1975 defines the term deposit to mean - “deposit” means any deposit of money with, and includes any amount borrowed by, a company, but does not include .....**

The definition given above has three limbs: *first*, deposit must be in the form of money; *second*, any amount borrowed by a company will amount to deposit; and *third*, those categories of amounts received by a company which have been excluded by rules prescribed by the Central Government will not be regarded 'deposits' for the purposes of this section.

Deposits assume importance for the reason that in case of private companies, as per section 3(1)(iii)(d) of the Companies Act, 1956 a Private Limited Company is prohibited from inviting or accepting deposits from persons other than its members, directors or their relatives and in case of public companies, the companies which propose to accept deposits, need to comply with the requirements stipulated under Section 58A and the rules made there under [Companies (Acceptance of Deposits) Rules, 1975] before acceptance of such deposits.

## EXEMPTION TO DEPOSIT

Following receipts of money by a company are exempted from being treated as deposits by virtue of the exemption specified under the Companies (Acceptance of Deposits) Rules, 1975:

- **Government** - Any amount received from the Central or State Government or from a local authority or any amount received from any other source repayment of which is guaranteed by the Central or State Government.
- **Foreign Sources** - Any amount received from a foreign government or any other foreign citizen, authority or person.
- **Banks** - Any amount received as loan from any banking company or SBI or any of its subsidiaries or any Banking Institution.
- **Public financial institutions** - Any amount received as loan from a notified Public Financial Institution.
- **Inter-Corporate Loans** - Any amount received from any other company.
- **Security Deposit from Employees** - Any amount received from an employee of the company by way of security deposit.
- **Security Deposit or advance from vendors/suppliers** - Any amount received by way of security or advance from purchasing or selling agents for the purpose of business of the company.
- **Subscription money and calls in advance** - Any amount received by way of subscription to any shares, stock, bonds or debentures which is pending allotment or any calls received in advance which is not repayable.
- **Any amount received in trust or in transit**
- **Directors, their relatives and members** - Any amount received from directors, their relatives and members in case of private companies and from directors in case of public companies.
- **Secured or Convertible debentures/bonds** - Any amount raised by the issue of bonds or debentures secured by the mortgage of any tangible fixed assets of the company or with an option to convert them into shares provided the value of debentures/bonds shall not exceed market value of the asset mortgaged.
- **Unsecured loans from promoters** - Any amount brought in by promoters and/or by their relatives as unsecured loan to meet out their obligation to contribute such finance, stipulated by the financial institution from which company has borrowed money. Exemption is available only till loan is repaid.

## CONDITIONS AND PROCEDURE FOR INVITATION AND ACCEPTANCE OF DEPOSITS

### ▪ Pre-requisites for accepting/inviting deposits –

1. Following types of deposits are prohibited:
  - a. Repayable on demand or notice
  - b. Repayable within 6 months or after 36 months of acceptance
  - c. Exemption is available subject to conditions.
2. Companies to have net owned fund of at least One Crore rupees to accept public deposits.
3. Restrictions on interest rate and brokerage are applicable for acceptance of deposits.
4. Companies which are in default in repayment of any deposit or interest thereon are not eligible to accept deposits.



### ▪ Limits for accepting deposits –

1. In case of non-government companies, aggregate deposits not to exceed -
  - a. 10% of the paid up capital and free reserves in case of deposits against unsecured debentures or deposits accepted from shareholders by a public company or any deposit guaranteed by the directors of the company.
  - b. 25% of the paid up capital and free reserves in case of deposits not covered under point 1 above.
2. In case of government companies, aggregate deposits not to exceed 35% of the paid up capital and free reserves.

### ▪ Form and Particulars of Advertisement –

1. Every company which seeks to **INVITE** public deposits must issue an advertisement in a leading English newspaper and one in Vernacular newspaper circulating in the State in which registered office of the company is situated.
2. Advertisement must be issued under the authority and in the name of the board of directors of the company and must contain the conditions for acceptance of deposits and the date on which text of the advertisement was approved by the Board.
3. Advertisement must contain the summarized financial position of the company as per last two audited balance sheets and other information as specified in the Rules.
4. Advertisement is valid only till expiry of 6 months from closure of financial year or by the time AGM for that year is held, whichever is earlier.
5. Before issue of advertisement, a copy of same must be filed with the Registrar, signed by majority of the directors on Board of the company.

### ▪ Statement in lieu of Advertisement –

1. Companies which intend to **ACCEPT DEPOSITS WITHOUT INVITING** them are required to file a statement in lieu of advertisement to the Registrar before accepting such deposits.
2. In the matter of content, validity period and signature, same rules as are applicable to advertisement shall be applicable to such statement also.

### ▪ Form of application for deposit and receipt of deposit –

1. Companies to issue application forms for accepting deposits containing all details as stipulated before and updated till the date of issuance of form.
2. Depositors to make application to company in the form specified above along with a declaration that the money to be deposited by them has not been borrowed from other people.
3. Company to furnish receipt of deposit to the depositor containing such details as has been specified in the Rules.

### ▪ Maintenance of liquid assets –

1. Before 30<sup>th</sup> of April every year, every company which has accepted deposits shall deposit or invest at least 15% of the amount of deposits maturing by 31<sup>st</sup> of March of that year in current or other deposits of any scheduled bank or unencumbered securities of the Central/State Government, or unencumbered securities mentioned under Indian Trusts Act or unencumbered bonds issued by HDFC.
2. The amount so deposited shall be utilized only for the purpose of repayment of deposits maturing during the year.
3. The amount remaining deposited / invested shall not at any time during the year fall below 10% of the amount of deposit maturing by 31<sup>st</sup> of March that year.

### ▪ Register of Deposits –

Every company accepting deposits must maintain a register of deposits at its registered office and make separate entries for each depositor. Register needs to be maintained for at least eight years in good condition.

## Return of Deposits –

Every company to which the Rules apply, shall on or before the 30th day of June, of every year, file with the Registrar, a return in the form prescribed under the rules and furnishing the information contained therein as on the 31st day of March of that year duly certified by the Auditor of the Company. A copy of the return shall also be simultaneously furnished to the Reserve Bank of India.

## Penalty –

If a company or any other person contravenes any provision of these rules, the company and every officer of the company who is in default or such other person shall be punishable with fine which may extend to five hundred rupees and where the contravention is a continuing one, with a further fine which may extend to fifty rupees for every day after the first, during which the contravention continues.

## LOANS

Loans are the most popular form of borrowings by corporates to cater different kinds of business needs. Companies Act permits borrowings in the form of loans, both secured and unsecured subject to the compliance of provisions stipulated therein.

A company uses various kinds of loans to finance its operations like cash credit, working capital loans, term loans, equipment finance loan etc. These various modes of financing can generally be categorized into:

- 1) Secured and unsecured loans,
- 2) Private and public loans,
- 3) Syndicated and bilateral Loans,
- 4) Other types of loans that display one or more of the characteristics noted above

A debt obligation is considered secured, if creditors have recourse to the assets of the company given as security to procure the loan on a proprietary basis or otherwise ahead of general claims against the company. Unsecured debt comprises financial obligations, where creditors do not have recourse to the assets of the borrower to satisfy their claims.

Private loans refer to loans obtained from director, members relatives etc. i.e. from internal sources whereas loans from any outside party like banks, financial institutions etc. are deemed to be public loans.

A syndicated loan is a loan that is granted to companies that wish to borrow more money than any single lender is prepared to risk in a single loan, usually many crores of rupees. In such a case, a syndicate of banks can each agree to put forward a portion of the principal sum. Loan syndication is a risk management tool that allows the lead banks underwriting the debt to reduce their risk and free up lending capacity. A Bilateral Loan is a kind of loan that involves a single borrower and a single lender.



## Under Standing Some Common Terms Associated With Corporate Borrowings



### Agreement

A loan agreement or 'facilities agreement' is a contract which regulates the terms of a loan.



### Collateral

Collateral is a security or guarantee (usually of an asset) that is pledged to cover the repayment of the loan if the borrower fails to meet the terms of the loan.



### Covenants

A loan covenant is a condition that a borrower must comply with in order to adhere to the terms of the loan.



### Interest Rate

This is the specified percentage that will be charged by the lender as payment for use of the funds issued.



### Personal Guarantee

Banks insist on the personal guarantee of the directors or promoters to additionally safeguard the loan even though the loan is taken for the business purpose of the company.



### Representations

These are statements of fact or declarations made by the lender within the loan document.



### Repayment Schedule

Refers to the period or frequency of repayment. The required repayment schedule may dictate monthly, quarterly, or lump sum payment.



### Restrictions

The lender may also place additional restrictions on the total debt a business agrees to incur, the amount of dividends or other payments to owners and/or principal investors capital expenditures, the sale of fixed assets.

## RELEVANT PROVISIONS OF COMPANIES ACT RELATING TO LOANS

### Section 292 – Certain powers to be exercised by Board only at meeting



Section 292 requires that the power to borrow money otherwise than on debentures and the power to issue debentures shall be exercised by the Board of Directors, on behalf of the company, only by means of a resolution passed at a meeting of the Board of Directors. In other words the same cannot be done through passing of a circular resolution.

The Section further provides that the Board may delegate the power to borrow money otherwise than on debentures to any committee of Directors, Managing Director, Manager or any other Principal Officer by passing a resolution to this effect and also specifying in the resolution the total amount up to which money may be borrowed

by the delegate. This section is applicable to both private and public companies.

### Section 293 – Restrictions on powers of Board

Section 293 imposes certain restrictions on the powers of the Board of Directors of a public company or a private company which is a subsidiary of a public company.

As per sub-section 1 of Section 293, a public company or a private company which is a subsidiary of a public company must obtain the approval of its share holders in a duly convened general meeting before -

Clause (a) – Selling, leasing or otherwise disposing of whole or substantially the whole of undertaking of the company, and

Clause (d) - Borrowing any money which, including the money already borrowed, is in excess of the paid up capital and free reserves of the company. The resolution must specify the total amount up to which money may be borrowed by the Board of Directors on behalf of the company.

### PROVISIONS RELATING TO CHARGES

Part V consisting of Sections 124 to 145 of the Companies Act, 1956 deals with registration of charges by companies.

### MEANING OF CHARGE

The word Charge is not defined in the Companies Act. Section 124 merely states that the expression 'charge' includes mortgage. For the applicability of section 124 - 145, charge would include a mortgage but shall exclude a pledge.

- Charges include *lien* as well as an equitable charge
- This section would apply to both Indian and Foreign companies.

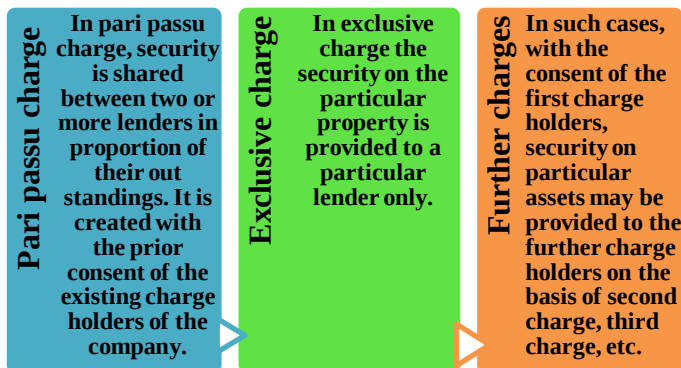
However, the language of section 125 uses the expression "*so far as any security on the company's property or undertaking is conferred thereby*" which makes it clear that **a charge is nothing but security of its property by the company in favour of a creditor with the intent of securing his debt.**



### NATURE AND TYPES OF CHARGES

1. **Fixed Charges:** In a fixed charge a company creating a charge can deal with the property only subject to charge. The identification of the charge does not change during the period for which the charge is created.
2. **Floating Charge:** In floating charge, Identification of the charge goes on changing and the final identification is at the time when the charge gets crystallized.

These charges may be created in favour of the charge holders as per terms and conditions agreed by them, like:-



### REGISTRATION OF CHARGES

Section 125 states that certain charges shall be void against the creditors and liquidators, unless they are registered with the Registrar of Companies. In respect of such charges registration becomes compulsory.

|                                                                                                               |                                                                                                                       |
|---------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------|
| <b>SECTION 125<br/>ENUMERATES THE<br/>KINDS OF CHARGES<br/>WHICH REQUIRE<br/>REGISTRATION.<br/>THESE ARE:</b> | (a) a charge for the purpose of securing any issue of debentures                                                      |
|                                                                                                               | (b) a charge on uncalled share capital of the company;                                                                |
|                                                                                                               | (c) a charge on any immovable property, wherever situated, or any interest therein;                                   |
|                                                                                                               | (d) a charge on any book debts of the company;                                                                        |
|                                                                                                               | (e) a charge, not being a pledge, on any movable property of the Company;                                             |
|                                                                                                               | (f) a floating charge on the undertaking or any property of the company including stock in trade;                     |
|                                                                                                               | (g) a charge on calls made but not paid;                                                                              |
|                                                                                                               | (h) a charge on a ship or any share in a ship;                                                                        |
|                                                                                                               | (i) a charge on goodwill, on a patent or license, on a trade mark, or on a copy right or a license under a copyright. |

The registration of a charge is intended to give notice to people who may not otherwise be aware of it, particularly to persons who may advance money to the company, and it may also serve the purpose of preventing a fraudulent and belated claim of a charge in the event of liquidation.



### CONSEQUENCES OF NON-REGISTRATION:

Non-Registration -

- ❖ Does not prejudice any contract or obligation for payment of money secured by the charge.
- ❖ Where the charge becomes void for registration, the debt secured becomes immediately payable.
- ❖ On a charge becoming void, no right of lien can be claimed on the documents of title.

The transaction does not become void or debt does not become irrecoverable but the security created by the charge or mortgage becomes void against liquidator and creditors.

## **PROCEDURES INVOLVED IN REGISTRATON OF CHARGES**

### **➤ Procedure For Registration Of Particulars Of Fresh Charges**

- 1) If the charge falls under any of the categories mentioned hereinabove, then the particulars of the charge need to be filed with the concerned Registrar of Companies within thirty days after date of creation of charge in e-Form No. 8 alongwith a certified true copy of the instrument or deed by which the charges are created or evidenced
- 2) If, due to unavoidable circumstances, the particulars of charge are not filed with the Registrar within 30 days, the Registrar may accept the particulars for registration during next 30 days with payment of additional fee for delayed filing of the particulars of charge after being satisfied for the reasons of delay.
- 3) In case the charge is not registered within the additional 30 days also, the company will have to approach the Regional Director for condonation of delay in registering particulars of creation of charge.
- 4) E-form 8 needs to be digitally signed by both the borrower and lender and also certified by a professional (CA/CS/CWA). Same is processed under Straight Through Process (STP) mode by the Registrar.
- 5) The charge is complete as and when particulars are filed with the Registrar and upon obtaining the certificate of registration the formalities are complete. The certificate is conclusive evidence that the Registrar has entered the particulars in the Register as required to be kept under the Act.
- 6) The particulars of charge created shall be entered in a Register of Charges maintained by the company indicating the particulars of the charge so created. The number and date of the certificate granted by the Registrar will also be entered in the Register.
- 7) Copy of the instrument creating the charge shall be kept at the registered office.
- 8) The details of charges registered for a company are available on the website of Ministry of Corporate Affairs for public viewing.

### **➤ Procedure For Modification Of Existing Charges**

- 1) Whenever any term or condition or the extent or operation of any charge registered by the company under section 125 is modified, then, particulars of such modification are also required to be registered with the concerned Registrar of Companies. It is to be noted that assignment of rights by the charge holder is also regarded as a modification of charge.
- 2) Any modification that is effected as a result of change of law is also required to be registered.
- 3) Modification of charge is effected by an agreement or letter containing particulars of modification. The normal modifications are:
  - a. Variation in the amount of charge
  - b. Variation in the rate of interest
  - c. Extension of the time of repayment.
  - d. New charge to rank pari passu with the existing charge
  - e. Assignment of charge in favour of another person.

- 4) The particulars of the modification of charge shall be approved at a meeting of the Board of Directors of the company and thereafter, the document, if any, shall be executed.
- 5) Particulars of modifications of charge shall be filed, with the concerned Registrar of companies in e-Form no 8 along with the following a certified true copy of the agreement or other instrument modifying the existing charges registered with the Registrar of Companies.
- 9) E-form 8 needs to be digitally signed by both the borrower and lender and also certified by a professional (CA/CS/CWA). Same is processed under Straight Through Process (STP) mode by the Registrar.
- 6) As the time-limit for filing particulars of modification of charge is the same as for the original charge, e-form 8 needs to be filed within thirty days of modification. If due to unavoidable circumstances, the particulars of modification of charge are not filed with the Registrar for registration then file within next thirty days after the expiry of first thirty days with payment of additional fee for delayed filing of the particulars of charge after satisfying the Registrar of Companies the reasons for delay. In case the modification is not registered within the additional 30 days also, the company will have to approach the Regional Director for condonation of delay in registering particulars of modification of charge.
- 7) Necessary entries to be made in the Register of Charges maintained by the company to reflect the modification.
- 8) A copy of the agreement shall be maintained at the company's registered office.

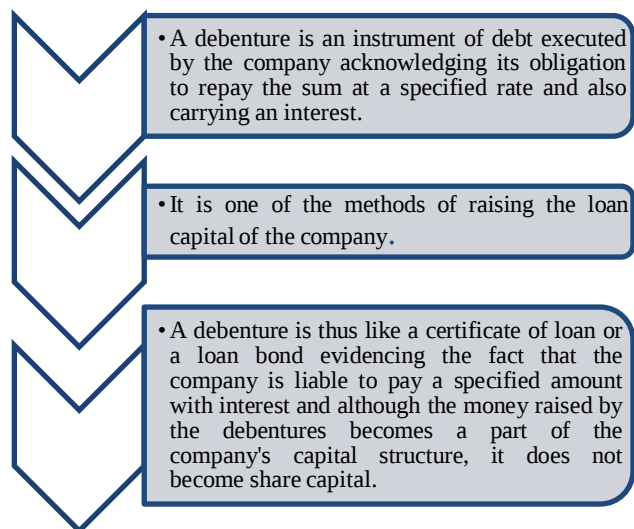
### **➤ Procedure For Filing Satisfaction Of Charges**

1. In accordance with section 138, when a charge, the particulars of which are registered with the Registrar, is satisfied in full, particulars thereof should be filed with the Registrar. Part satisfaction does not attract this section but shall be registered as modification of charge under section 135.
2. When the company has repaid the amount in full for which the charge was created a letter confirming satisfaction from the party in whose favour the charge was created needs to be obtained. In some cases a deed of release (e.g. in the case of mortgage) is executed in which case, a certified copy of the said deed may be sent to the Registrar.
3. Particulars of satisfaction of charge are filed in e-Form No 17 of the Companies (Central Government) General Rules and Forms, 1956, along with the instrument evidencing satisfaction of charge, digitally signed by the borrower and certified by a professional.
4. The particulars must be filed by the company.
5. The form should be filed within 30 days of satisfaction. Otherwise, the company will have to approach the Regional Director for condonation of delay in filing particulars of satisfaction of charge.
6. In case where banks are involved the period of 30 days will be counted from the date of issue of the bank's letter intimating the companies about the satisfaction of charges.
7. The Registrar will issue a memorandum of satisfaction of charge which is the evidence of the fact the satisfaction of charge has been taken or record by the Registrar.
8. Suitable entry shall be made in the register of charges maintained by the company against the concerned charge.

## ➤ DEBENTURES/BONDS

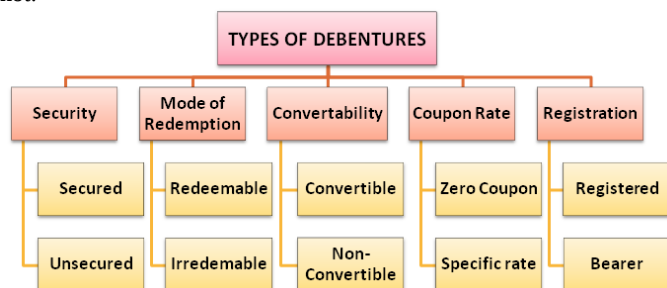
### Meaning of Debentures

The word debenture has been derived from the latin word “debere” which means to borrow. Debenture is a written instrument acknowledging a debt under the common seal of the company.



### Definition Under Companies Act, 1956

Debentures have been defined under Section 2 (12) of the Act to include debenture stocks, bonds and any other securities of the company whether constituting a charge on the company's assets or not.



### ADVANTAGES

Control of company is not surrendered to debenture holders because they do not have any voting rights.

Trading on equity is possible as debenture holders get a lower rate of return than the earnings of the company.

Interest on debenture is an allowable expenditure under Income Tax Act, 1961 hence incidence of tax on the company is decreased.

Debenture can be redeemed when company has surplus funds.

### DISADVANTAGES

Cost of raising capital through debentures is high of high stamps duty.

Common people cannot buy debenture as they are of high denominations.

They are not suitable for companies earning greater than the rate of interest which they are paying on the debentures.

### PROVISIONS RELATING TO DEBENTURES UNDER COMPANIES ACT

⇒ The power to issue debentures can be exercised on behalf of the company at a meeting of the Board of Directors {**Section 292(1)(b)** of the Companies Act}

⇒ A public company may, however, require the approval of shareholders to borrow money in excess of the aggregate of its paid up capital and free reserves. {**Section 293 (1) (d)**}

⇒ **Section 372 A** of the Companies Act also regulates inter-corporate loan and investments and stipulates the ceiling limits on investments and the amount of loan that can be borrowed by a company. The explanation clause of this section states that the loan shall include debentures.

⇒ **Section 117 to Sections 123** of the Companies Act, 1956 regulate the provisions relating to debentures, appointment of debenture trustees, their duties, creation of Debenture Redemption Reserve Account, liability of trustees etc.

⇒ As per **Section 125 (4)** of the Companies Act, registration of a charge for purpose of issue of debentures is mandatory.

⇒ **Section 128** stipulates that where a company issues series of debentures which is secured by charge, benefit of which will be available to all debenture holders pari passu, the company shall file the prescribed particulars in Form 10 with the Registrar of Companies for registration of charge. These forms shall be filed within 30 days after the execution of the deed.

⇒ **Section 205C** stipulates that matured debentures and interest accrued on matured debentures remaining unpaid / unclaimed for a period of seven years with companies from the date they became due for payment shall be credited to Investor Education and Protection Fund.

⇒ The relevant sections of the companies act 1956 dealing with the procedure for the issue of debentures are 56(3), 60, 64, 67, 70-74, 108-113, 117-123, 128-129, 133-134, 143, 152-154, 292 and 293.

⇒ Debentures are issued in accordance with the provisions of the articles, usually by a resolution of the board of directors.

⇒ Debentures may be issued at par, at a premium, or at a discount if permitted by the articles of the company. Debentures unlike shares may be issued at a discount without any restriction. The reason is that they do not form part of the capital of the company.

⇒ Particulars of any commission, discount or allowance paid either directly or indirectly to any person for his subscribing or procuring subscription for debentures of the company must be filed with the registrar.

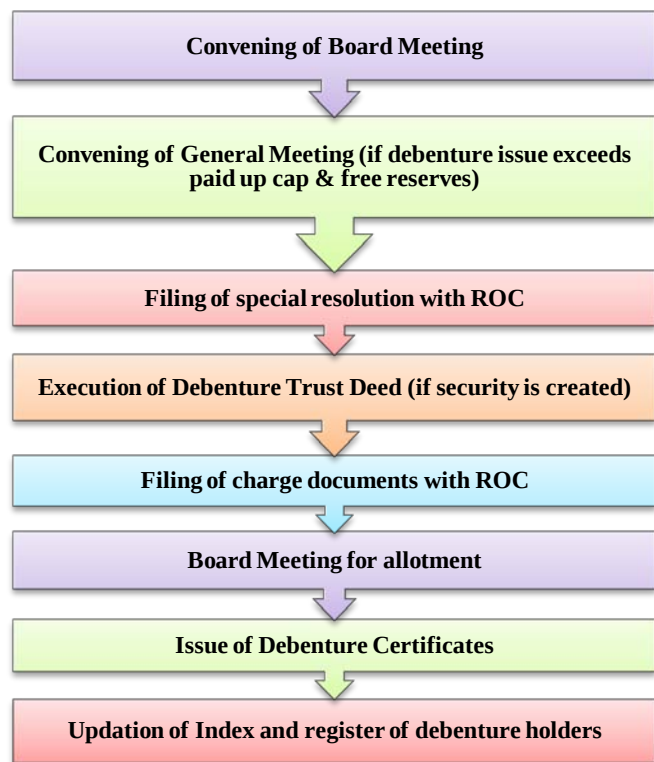
⇒ Debentures may be redeemable at par or at premium but their redemption at a discount is not permitted.

⇒ **Section 117** provides that no company shall, after the

commencement of the act issue debentures carrying voting rights at any meeting of the company.

⇒ The legal provisions as to prospectus, allotment, issue of certificates etc. applicable to shares also apply to debentures, but the condition of minimum subscription is not applicable to the issue of debentures.

#### PROCEDURE RELATING TO ISSUE OF DEBENTURES



#### PROCEDURE IN DETAIL

##### A. CONVENING OF BOARD MEETING:

To consider -

- Issue of debentures - quantum of issue, time and when the issue should be made, nature of debentures, whether the issue should be fully convertible, partly convertible/ non convertible
- Whether such debentures will also carry warrants entitling the holders thereof to apply for equity shares at a predetermined price to be issued by the company within a specified period.
- Rate of interest payable
- Terms of conversion of debentures into equity shares indicating the amount to be converted into equity shares, number of equity shares for debentures at a each stage of conversion and redemption of balance amount, if any and the date of redemption payment.
- Security by way of mortgage or charge on the assets of the company
- Appointment of debenture trustees
- Creation of debenture redemption reserves
- Execution of debenture trust deed
- Agenda of general meeting to secure the consent of shareholders for the debenture issue
- Issue of offer document

##### B. CONVENING OF GENERAL MEETING

To passing the following resolutions:

- Increasing the borrowing powers of the Board under section 293(1)(d) of the Act, 1956 if the existing limit is not

sufficient to accommodate the proposed borrowings

- Authorization to create mortgage under section 293(1)(a) of the Companies Act, for issue of secured debentures
- Permission under section 81(1A) for issue of debentures

##### C. ROC FILING

Form 23 within 30 days of passing the special resolution to be filed with ROC.

##### D. OFFER DOCUMENT -

Shall contain -

- Amount on conversion, time of conversion
- In case of PCD/NCD, redemption amount, period of maturity, yield on redemption of PCD/NCDs
- Full information relating to the terms of offer
- The certificate from a financial institution or bankers about their no objection for a second or pari passu charge being created in favour of the trustees to the proposed debenture issues has been obtained

##### E. UNDERTAKINGS

- That the company shall disclose the complete name and address of the debenture trustee in the annual report.
- That the company shall furnish a confirmation certificate that the security created by the company in favour of the debenture holders is properly maintained.

##### F. ASSETS TO BE CHARGED

The offer document shall specifically state the assets on which security shall be created and shall also state the ranking of the charge.

##### G. EXECUTION OF DEBENTURE TRUST DEED

The trust deed shall be executed by the issuer company in favour of debenture trustee within 3 months of the closure of the issue. It should also be registered under the Indian Registration Act.

##### H. ALLOTMENT OF DEBENTURES

On closure of subscription period and receipt of applications, the basis of allotment should be finalised. The Board resolution should be passed for allotment of debentures.

##### I. ROC FILING

In the event of issue of debentures in series, Form 10 shall be filed with ROC.

##### J. ENDORSEMENT ON DEBENTURE CERTIFICATE

The Registrar will issue the certificate of Registration which shall be endorsed on every debenture certificate

##### K. ISSUE OF DEBENTURE CERTIFICATE

Arrangements should be made for issuing debenture certificate to the allottees within 3 months after the allotment or within the period mentioned in the debenture trust deed. Stamp should be affixed according to the respective state stamp act.

##### L. CREATION OF DEBENTURE REDEMPTION RESERVE

The debenture redemption reserve should be created for redemption of debentures and the company shall credit adequate amount every year from out of its profits until the debentures are fully redeemed.

## PROVISIONS RELATING TO REGISTRATION OF CHARGE IN CONNECTION WITH ISSUE OF DEBENTURES

Section 128 allows registration of certain particulars in case where a company issues a series of debentures and the debenture holders are entitled *pari passu* to the benefit of a charge created for the benefit of debenture holders. The company shall file following particulars with the concerned Registrar of Companies for registration of charge under section 125(4):-

- (1) The total amount secured by the whole series.
- (2) The dates of the resolutions authorising the issue of the series and the date of the covering deed, if any, by which the security is created or defined.
- (3) A general description of the property charged.
- (4) The names of the trustees, if any, for the debenture holders.
- (5) The deed containing the charge or a duly verified copy thereof.
- (6) Particulars as to the amount or rate percent of the commission discount or allowance paid or made in connection with debentures. [Section 129]

### FOLLOWING POINTS ARE IMPORTANT IN THIS ASPECT:-

- (a) Failure to file particulars of such charge with the Registrar of Companies shall not affect the validity of the debentures issued.
- (b) Debentures may itself contain a charge or give a reference as to any other instrument in this regard.
- (c) The particulars of charge as given above shall be filed together with the deed containing the charge, or a copy of the deed verified in the prescribed manner, or if there is no such deed, one of the debentures of the series.
- (d) The company shall file with the Registrar, particulars of the date and amount of each issue of debentures of series, if there is more than one, but failure to file such particulars shall not affect the validity of the debentures issued.
- (e) Debentures must also be registered under the Indian Registration Act.
- (f) Section 133 requires that the company shall cause a copy of every certificate of registration given under section 132, to be endorsed on every debenture or certificate of debenture stock which is issued by the company and the payment of which is secured by the charge so registered.

A company shall not be required to cause a certificate of registration to be endorsed on any debenture or certificate of debenture stock issued by the company, before the charge was created. [Proviso to section 133]

If any person knowingly delivers, or authorises or permits the delivery of any debenture or certificate of debenture stock which is required to be endorsed with a copy of a certificate of registration, as stated above, without the copy being so endorsed upon it, he shall, without prejudice to any other liability, be punishable with fine which may extend to rupees ten thousand.

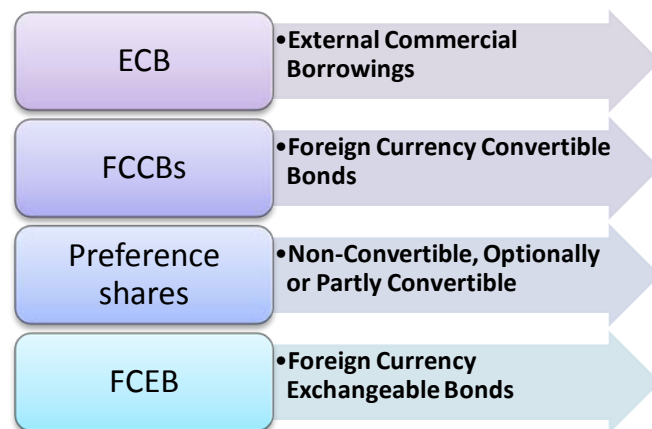
### Prescribed forms

The prescribed e-Form 8 & 10 *vide* Companies (Central Government's) General Rules and Forms (Amendment) Rules, 2006 along with the instruments evidencing the charge shall be filed on line to the MCA/ROC, under the digital signatures of both the

company and the creditor along with the requisite fee.

## BORROWINGS FROM FOREIGN SOURCES

At present, Indian companies are allowed to access funds from abroad in the following methods:



### ➤ External Commercial Borrowings

External Commercial Borrowings (ECB) refer to commercial loans in the form of bank loans, buyers' credit, suppliers' credit, securitized instruments (e.g. floating rate notes and fixed rate bonds, non-convertible, optionally convertible or partially convertible preference shares) availed of from non-resident lenders with a minimum average maturity of 3 years.

ECBs include the following

- Commercial Loans
- Syndicated Loans
- Floating/Fixed Rate Notes and Bonds
- Lines of Credit from Foreign Banks and Financial Institutions
- Import Loans, loans from the export credit agencies of other countries
- Foreign Currency Convertible Bonds (FCCBs) before conversion
- Commercial Loans from multilateral agencies such as International Finance Corporation, Asian Development Bank, Commonwealth Development Corporation, etc.
- Trade Credit including buyer's credit and supplier's credit of a maturity period of three years and above.



### ➤ Foreign Currency Convertible Bonds (FCCBs)

Refers to a bond issued by an Indian company expressed in foreign currency, and the principal and interest in respect of which is payable in foreign currency. These bonds are required to be issued in accordance with the scheme viz., "Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993", and subscribed by a non-resident in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part, on the basis of any equity related warrants attached to debt instruments. The issue of FCCBs is also required to adhere to the provisions of Notification FEMA No. 120/RB-2004 dated July 7, 2004, as amended from time to time.

### ➤ Preference Shares (Non-convertible, partially or optionally convertible)

Funds received for issue of non-convertible, partially or optionally convertible preference shares on or after May 1, 2007 would be considered as debt and should conform to the ECB policy.

### ➤ Foreign Currency Exchangeable Bond (FCEB)

Refers to a bond expressed in foreign currency, the principal and

interest in respect of which is payable in foreign currency, issued by an Issuing Company and subscribed to by a person who is a resident outside India, in foreign currency and exchangeable into equity share of another company, to be called the Offered Company, in any manner, either wholly, or partly or on the basis of any equity related warrants attached to debt instruments. The FCEB must comply with the "Issue of Foreign Currency Exchangeable Bonds (FCEB) Scheme, 2008".

## ROUTES FOR OBTAINING ECB

- **Automatic Route** - ECB for investment in real sector-industrial sector, infrastructure sector-in India, and specified service sectors are under Automatic Route, i.e. do not require Reserve Bank / Government of India approval.
- **Approval Route** – Certain proposals more specifically described later in this write up fall under the approval route. In case of doubt as regards eligibility to access the Automatic Route, applicants may take recourse to the Approval Route.

### Automatic Route

- Corporates, including those in the hotel, hospital, software sectors (registered under the Companies Act, 1956) and Infrastructure Finance Companies (IFCs).
- Units in Special Economic Zones (SEZ) for their own requirement.
- NGOs involved in Micro Finance Activities subject to certain conditions.

- International Banks
- International Capital Markets
- Multilateral Financial Institutions (such as IFC, ADB, CDC, etc.)/regional financial institutions and government owned development financial institutions
- Export Credit Agencies
- Suppliers Of Equipment
- Foreign Collaborators
- Foreign Equity Holders (other than erstwhile overseas corporate bodies (OCBS) subject to paid up capital requirements.

## **A M O U N T & M A T U R I T Y**

- The maximum amount of ECB which can be raised by a corporate other than those in the hotel, hospital and software sectors is USD 750 million or its equivalent during a financial year.
- Corporates in the services sector viz. hotels, hospitals and software sector are allowed to avail of ECB up to USD 200 million or its equivalent in a financial year for meeting foreign currency and/ or Rupee capital expenditure for permissible end-uses. The proceeds of the ECBs should not be used for acquisition of land.
- ECB up to USD 20 million or its equivalent in a financial year with minimum average maturity of three years.
- ECB above USD 20 million or equivalent and up to USD 750 million or its equivalent with a minimum average maturity of five years.
- ECB up to USD 20 million or equivalent can have call/put option provided the minimum average maturity of three years is complied with before exercising call/put option.

## **A L L I N C O S T C E I L I N G S**

- All-in-cost includes rate of interest, other fees and expenses in foreign currency except commitment fee, pre-payment fee, and fees payable in Indian Rupees.
- The payment of withholding tax in Indian Rupees is excluded for calculating the all-in-cost.
- The all-in-cost ceilings for ECB are reviewed from time to time. The following ceilings are valid until reviewed:

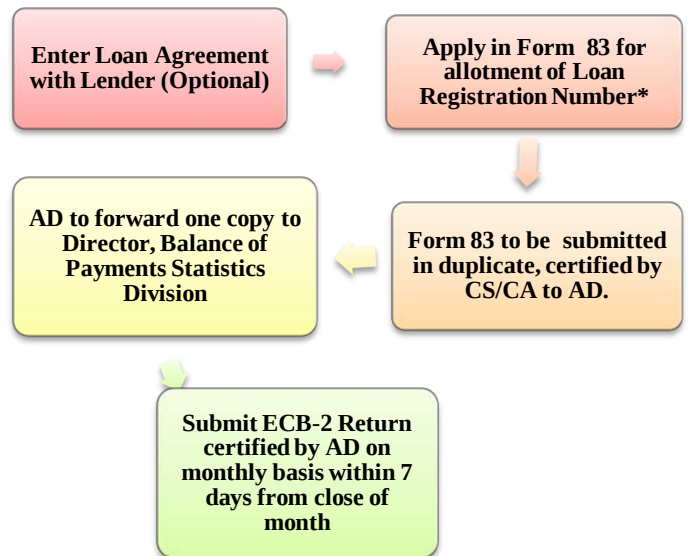
| Average Maturity Period          | All-in-cost Ceilings over 6 month LIBOR* |
|----------------------------------|------------------------------------------|
| Three years and up to five years | 300 basis points                         |
| More than five years             | 500 basis points                         |

- In the case of fixed rate loans, the swap cost plus margin should be the equivalent of the floating rate plus the applicable margin.



PERMITTED USE

- **INVESTMENT (Import of Capital Goods, New Projects, modernization/expansion of existing production Units) in:**
  - real sector - industrial sector
  - small and medium enterprises
  - infrastructure sector
  - specified service sectors namely hotel, hospital, software in India
- ODI in JVs/WOS subject to guidelines on Indian Direct Investment in JV/WOS abroad
- First stage acquisition of shares in the disinvestment process and also in the mandatory second stage offer to the public under the Government's disinvestment programme of PSU shares.
- Lending to self-help groups or for micro-credit or for bonafide micro finance activity including capacity building by NGOs engaged in micro finance activities.
- Payment for Spectrum Allocation.
- NBFCs categorised as Infrastructure Finance Companies are permitted to avail of ECBs, including the outstanding ECBs, up to 50 per cent of their owned funds, for on-lending to the infrastructure sector



\* It is mandatory to obtain LRN before receiving ECB.

OTHER POINTS FOR CONSIDERATION

- ⇒ AD Category - I banks have been delegated powers to convey 'no objection' under the Foreign Exchange Management Act (FEMA), 1999 for creation of charge on immovable assets, financial securities and issue of corporate or personal guarantees in favour of overseas lender / security trustee, to secure the ECB to be raised by the borrower.
- ⇒ The choice of security to be provided to the lender/supplier is left to the borrower.
- ⇒ Borrowers are permitted to either keep ECB proceeds abroad or to remit these funds to India, pending utilization for permissible end-uses.
- ⇒ Prepayment of ECB up to USD 750 million may be allowed by AD banks without prior approval of Reserve Bank subject to compliance with the stipulated minimum average maturity period as applicable to the loan.
- ⇒ The existing ECB may be refinanced by raising a fresh ECB subject to the condition that the fresh ECB is raised at a lower all-in-cost and the outstanding maturity of the original ECB is maintained.
- ⇒ The designated AD bank has the general permission to make remittances of instalments of principal, interest and other charges in conformity with the ECB guidelines issued by Government / Reserve Bank of India from time to time.
- ⇒ The primary responsibility to ensure that ECB raised / utilised are in conformity with the ECB guidelines and the Reserve Bank regulations / directions is that of the borrower concerned and any contravention of the ECB guidelines will be viewed seriously and will invite penal action under FEMA 1999

NON PERMITTED USE

- For on-lending or investment in capital market or acquiring a company (or a part thereof) in India by a corporate [investment in Special Purpose Vehicles (SPVs), Money Market Mutual Funds (MMMFs), etc.,
- for real estate sector,
- for working capital, general corporate purpose and repayment of existing Rupee loans.
- Issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by banks, Financial Institutions and Non-Banking Financial Companies (NBFCs) from India relating to ECB is not permitted

## APPROVAL ROUTE

ELIGIBLE LENDERS

- International Banks
- International Capital Markets
- Multilateral Financial Institutions (such as IFC, ADB, CDC, etc.)/regional financial institutions and government owned development financial institutions
- Export Credit Agencies
- Suppliers Of Equipment
- Foreign Collaborators
- Foreign Equity Holders (other than erstwhile overseas corporate bodies (OCBS) subject to paid up capital requirements.

ELIGIBLE

BORROWERS

- On lending by the EXIM Bank for specific purposes will be considered on a case by case basis.
- Banks and financial institutions which had participated in the textile or steel sector restructuring package as approved by the Government are also permitted to the extent of their investment in the package and assessment by the Reserve Bank based on prudential norms.
- ECB with minimum average maturity of 5 years by Non-Banking Financial Companies (NBFCs) for leasing to infrastructure projects
- IFCs including the outstanding ECBs, beyond 50 per cent of their owned funds, for on-lending to the infrastructure sector subject to conditions
- FCCBs by Housing Finance Companies Subject to conditions.
- SPVs set up to finance infrastructure companies
- Multi-State Co-operative Societies engaged in manufacturing activity
- SEZ developers for providing infrastructure facilities within SEZ
- Corporates in the services sector viz. hotels, hospitals and software sector beyond USD 100 million per financial year.
- Corporates which have violated the extant ECB policy and are under investigation by the Reserve Bank and / or Directorate of Enforcement
- Cases falling outside the purview of the automatic route limits and maturity period

AMOUNT & MATURITY

- Corporates in the services sector viz. hotels, hospitals and software sector are allowed to avail of ECB beyond USD 100 million or its equivalent in a financial year for meeting foreign currency and/ or Rupee capital expenditure for permissible end-uses. The proceeds of the ECBs should not be used for acquisition of land.
- Corporates can avail of ECB of an additional amount of USD 250 million with average maturity of more than 10 years under the approval route, over and above the existing limit of USD 750 million under the automatic route, during a financial year.
- Prepayment and call/put options would not be permissible for such ECB up to a period of 10 years.
- Other ECB criteria, such as end-use, recognized lender, etc., need to be complied with.

Provisions regarding all-in-cost ceilings, permitted and non-permitted end uses and other important points are same as in case of automatic route.

## CONVERSION OF ECB INTO EQUITY

Conversion of ECB into equity is permitted subject to the following conditions:

- The activity of the company is covered under the Automatic Route for Foreign Direct Investment or Government (FIPB) approval for foreign equity participation has been obtained by the company, wherever applicable.
- The foreign equity holding after such conversion of debt into equity is within the sectoral cap, if any,
- Pricing of shares is as per the pricing guidelines issued under FEMA, 1999 in the case of listed/ unlisted companies.

Conversion of ECB may be reported to the Reserve Bank as follows:

- Borrowers are required to report **full conversion of outstanding ECB into equity** in the form FC-GPR to the Regional Office concerned of the Reserve Bank as well as in form ECB-2 submitted to the DSIM, RBI within seven working days from the close of month to which it relates.
- In case of **partial conversion of outstanding ECB into equity**, borrowers are required to report the converted portion in form FC-GPR to the Regional Office concerned as well as in form ECB-2 clearly differentiating the converted portion from the unconverted portion.

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