

B.com Semester II

Subject: Secretarial Practice – II

Unit: Unit 1 Alteration in Share and Debenture [Part 2 Debenture]

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Unit 1 Alteration in Share and Debenture [Part 2 Debenture]

What is Debenture?

A debenture can be described as a debt instrument issued by a company to the public in order to raise funds for medium or long-term usage. It is just like a bank loan, with debt obligation and liability for interest payment, but instead of borrowing from a bank, these are issued and traded in the capital market. A debenture is a legal document that states the amount invested or lent, interest due, and the repayment plan. At the conclusion of the term, the investor receives the principal and interest.

According to Section 2 (12) of the Indian Companies Act 1956, “a debenture is a document which either creates a debt or acknowledges it.”

Generally, debentures are issued with a fixed rate of interest, which is called the Coupon Rate. A debenture holder receives interest according to the coupon rate specified in the debenture certificate.

Types of Debentures

Debentures can be further classified on the following basis:

A. On the basis of Convertibility:

- **Convertible Debentures:** Convertible debentures are debentures that have the ability to be changed into equity capital or any other security after the lapse of a certain period. The owners of the company may choose to do this at their discretion. Such shares give a creditor the privilege of being a secured investor of the company and changing his status to that of a shareholder if the returns are lucrative and the company has a good financial position. These are further classified as:
 1. **Fully Convertible Debentures:** These are converted into equity shares after the lapse of a certain period specified at the time of issue of such debentures.
 2. **Partly Convertible Debentures:** The type of convertible debentures, a part of which are partly converted into equity. The unconvertible part is redeemed after the lapse of a certain period or as specified. A company may offer partly convertible debentures with a buy-back facility as well.
- **Non- Convertible Debentures:** Such debentures do not bear any option to be converted into equity at any point of time in their lifetime and are redeemed fully at the end of a specified period, decided at the time of the issue of such debentures.

B. On the basis of Registration:

- **Bearer Debentures:** Similar to negotiable instruments, these debentures are easily transferrable. They are given to the buyer without any registration document. The

debentures shall vest in and be owned by the person who, in good faith and for compensation, purchases them.

- **Registered Debentures:** To transfer these debentures, a specific process must be performed. A transfer voucher must be signed by the transferor and transferee i.e. both parties involved in the transfer. Along with registration costs, the form is delivered to the business. The purchaser's name is then entered into the register.

C. On the basis of Security:

- **Secured or Mortgaged Debentures:** The company's assets are pledged as security for issuing these debentures. Debenture holders have the right to sell the assets in order to satisfy their claims in the event of a default in the payment of interest or principal. A floating charge over all of the company's assets may be placed on the debentures. Asset sale revenues are first used to settle floating charge debentures.
- **Simple, Naked or Unsecured Debentures:** No security over the company's assets is provided for these debentures. Compared to other creditors, they are not given any preference. When the corporation is being wound up, they receive the same treatment as unsecured creditors. This makes them simple unsecured creditors.

D. On the basis of Coupon Rate:

- **Specific Coupon Rate Debentures:** As the name suggests, such debentures bear a specific rate of interest, which ought to be settled by the company irrespective of profits or losses.
- **Zero-Coupon Rate Debentures:** Such debentures do not carry any interest rate. It is sold by the issuing company to the buyers at a deep discount from its eventual maturity value. The difference between the issue price and the maturity value represents the gain or interest earned by the buyer.

E. On the Basis of Tenure:

- **Redeemable Debentures:** Redeemable debentures are those that must be repaid at the end of a specified period, either all at once or in installments, either at a premium or at face value, during the lifetime of the entity.
- **Irredeemable Debentures:** Such debentures are not redeemed or paid back during the company's existence. Such redemption may be possible in the event that the company is wound up.
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Procedure for Issue of Debentures by a Company

Step 1: Call for a Board Meeting

Call and hold a Board meeting to determine which sorts of debentures the Company will issue. Pass resolutions seeking approval of the following items at the Board meeting:

- Private placement offer letter in Form Number PAS – 4 and Application Forms
- Appointment of a Debenture Trustee and approval of Form No. PAS – 5 Sanction of Debenture Trustee Agreement
- Appointment of an expert for approval of a borrowing power increase, if necessary
- To allow the creation of a charge on the company's assets.

- Accept the Terms and Conditions of the Debenture Subscription Agreement.
- The extraordinary general meeting of shareholders will be held on the following day, date, and hour.

Step 2: Preparation of a Document

Prepare the following documents and issue notice for an extraordinary general meeting based on the decisions of the Board Meeting:

- Offer Letter for Private Placement in Form No. PAS – 4 and Application Forms for Debenture Subscription Agreements
- Form No. PAS – 5 Debenture Trustee Agreement Mortgage Agreement for the development of a charge on the company's assets records of a private placement offer
- Finally, send out notices of the extraordinary general meeting, along with an explanation.

Step 3: Setup an Extraordinary General Meeting

Hold an extraordinary general meeting and pass a special resolution authorizing the issuance of convertible secured debentures to increase the company's borrowing ability and authorizing the Board to place a charge on the company's assets.

Step 4: Filing of a Documents

Prepare and file the following documentation once the debenture issue has been approved.

- Fill out Forms PAS 4 and PAS 5 and submit them to the Registrar of Companies in Form GNL 2.
- File a Form Number MGT – 14 Offer Letter with the Registrar of Companies (ROC).
- File a copy of the Board of Directors' resolutions, Special Resolutions, Debenture Subscription Agreements, Debenture Trustee Agreements, and other documents with the Registrar of Companies using Form Number MGT – 14.
- After allocating debentures, file Form No. PAS – 3 relating to return of allocation with the Registrar of Companies (ROC).
- Fill out Form Number CHG – 9 to create a charge on the Company's assets.

Step 5: Issue of Debenture Certificate

In the case of any debenture allocation, the certificate of debenture should be issued within six months of the date of allocation.

Redemption of debentures

In the process of redemption of the debentures, the company pays back the debt raised in the form of debentures. The company has to fix a maturity period for the debentures. As a result, the holders of debentures are repaid their investment at a price either equal to or

above their face value at maturity. When the debentures are issued, the company must adhere to all terms and conditions described in the prospectus.

Methods or modes of redemption of debentures

Value at the time of redemption

To ensure the interests of debenture holders and the company are not at risk, the Companies Act, 2013 grants the issuing company multiple options for redeeming the debentures. When the company redeems its debentures, it can redeem them at a value that has been predetermined when the debentures were issued. Debentures can be redeemed at several different values, such as:

- **At par:** In this case, the debentures have a face value equal to their redemption value.
- **At premium:** In such a scenario, a higher redemption value is assigned to the debentures than their face value. The redemption value can, for example, be Rs. 110 or 120 per debenture if the face value is Rs. 100.
- **At discount:** Debentures are redeemable for less than their face value in this case. For example, debentures with a face value of Rs 100 can be redeemed for Rs. 90 or 80 per debenture, as agreed when the debentures were issued.

Methods of redemption of debentures

It is the issuing and redeeming of debentures that makes debentures functional in an organization. A debenture is a certificate acknowledging the debt that is issued under the seal of the organization. A debenture is redeemed by paying its principal back to its holder. Therefore, debt obligations for debentures are discharged when debentures are redeemed. The redemption of debentures can be accomplished in a variety of ways, each with its own accounting method. In general, they fall into the following categories:

1. Redemption by payment in lump sum

There are many options for redeeming debentures, including this type. In comparison to other redemption methods, this method is simpler. A lump sum redemption occurs when debenture holders receive their promised amount on a specific date. The lump sum is the total principal amount of all debentures whose redemption occurs without a premium or discount. Whenever debentures are issued and redeemed for a lump sum, a fixed date is given. A debenture agreement will indicate this date as the maturity date. However, the organizations have the option of paying the debentures before maturity as well. Before the payment is made, the organization has a clear idea of the amount and the date. Therefore, it is possible to manage the resources properly.

The holders of these debentures are paid their agreed value in a single one-time payment under this redemption method. Payment will be in accordance with the agreement at the time of issuance of the debentures. The company may be able to meet its commitments on time with funds set aside under the Debenture Redemption Reserve (DRR) by making appropriate investments and arranging its finances.

2. Redemption of debentures in instalments

The company also agrees to redeem its debentures through instalments, which must be paid in accordance with the agreement at the time of issuance. A regular schedule of payments may or may not be agreed to at the time of debenture issue. By redeeming debentures through such a mechanism, the company is relieved of the burden of raising *ad hoc* amounts at maturity.

Every year, a portion of the debentures is redeemed. In most cases, the drawings determine which debentures need to be paid in which year. This is accomplished by placing slips indicating the number of debentures to be redeemed, and then taking out at random the number of slips equal to the number of debentures to be redeemed. It is called 'Redemption by Drawings'. Debentures are usually redeemed based on the number of years they have been issued divided by the total amount of debentures issued. In accordance with the terms of the issue, holders of debentures whose slips have been taken out are repaid at par or at a premium. The redemption under this method is subject to the requirement of creating a debenture redemption reserve equal to 50% of the total amount of the debentures.

3. Redemption by purchasing the debentures through open market

The redemption of debentures can also be accomplished through open market purchases. In this way, the company is able to redeem its shares at a discounted price, which would have a positive impact on its bottom line. A company can redeem its own debentures by purchasing them in the open market if its articles of association enable it to do so. Purchase of the debentures serves the following purposes:

- In order to earn more profits at a later date, this can be used as an investment which can then be sold at a higher price at the time of sale
- The debenture liabilities will be cancelled if the debenture rate is higher than the current rate of interest in the market.

It is a special requirement for a company to redeem its shares by purchasing them on the open market. The Articles of Association authorize the company to purchase its own debentures on the open market. This procedure is followed by the company, especially when the debentures of its own company are available for sale at a discount on the stock market and they wish to purchase them. Furthermore, they may wish to purchase it in order to save the interest that would otherwise have been payable on these bonds. The company may either cancel or keep alive the debentures purchased from the stock market for future issuance. These debentures are held as an investment in the company's own debentures. Unless the Board of Directors passes a resolution, the cancellation cannot occur.

4. Redemption by conversion of debentures into shares or new debentures

Debentures are most commonly redeemed by converting them into equity shares or preference shares or even into new ones. There is no limit to the number of new debentures that are issued, and the coupon rate can either match or be higher or lower than that of the existing debentures. In order to provide adequate information to the

shareholders of the company about the impending addition to their share capital or the new long-term liabilities of the company, the company must mention the term 'convertible' as a prefix to the debentures on their balance sheet. The following is the procedure of conversion:

- There should be an option for conversion in the articles of association of the company.
- The Board of Directors shall hold a meeting and pass the Board Resolution for the Conversion of Compulsory Convertible Debentures (CCDs) into Equity Shares, together with the notice of the General Meeting for approval by the shareholders of the company.
- A special resolution for converting CCDs into equity shares should be passed at the general meeting of the shareholders of the company. A special resolution must be accompanied by an explanation pursuant to Section 62 of the Companies Act, 2013. All necessary information regarding the conversion should be included in the statement.
- The Form-MGT-14 must be filed with the Registrar of Companies, within 30 days of passing a Special Resolution.
- The holders of compulsorily convertible debentures receive a letter of option. The Company Secretary is required to verify the consent of the debenture holders at the time of conversion.
- Following this, the company needs to receive a valuation report in order to proceed with the conversion process.
- In the event that a special resolution is passed, the allotment of a share should take place within twelve months of the date of the resolution. Based on the valuation report, the price of the share is determined.
- In accordance with Form SH-1, share certificates must be prepared and issued.
- Holders of shares are issued share certificates, and their names are entered in the Register of Members.
- In 30 days following an allotment of Form PAS-3, a return allotment of securities must be filed with the Registrar. Fees should be paid and a list of all holders should be provided according to the Companies (Registration Offices and Fees) Rules, 2014.

5. Redemption of debentures by sinking funds

Debenture Redemption Funds, also known as Sinking Funds, are funds created by appropriating some profits for the redemption of debentures at maturity, then investing the amount appropriated in investments. Sinking funds, or Debenture Redemption Funds, are created to invest money set aside from profits every year outside the business. The company uses the fund to invest or buy insurance policies. It is reinvested in the fund again after the income is received from the said investments or policies. Upon redemption, investments are sold or policies are surrendered to obtain the funds needed to pay off the debenture holders.

Assignment Questions

- 1. What is Debenture? State methods of reduction (Redemption) of debentures.**
- 2. Explain types of debentures in detail.**