

Borrowing Powers & Methods

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Borrowing Powers of A Company

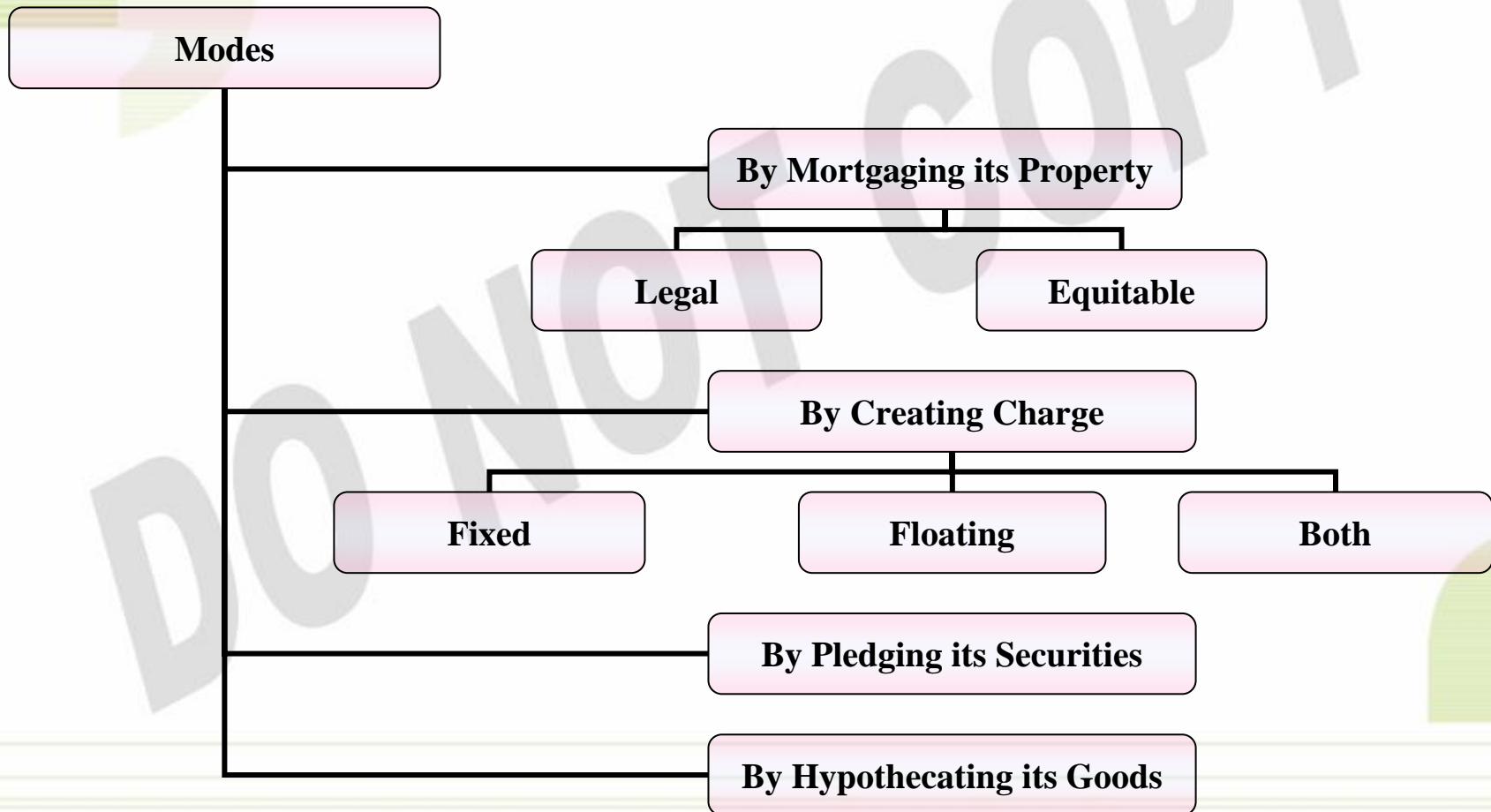
The power to borrow money is solely depend upon Memorandum of Association and Articles of Association of company. In case company is not granted power to borrow, it can be given it, by making suitable alteration in Memorandum of Association after passing a several resolutions in shareholders meeting. Creditors before giving loans to company are expected to go through the Memorandum of Association and register of mortgages of company, to find out the amount that is already borrowed by company.

Borrowing Powers of A Company

If company crossing its limits and in case it makes default for the payment or repayment of such excess credit, the creditor cant sue the company for recovering the excess amount. A private company can exercise the power of borrowing after its incorporation. But a public company can exercise this power only after getting the Certificate of Incorporation.

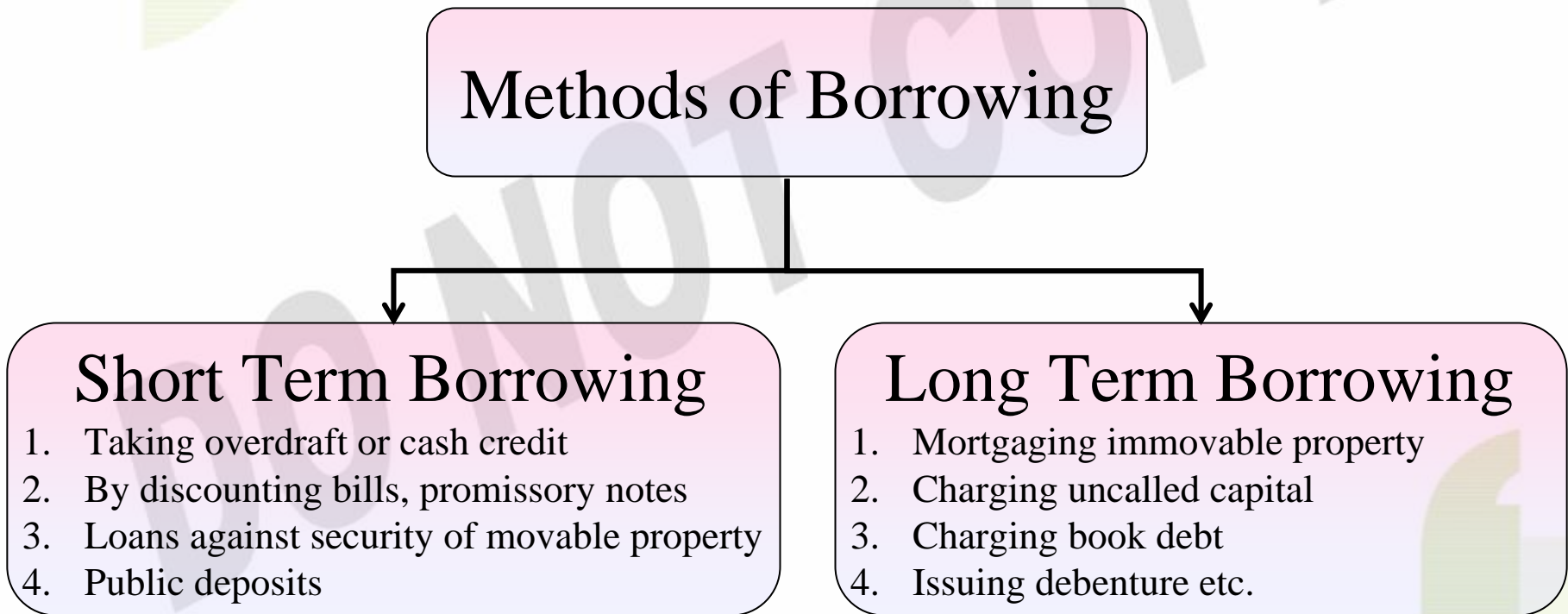
Modes of Giving Securities

Every company has to offer some security for borrowing. There are various modes of giving securities. Following chart represent some of the important ones



Methods of Borrowing

After seeing different modes of offering securities, let's look at some of the methods of borrowings. These methods can be explained with the help of the following chart.



Preventing Misuse of Public Deposits (Act 1974)

To safeguard the interest of the people, the Companies (Amendment) Act, 1974, has inserted a new section – 58A. The main provisions of the same are as below;

1. The Central Government is empowered (in consultation with R.B.I.) to prescribe the conditions and limits up to which deposits may be accepted.

Preventing Misuse of Public Deposits (Act 1974)

2. Every deposit accepted by the company before this Act, shall be repaid in accordance with the terms of such deposits.
3. This section has also provide penal provision for companies and their defaulting officers.
4. Under Sub section (7), the Central Government after consulting R.B.I., can exempt any company from the provision of section 58A.

Companies (Acceptance of Deposit) Rules, 1975

This rule announced by the Central government, apply to all non-banking and non-financial companies, both public as well as private. In 1978 further amendment was made to the Companies (Acceptance of Deposit) Rules. The new provisions introduced are as below;

1. A company can accept deposit from the public only up to 10% of its aggregate paid up capital and free reserves.

Companies (Acceptance of Deposit) Rules, 1975

The new provisions introduced are as below;

1. A company can accept deposit from the public only up to 10% of its aggregate paid up capital and free reserves.
2. All categories of deposits cant exceed 25% of the owned funds of company.
3. All deposits in excess of these limits have to be refunded before 31st March 1980.
4. The maximum period of acceptance of deposits is 36 months.

Registration Charges

Under Section 125 of Companies Act, the following charges created by a company must be registered with the Registrar of companies.

1. A charge for the purpose of securing any issue debenture.
2. A charge on uncalled share capital of the company.
3. A charge on any immovable property.
4. A charge on any book debt of company.
5. A charge (not being pledge) on any movable property.
6. A floating charge on any property including stock in trade.
7. A charge on calls made but not paid.
8. A charge on any ship or any share in a ship.

Registration Charges

If company fails to register charges with the Registrar, the consequences are as below.

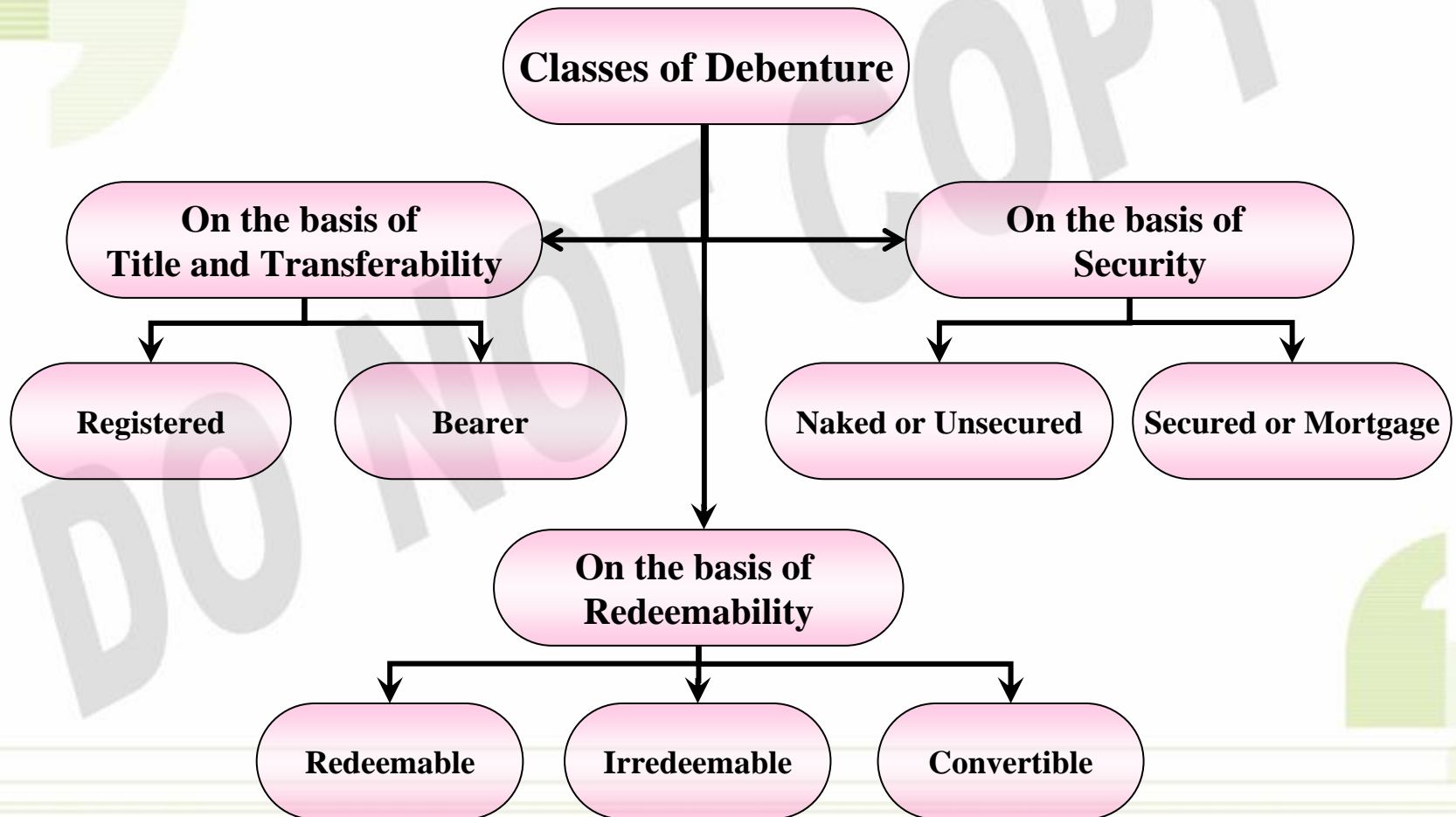
1. If the company goes into liquidation, the secretary has no value for the lender of the money and charge will be paid.
2. Although, company can not escape liability and will have to pay the debt.
3. The creditors will rank as an ordinary creditors.
4. The officer and company who is in default is liable to fined upto Rs.500/- per day of default.

Debenture

According to Section 2(12) of the Companies Act, debenture includes debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of the company or not. Debentures are also issued to the public by means of prospectus. The debenture holder is the creditor of the company. But he is entitled to receive interest at certain rate per annum.

Classes of Debenture

There are different types of debentures on the basis of different terms, their classification can be explain with the help of following chart.



Debenture & Debenture Stock

As stated in definition, “debenture include debenture stock, bonds etc”. There is every possibility that one can assume the term debenture and debenture stock are alike. Following points shows the main difference between them.

1. The debenture is a document evidencing debt, whereas debenture stock is a debt itself which is divided into convenient parts.

Debenture & Debenture Stock

2. Debenture are always issued in fixed round amounts. They are indivisible and transferable. On the other hand debenture stock is divisible to any extent and may be transferable.
3. Each debenture should bear stamp duty, whereas no such duty is required on each debenture stock certificate.
4. Debenture may not be secured by mortgage but debenture stock is almost always secured by mortgage.

Debenture & Shares

A public company can issue shares to the public through its prospectus immediately after getting the certificate of incorporation. At this stage it is not possible to company to issue debentures due to no security for mortgage, company as an out infant stage may find it difficult to pay interest on debentures.

When company get established it can issue debentures at lower rate of interest. This enables the company to raise finance & improve lending to increase in profits.

Many companies nowadays prefer to issue convertible debentures instead of redeemable preference shares.

Debenture Holder Vs. Shares Holder

Points	Share Holder	Debenture Holder
Status	He is proprietor of company.	He is creditor of company.
Income	Can't receive any dividend unless the company makes a profit.	Is entitled to receive interest irrespective of profit earned by company.
Repayment	Except in case of Redeemable Preference Shares, Share-Capital cant be repaid.	Debenture loan can be liquidated.
Order of Repayment	In case of winding up share holder gets last priority.	In the event of winding up debenture holders must paid first before anything can be distributed among the share holders.
Voting Right	As the member of company has right to vote in meetings.	Debenture holder has no voting rights.

Issue of Debentures

As like shares, debentures can be issued at par, at premium or even at discount. Similarly it can be redeemed at par, premium. Redemption of debentures at a discount is not allowed.

A private company can issue debentures after getting certificate of incorporation, but public company can do so only after getting the Certificate of commencement of business.

Issue of Debentures

Unlike in issue of shares, debentures can be issued without having minimum subscription clause. But at least 5% of the issue price of each debenture must be received by company in cash.

The debentures are always fully paid, though the amount of the same can be paid in several installments i.e. on application allotment etc.

Steps in Issue of Debentures

Although the steps of issue of Debentures are same as shares. Some important of them elaborated below.

1. The board of directors must passed resolution for issue.
2. Prospectus or statement in lieu of prospectus should be filed with Registrar of companies, if the debentures are to be offered to public.
3. If the amount of the debentures exceeds the paid up capital and free reserves of the company, the shareholder's approval by way of ordinary resolution has to be obtained.
4. Application money received must be deposited in schedule bank.
5. The company has to prepare a register of Debenture holders.
6. The secretary has to prepare certificate of debentures and keep them ready for delivery within three months of allotment.

Trust Deed

When company issue debentures for subscription, normally it has to execute a trust deed, mortgaging its assets in favor of the debenture holders. Banks investment companies, insurance companies may act as trustees. The deed contains right and power of trustees, maximum amount of debenture issued, rate of interest and manner of repayment. The creation trust deed protects the interest of debenture holders in many ways. In case any default is made by the company, trustees takes steps to safeguard the interest of debenture holders. Trustees may be empowered to sell the assets or securities and realised due without intervention of court. They keep constant vigil over the affairs of the company.

Rights of Debenture Holders

Though, as seen earlier, the debenture holders are creditors of company and not the members, hence they can't enjoy member's rights. But following rights are enjoyed by them.

1. Right to inspect Trust deed
2. Right to nominate 1 or 2 non-retiring directors

The trust deed can be inspected by debenture holders & demand a copy of it by paying Rs.10/- This has come into effect from 15th July 1988. Generally the rights of debenture holders are delegated to trustees, who are ultimately entitled to take necessary action.

Rights of Debenture Holders

Unsecured debenture holders are creditors of company, can sue company for repayment of principal sum along with interest. They can also apply court for the winding up of the company and prove their claims. The secured debenture holders in addition to above rights have following rights;.

1. If the terms of debenture issue empower, they can take possession of mortgage property and sell through trustee.
2. If company becomes insolvent, they can sell off the security and provide for the balance before court.

Register of Charge

Section 143 of companies Act, says every company must maintain a register of charge which contains following information.

1. Description of property charge.
2. The amount of charge.
3. Date on which charge is created.
4. Name and address of the mortgages or the trustees.
5. Date of filing of particulars of all charges with Registrar.

Register of Charge

Specimen of the company's register of charge is given below.

No. of entry	Date of charge or the date of resolution creating series of debenture	Particulars of the property charged	Amount of charge Rs.	Name and address of the mortgages entitled to the charge	Date of filing particulars with the Registrar	Date of discharge or redemption of charge
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Register of Debenture Holders

It is obligating for every company to maintain a register of debenture holders and separate index of debenture holders if their numbers exceeds 50. this register must be kept up-to-date, kept at the company's head office and should be open to inspection by debenture holders. It can be rectified with the sanction of court and company shall file with Registrar the notice of same within 14 days from the date of sanction received from the court.

Specimen of Register of Debenture Holders

Name:.....

Address:.....

Description:.....

Left hand side of the Register:

Debentures Transferred

Date transferred	No. of instrument of transfer	Transferor's name	Transferor's folio in the register	Amount transferred	Distinctive No. of bonds

Right hand side of the Register:

Debentures Acquired

Date of registration of transfer	Transfer No.	Transferor's name	Transferor's folio in the register	Amount transferred	Distinctive numbers	Balance held

Transfer of Debenture

The procedure for transferring registered debenture is same to that of transfer of shares. The transfer must submit from at the company's head office along with the Debenture Certificate. The secretary after scrutinising, placed the instrument of transfer before the board for approval. If board approves, the secretary takes necessary steps to make transfer.

Transfer of Debenture

The endorsed debenture bond must be issued to the transferee within two months from the date of application. If board refuse to transfer, the notice of same must be given to transferor & transferee within two months from the date of delivery of transfer deed to company. Bearer or unregistered debentures can be transferred by mere delivery and company maintains no records of the transfer.

Procedure for Payment of Interest

Interest payment to debenture holder is mandatory in all circumstances. The procedure for same is depend upon the type of debenture. The rate of interest is specified in terms of issue. The rate of interest can not be more than that of fixed by Central Government. Procedure for payment of interest can be classified in to two.

1. Interest on Bearer Debenture
2. Interest on Registered Debentures

Procedure for Payment of Interest

1. In this case, the moment interest falls due, the company notifies through newspapers and stock exchanges the date of payment as well as the place and the manner of such payment. A special account is opened in bank for making interest payment. The payment of interest is made to the bearer of debenture on production of interest coupons attached to the debentures.

Procedure for Payment of Interest

2. The procedure is very similar to that of payment of dividends. When interest is due on registered debentures, the company notifies the same as well as the closure of the transfer register. The secretary prepares the list of debenture holders and copy of this list is sent to the bank through which the payment is made.

Duties of Secretary (Payment of Interest)

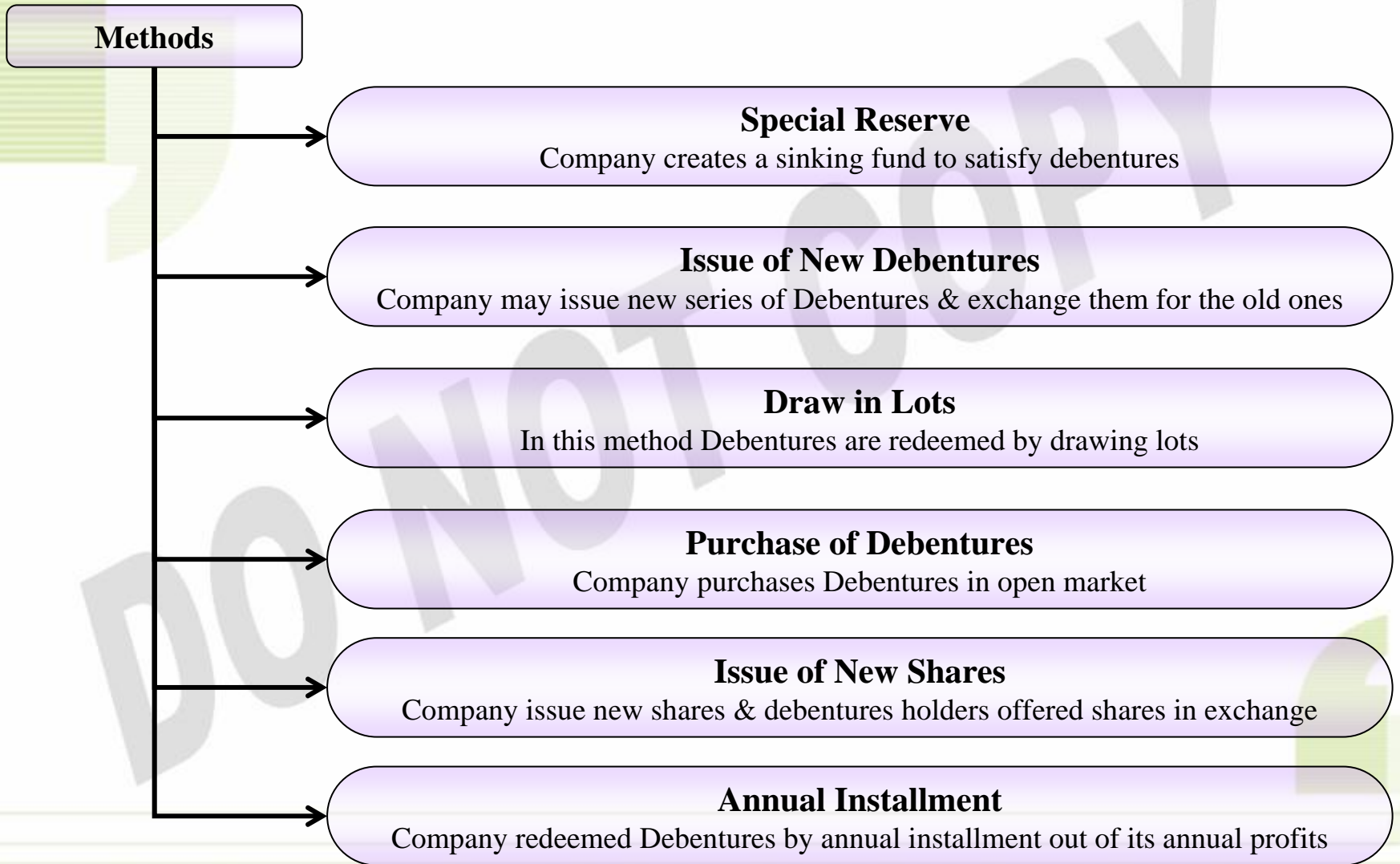
Following are some of the duties of secretary in relation to payment of interest to debenture holders.

1. As and when the interest due, secretary has to notify the same in newspapers.
2. After that he should prepare a list of debenture holders containing all necessary information in it. For e.g. amount of interest, name, etc.
3. He should send copy of this list to the bank.

Duties of Secretary (Payment of Interest)

4. He should open special account of the company with the bank.
5. For deceased debenture holder, he should prepare interest warrants without giving the names of holder and should send them to banks.
6. When all payments of interest have been made, he should arrange for the receipt of list of debenture, interest warrants etc. from bank.
7. Finally, he should make an entry in respect of payment made in the list.

Methods of Redemption of Debentures



Duties of Secretary (Issue of Debentures)

1. Arrange Board meeting to pass resolution deciding the issue of debenture.
2. To examine to obtain or not consent of Controller of Capital Issue as per the Capital Issues (exemption) order 1969.
3. If issue is underwritten, secretary has to see Board passes a resolution and also fix their remuneration.
4. He should arrange for the execution of the trust deed.
5. He should arrange with the company's bankers for receiving applications.

SEBI's Guidelines For Issue of Debentures

On 11-6-1992 SEBI issued guidelines for fully convertible/ partially convertible/ non-convertible debentures. Some of them are as below;

1. Issue of FCDs having conversion period more than 36 months not permissible, unless same is optional with put & call option.
2. Compulsory credit rating will be required if conversion is made for FCDs after 18 months.
3. In case of PCDs/NCDs credit rating is compulsory where maturity exceeds 18 months.
4. SEBI may prescribe additional disclosure requirement from time to time, after due notice.