Section A-Review paper

ANALYSIS: MANDATORY ISSUE OF DEBT SECURITIES WITHIN LEGAL PERSPECTIVE.

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Abstract

Debt securities are essentially securities, or financial instruments, where an entity receives a loan from an investor and has to pay that amount along with added interest back to the investor. This research paper analyses the issue of debt securities, and its legal perspective. This research paper deals with the definition and characteristics of debt securities, and various types of debt securities such as government securities, commercial paper, corporate securities, and call money, followed by the principal role the Securities and Exchange Board of India plays in the sphere of debt securities, with regards to safeguarding the interest of investors and expanding capital markets by means of legislation and rules. This paper also deals with the ‘private placement’ of securities, that is, transactions of securities that are publicly disclosed. Moreover, the NCS Regulations have been dealt with, which set down rules for corporations while issuing privately placed debt securities, such as preventing the issuer’s directors from entering the securities market and disallowing fugitive financial offenders from doing the same. The paper then deals with the importance of debt securities in the capital market, with reference to its role in helping the government to acquire funds it needs for development. It gives both public and private initiatives for options for funding as it reduces the stress on institutional finance. It can help in making India’s bank-based finance system stronger by reducing the difficulties faced by banks with regards to the long-term sources of finance. The paper also deals with the various legal perspectives of debt securities and their mandatory issue.

Introduction

Debt securities are defined as negotiable financial products, which means they may be easily transferred from one owner to the other. The most prevalent type of such security is bonds. They are an agreement between the debtor and the creditor that requires the borrower to pay an agreed-upon interest rate on the principle over a certain amount of time and then return the principal at expiration. Government and non-government entities can both issue bonds. They come in a variety of shapes and sizes. Fixed-rate bonds and zero-coupon bonds are common constructions. Debt securities include things like floating-rate notes, preferred shares, and mortgage-backed investments. A bank loan, on the other hand, is a non-negotiable financial instrument. Debt securities will always have an issue date and a value at which purchasers can purchase them when they are initially released. In addition, issuers must pay an interest rate, commonly known as the coupon rate. The coupon rate may be set for the duration of the security's life or it may change in response to inflation and real conditions. The issuer should refund the principle at face value and any outstanding interest on the maturity date. The word that categorizes debt instruments is determined by the maturity date. Short-term securities have a one-year maturity, medium-term securities have a one-to-three-year maturity, and long-term securities have a three-year or longer maturity. The annual rate of return an investor might anticipate if a loan is held to maturity is measured as yield-to-maturity (YTM). It analyses the bond's dividend payments, purchase price, and face value when comparing securities with identical maturity periods. In terms of form, return on capital, and legal implications, debt instruments are fundamentally different from stocks. Debt securities have a set duration for repayments and an agreed-upon interest payment schedule. As a result, a shareholder's earnings may be predicted using a set rate of return, known as yield-to-maturity. Investors can opt to sell debt instruments before they mature, potentially earning a profit or loss. Debt securities are typically thought to be less risky than stocks. There is no set duration with equity, and dividend payments are not guaranteed. Dividends are given at the company's option and vary based on the performance of the business. Equities do not provide a guaranteed rate of return due to the lack of a dividend distribution plan. When stock is sold to private entities, investors will get the marketplace value of their shares, which may result in a capital gain or loss on their original investment.

What are debt securities?

Before discussing debt securities, the paper will talk about what is a 'security.' A security is a form of a financial instrument. A financial instrument is a contract that gives both financial assets for one entity and financial liabilities for the other entity.[1] Assets can include cash or right to get access to cash, and liabilities include obligations such as delivering cash to the entity. A security can be defined in more detail within various jurisdictions; for example, in India, what constitutes a security is given in clause (h) of Section 2 of the Securities Contracts (Regulation) Act, 1956, and includes shares, bonds, stocks, Government securities and interest in securities.[2]

Securities can be of two types; equity and debt. Equity securities are those where a shareholder gets the ownership of a certain percentage of the entity. It includes common stock, common share and preferred stock.[3] These securities don't have a maturity date. An equity shareholder would be entitled to voting rights, given its ownership over a percentage of the entity. Moreover, equity securities have a variable return;[4] these securities are dependent on the risks of the entity's profits or losses, and thus, returns can be either highly positive or highly negative.

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[1] Robert J.Kirk, IFRS: A quick reference guide, pg. 391, (2009).

[2] The Securities Contracts (Regulation) Act, 1956, §2(h).

[3]The Economic Times, https://economictimes.indiatimes.com/wealth/invest/how-debt-securities-differ-from-equity-securities/nature-of-returns/slideshow/82545775.cms (last visited Dec. 29, 2021).

[4] *Ibid.*

Debt securities, meanwhile, refers to money that has been borrowed and that has to be paid back with terms that dictate the interest, time and maturity of the loan.[5] It is different from equity securities; debt securities require that the borrower repay the principal or sum of money that was borrowed. It has pre-decided returns to the owner in the form of interest payments that must be made, and the owner has no voting rights like in equity securities. Debt securities can be listed on a stock exchange, or be issued to a pre-decided group of investors on the basis of private placement.[6]

There are various types of debt securities, such as:

1. Government securities, which helps funding of Government expenditure on infrastructure, health and defence,
2. Commercial Paper, which is a short-term instrument for a period of upto one year issued by companies to raise money,
3. Corporate Bonds, issued by public and private corporations where they return the money on an agreed date,
4. Call Money, which is used by banks for meeting the Cash Reserve Ratio (CRR) & Statutory Liquidity Ratio (SLR) requirements ordered by the RBI.[7]

Debt securities also have many benefits attached to it which make them more attractive. There is a guaranteed return of money that was lent, because if the entity who took the loan fails to return this money, there can be consequences for them. Interest is added to the original loan over time, which leads to an eventual profit for the investor.[8] Moreover, they provide for a steady stream of income through Interest Payments that are made to investors, which helps their cash flow needs.[9] It is less riskier than equity as it is not at all dependent upon the profits or losses of the entity; it is bound by a contract for repayment.

SEBI's role in the issue of debt securities

A debt security is a form of financial instrument established when someone loans cash to someone else. Corporate bonds, for instance, are debt instruments issued by companies and marketable securities. Investors give money to businesses in exchange for a certain number of interest payments and the repayment of their principle at the conclusion of the bond's term.[10] SEBI is responsible for overseeing the regulation of all participants in the Indian capital market. It tries to safeguard investors' interests and grow capital markets by implementing a

[5] Will Kenton, *Securities*, Investopedia (Mar. 20, 2021), https://www.investopedia.com/terms/s/security.asp.
[6] LexisNexis, https://www.lexisnexis.com/uk/lexispsl/bankingandfinance/document/391289/57DN-7YJ1-F185-X3YY-00000-00/Types_of_debt_securities_overview (last visited Dec. 30, 2021).
[7] WISHFIN, https://www.wishfin.com/mutual-fund/different-types-of-debt-securities-in-debt-mutual-funds/ (last visited Dec. 30, 2021).
[8] GoCardless, https://gocardless.com/guides/posts/debt-securities/ (last visited Dec. 30, 2021).
[9] Corporate Finance Institute, https://corporatefinanceinstitute.com/resources/knowledge/credit/debt-security/ (last visited Dec. 30, 2021).
[10] Jason Fernando, *Debt Security*, (Dec. 14, 2020), https://www.investopedia.com/terms/d/debtsecurity.asp

variety of legislation and rules.[11] SEBI has also issued a regulation Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008[12] to help with the debt securities in India. SEBI regulates stock exchange activity, protects shareholders' interests, and ensures the safety of their investments. It also intends to combat theft by unifying its legislative laws and encouraging businesses to self-regulate. The regulator also facilitates a competitive professional marketplace for intermediaries. Apart from the above responsibilities, Sebi operates a platform where issuers can raise money in an appropriate manner. Investor security and the transmission of precise and accurate data are also safeguarded. The Securities and Exchange Commission (SEBI) investigates stock trades and guards against corruption in the securities industry. It is in charge of stockbrokers and sub-stockbrokers. It provides market training to investors in order to help them comprehend the marketplace in a better way.[13]

Private placement of debt securities

A 'private placement' of securities is a securities transaction that is publicly disclosed. The term "private placement" refers to the issuance of securities to fewer than 50 people. Apart from a public offering, a private placement does not need to file an offer document with the Securities and Exchange Board of India (SEBI) for approval. It also cannot include any broad notice, public solicitation, marketing, or any course or conference to which participants have been engaged through a general solicitation or marketing. The Companies Act of 2013[14] establishes rules for private placement. After SEBI published rules on September 30, 2003, limited companies corporations began to regulate privately placed debt issuance. However, in light of the market's explosive expansion and the risks it poses, SEBI has mandated that all debt securities, regardless of their form of issuance (private placement or public/rights issue), be listed under a separate listing agreement (SEBI 2004). SEBI has amended its regulations on a regular basis since then. The SEBI (Issuing and Listing of Debt Securities) Regulations, 2008[15] govern the issue of securities through private placement (SEBI 2016).[16] Section 42 of the Companies Act of 2013[17] defines a "private placement" as "any proposal of securities or admittance to submit securities to a chosen group of individuals by a corporation (other than by way of public offer) through the issue of a private placement offer letter that fulfils the circumstances specified in this segment, such as the condition that the offer or open invite shall not exceed 50 or such greater number as may be recommended" (excluding qualified institutions).[18]

[11] *SEBI- Security and exchange board of India,* (Oct. 06, 2021, 04:53 p.m.), https://cleartax.in/s/sebi

[12] Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008, Reg. 1.

[13] *What is SEBI?,* Business Standards, https://www.business-standard.com/about/what-is-sebi#collapse

[14] The Companies Act, 2013

[15] The SEBI (Issuing and Listing of Debt Securities) Regulations, 2008, Reg. 2.

[16] Avdesh Kumar Shukla, *Choice of Private Placement as an instrument for rasing Debt Resources: An evidence from Indian firms, Reserve Bank of India,* https://rbidocs.rbi.org.in/rdocs/Content/PDFs/2CPPIRDREBB826538CACE49BE80E7C9C272BE5A13.PDF

[17] The Companies Act, 2013, § 42

[18] *Issue and listing of debt securities*, (Jul. 2017), https://www.icsi.edu/media/webmodules/ISSUE_AND_LISTING_OF_DEBT_SECURITIES.pdf

The NCS Regulations propose a stronger eligibility condition for underwriters for private placements of debt securities, similar to the original standards for public debt securities offerings. As a result, under the following situations, corporations would be disqualified to issue privately placed debt securities:[19]

- if the Board prohibits the issuer, any of its proponents, promoter group, or directors from entering the securities market or trading in securities for the term of the prohibition.
- if any of its sponsors or executives are fugitive financial offenders as defined by Section 12 of the Fugitive Economic Offenders Act of 2018[20],
- if any of the issuer's proponents or full-time directors is also a promoter or full-time director of a firm that the Board has forbidden from entering the stock exchange or trading securities, but apart from:
    - in the situation of an individual who was elected as a director solely on the basis of a debenture trustee's candidacy in another firm;
    - after the debarment term is ended.
    - All Government Securities, including Treasury Bills, are presumed to be admitted to trading on the Exchange as soon as they are published, according to the Exchange's Bye Laws[21]. The Securities and Exchange Board of India (SEBI) has reduced listing and disclosure rules, which has enhanced the attractiveness of individually issued d8ebt securities. Issue of debt securities is governed by the SEBI (Issue and Listing of Debt Securities) Regulations, 2008 and its revisions.[22]

Importance of Debt Securities in Capital Market

The debt market enables the government to collect funds to support its development initiatives. It is critical to the economy's effective deployment and distribution of resources. Because government investments are created to suit the government's short as well as long financial demands, they've become important tools for organisational credit control, financial monitoring, and short-term liquidity management. The debt market also gives public and private sector initiatives more funding options and relieves the demand on institutional finance. It also improves resource mobilisation by releasing illiquid retail investments like gold.[23]

[19] Rukmani Roychowdhury, *Private Placement Of Debt Securities - An Analysis In Terms Of The Proposed SEBI (Issue And Listing Of Non-Convertible Securities) Regulations, 2021,* K Law, (Nov. 29 2021), https://www.mondaq.com/india/securities/1133958/private-placement-of-debt-securities--an-analysis-in-terms-of-the-proposed-sebi-issue-and-listing-of-non-convertible-securities-regulations-2021

[20] Fugitive Economic Offenders Act of 2018 § 12

[21] Securities and Exchange Board of India Bye Laws

[22] *Private Placement,* https://www.msei.in/corporates/listing@mcx-sx/debt/private-placement

[23] *'What is the importance of Debt Market to the economy?'* Times of India, (Sep 8, 2017, 05:23 p.m.)

Only when a parallel development in the equity and debt segments is maintained is an economy's capital market regarded as adequately developed. A well developed debt market could be the best option, not just for achieving infrastructural funding requirements, but also for relieving banks of all the difficulties of long-term sources of finance and spreading out the huge financing risk to a broader investor base, thereby strengthening India's bank-based finance system, allowing corporate borrowers to tap the low-cost market, allowing investors, including FIIs, to obtain fixed and yet greater returns, but also, above everything, to make sure that India's bank-based financial system grows.[24]

Fixed income instruments provide a regular flow of payments in the form of interest and principal payback at the instrument's expiration. Debt securities are offered by qualified businesses in exchange for funds borrowed from investors in these instruments. As a result, many debt securities have a definite charge on the institution's assets and, in general, possess a good level of security due to the firm's fixed and/or movable property. Fixed income securities assist investors by preserving and increasing their invested cash while also ensuring the receipt of monthly interest income.[25]

Investment in debt securities is considered safer than equity securities. However, it should be noted that they are not completely risk-free. These risks include default risk, interest rate risk, reinvestment rate risk. Counter-party risk, as well as price risk, are the risks associated with trading in debt securities.

Debt Securities and SEBI

Sebi has consolidated rules governing the issuing of debt instruments into a single regulation to make compliance easier for listed companies. Sebi's board of directors adopted a proposal in this respect in June, prompting the action. According to the announcement, the government has combined the ILDS (Issue and Listing of Debt Securities) and NCRPS (Non-Convertible Redeemable Preference Shares) laws into a single regulation dubbed — Regulation of the Securities and Exchange Commission (Sebi) on the Issue and Listing of Non-Convertible Securities.[26] SEBI, the market supervisor, has increased the bar on transparency and

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https://timesofindia.indiatimes.com/business/faqs/market-faqs/what-is-the-importance-of-debt-market-to-the-economy/articleshow/60425009.cms

[24] Nikhil Totuka, *'Debt Market in India: An Overview',* Lexology, (Oct. 27, 2020) https://www.lexology.com/library/detail.aspx?g=aa9c7b4d-ba77-46c3-b9a0-533aa6268ab0

[25] ZeeBiz WebTeam, '*What is debt market? Know the risks and benefits here',* ZeeBussiness, (Nov. 10, 2021, 02:40 pm), https://www.zeebiz.com/personal-finance/news-what-is-debt-market-know-the-risks-and-benefits-here-170335#:~:text=According%20to%20BSE%2C%20the%20debt,features%20are%20issued%20and%20traded.&text=for%20your%20reference.-,According%20to%20BSE%2C%20the%20debt%20market%20is%20the%20market%20where,features%20are%20issued%20and%20traded.

[26] *Sebi merges debt securities rules into single regulation, Economic Times*, (Aug. 11 2021, 01:08 a.m.), https://economictimes.indiatimes.com/markets/bonds/sebi-merges-debt-securities-rules-into-single-regulation/articleshow/85223176.cms

corporate governance standards for firms that only disclose their bigger debt issuances, thereby putting them in line with the requirements currently in place for businesses that list their stock. Many analysts, however, believe that the new requirements, while well-intentioned, may nonetheless place greater compliance costs on high-value loan issuers. The most recent set of indicators, which were tried to introduce as legislative changes to the Listing Obligations and Disclosure Requirements (LODR) Regulations, have now enlarged some regulations that were heretofore only relevant to equity listed entities to certain high-value debt companies listed — those with non-convertible debt instruments with an excellent quality of 500 crores or more — and have made them 'comply or explain' until March 31, 2023, after which adherence will be compulsory by law.[27] The Regulations' Chapter III[28] covers the public offering and Listing of debt securities and non-convertible redeemable preference shares. A draught offer memorandum must be submitted with all of the stock exchanges on which such instruments are planned to be listed, through the objectives of the top management, before a public offering of debt instruments and/or non-convertible redeemable preference shares may be undertaken. For a period of seven business days, the draught offer documentation submitted will be publicly disclosed by publishing it on the stock exchange(s) website for public comment. It will also be available on the issuer's and lead manager's high-value.

The identities and contact numbers for the responsible person, who will be the issuer's Company Secretary, should be clearly specified in the draught solicitation documents. This includes the compliance officer's postal and email addresses, as well as his or her contact number. Prior to filing the offer document with the Registrar of Companies, the senior manager must ensure that any comments received on the draught offer document are appropriately handled. Prior to submitting the offer document with the Registrar of Companies, the lead manager must provide the Board with a proper research certificate in the manner specified in Schedule III[29] of these regulations.[30]

Conclusion

Floating-rate notes, preferred shares, and mortgage-backed securities are examples of debt securities. The coupon rate may be fixed for the life of the security or it may fluctuate in reaction to inflation and real-world situations. Investors might choose to sell debt securities before they mature in order to benefit or lose money. Debt securities are often considered to

[27] K.R.Srivats, *Non-convertible debt securities: SEBI mandates higher disclosures for high value debt listed companies,* Business Line, (Sep. 11 2021), https://www.thehindubusinessline.com/news/lodr-changes-non-convertible-debt-securities-sebi-mandates-higher-disclosures-for-high-value-debt-listed-companies/article36405391.ece

[28] *Supra* note 15.

[29] *Idbi*

[30] *Merger of SEBI (Issue and listing of Debt Securities) Regulations, 2008 and SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013 into SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021*, SCC, (Aug. 10 2021), https://www.scconline.com/blog/post/2021/08/10/merger-of-sebi-issue-and-listing-of-debt-securities-regulations-2008-and-sebi-issue-and-listing-of-non-convertible-redeemable-preference-shares-regulations-2013-into-sebi-issue-and-listing-of-n/

be safer than equities. Debt securities, unlike equity securities, require the borrower to repay the principle or amount borrowed. Equity securities are those in which a shareholder receives a percentage of the company's ownership.Debt securities can be listed on the stock exchange or provided privately to a small group of investors. Debt instruments, on the other hand, are loans that must be returned according to the loan's terms, which include tax, duration, and expiry. A financial instrument is a transaction that produces financial assets and obligations for one entity while also creating financial liabilities for another. It has pre-determined returns to the owner in the form of interest payments that must be made, and unlike equity securities, the owner has no voting rights. Cash or the right to access cash are examples of assets, whereas responsibilities such as delivering cash to the company are examples of liabilities. In India, debt instruments must be issued in order to ensure regular interest payments and principal repayment.