

What will you learn in this chapter ?

- 3.1 Definition of Debenture
- 3.2 Types of Debentures
 - 3.2.1 Mortgage Debenture
 - 3.2.2 Fully Convertible Debenture (FCD)
 - 3.2.3 Partly Convertible Debenture (PCD)
 - 3.2.4 Non Convertible Debenture (NCD)
- 3.3 Procedure of Issuing Debentures
- 3.4 Rights of Debenture Holders
- 3.5 Debenture Trust Deed
- 3.6 Procedure of Transfer of Debentures
- 3.7 Difference between Shares and Debentures

Introduction

In today's modern times when Joint Stock Companies need capital for a long time period, they issue shares or debentures to raise capital. Debenture means borrowed capital. Debenture is a document issued under the common seal of the company for raising debt and acknowledging the debt. The interest on debt raised through debenture is paid at a pre-determined rate. For this, companies create a floating charge on the assets of the companies.

3.1 Definition of Debentures

The term "debenture" is derived from the latin word 'Deber' meaning debt. Thus, it can be said that debenture is a document denoting debt of the company.

"Debenture is a type of document issued under the common seal of the company acknowledging the debt."

-Sir Francis Parmer

Debenture is "A document containing an acknowledgement of indebtedness; issued by the company under its common seal, and giving an undertaking to repay the debt, at a specified rate or at the option of the company and in the meantime to pay interest, thereon at a fixed and at interval stated in debentures."

Debenture is a document, (i) issued under the common seal of the company (ii) acknowledging the debt of a specified amount (iii) in which till the principal amount is repaid (iv) interest at specified rate is payable under the contract (v) a charge is created on the assets of the company.

"Thus, joint stock companies established under the Companies Act issue debentures for long term capital requirement. The debenture can be redeemed after a fixed period. A relationship of debtor and creditor is created between the company and the debenture holder. The Debenture holder does not get a right to vote in the company and he cannot participate in the management of the company. But debenture holders can appoint debenture trustee to safeguard their interest. When the company goes into liquidation, the debenture holders are paid their money on priority basis by selling the assets of the company.

3.2 Types of Debentures

For the convenience of public, the company Management issues different types of Debenture. Debenture holders give utmost importance to the security of their money.

Types of Debentures : (1) Mortgage Debenture (2) Fully Convertible Debenture (FCD) (3) Partly convertible Debenture (PCD) (4) Non Convertible Debenture (NCD).

3.2.1 Mortgage Debenture : The company, by issuing such debentures, create a charge on the assets which can be fixed charge or floating charge. The company has to obtain the approval of the trustees of debenture holders, before taking any decision regarding these assets. At the time of liquidation, the debenture holders have the first right on the assets of the company.

3.2.2 Fully Convertible Debentures - FCD : In accordance with the agreement with debenture holders, on completion of the specified time period, these debentures are converted into equity shares. The Company gives two options to holders: (i) To redeem the debentures or (ii) To take equity shares of the same amount. If the debenture holder opts for Fully Convertible Debentures (FCD) then his rights as creditor come to an end and he gets rights as equity share holder.

3.2.3 Partly Convertible Debenture - PCD : Here the debenture is divided into two parts, where one part is fully convertible and the other part is non convertible. Equity shares are issued against the convertible part while the non convertible part is redeemed.

3.2.4 Non-Convertible Debenture - NCD : These debentures are not converted into equity shares. The holders are paid their money back by redemption at the end of the specified time period.

3.3 Procedure of Issue of Debentures

There are specific provisions in the Indian Companies Act for the issue of debentures. It is necessary to comply with all these provisions at the time of issuing debentures. If any of these provisions is not complied with, then the company / concerned officer of the company is liable for punishment. It is necessary to ensure that there should be no risk or danger to the interest of debenture holders. The procedure for the issue of debenture is as under :

(1) Resolution by Board of Directors : First of all, the provisions of debentures of the Articles of the company are studied, then a resolution is passed in the meeting of the Board of Director to issue debentures. At the meeting, a decision is taken regarding the amount of total issue, rate of interest, payment of interest, number of debenture certificates and conditions.

(2) Resolution by General Meeting of the Company : The sanction for issue of debentures is obtained in the General Meeting of the company. If, due to issue of debentures, the debt of company exceeds free reserves of the company or if the debentures are to be issued for an amount exceeding free reserve fund, then the approval of members is obtained by convening the General Meeting of members.

(3) Permission of SEBI : It is necessary to ensure that the provisions of the Companies Act and guidelines of SEBI are complied with and permission of SEBI is obtained.

(4) To Issue Prospectus : Public Limited companies invite general public to subscribe to the debenture by issuing prospects which describes contents of debentures. Investors study it and take decision to purchase the debenture.

(5) Appointment of Trustees for Debentures : In order to safeguard interests of debenture holders a trust deed / Debenture Trust Deed is prepared under the Trust Act. The Trustees for Debentures are appointed in the company.

(6) Agreement with Underwriters : If the Board of Directors decides to enter into an agreement with underwriters for the issue of debentures, it is done at this stage. The conditions are determined for both parties.

(7) To Open an Account with a Scheduled Bank : The company has to open an account with a Scheduled Bank to receive applications and money for debenture

(8) Registration in Stock Exchange : If it is so stated in the Prospectus, the company has to apply to a recognized stock exchange for the listing of debenture issue so that the debentures can be traded in the market. If the stock exchange refuses to register or cancels the registration of debenture issue, the company has to pay back the money to the debenture holders.

(9) To prepare Allotment Register for Debentures : After the closure of subscription, as specified in the prospectus, the Company Secretary has to prepare a register on basis of application

received. A decision regarding allotment of debentures is taken in the meeting of the Board of Directors. After deciding the allotment of debentures, the process of remittance of debenture certificate is commenced.

(10) Debenture Certificates : If the subscription to the debentures is to be made through part payment of debenture money, then after receiving the full amount towards the debentures allotted the company secretary prepares debenture certificates and in accordance with the provisions of the Companies Act dispatches the certificates to debenture holders.

3.4 Rights of Debenture Holders

Debenture holders are entitled to certain rights. Debenture holders are creditors of the company and therefore there is a relationship of debtor -creditor between the company and debenture holders. The various rights of debenture holders are as under :

- (1) Right to receive interest at the specified time and rate
- (2) Get back the money, invested, on the date of maturity
- (3) To examine and study documents at the registered office of the company
- (4) To obtain information by depositing the requisite fee
- (5) The company prepares a trust deed with debenture holders. Debenture holders have right to be informed that functioning is conducted according to provisions of the deed.
- (6) Right to appoint Debenture Trustee to safeguard the interests of debenture holders.
- (7) The Board of Directors have to take into confidence the debenture trustees before making any important decisions.
- (8) To ensure that the property mortgaged under the trust deed is adequately safeguarded.
- (9) Right to initiate legal action if the conditions / provisions of trust deed, in respect of property under security, are not complied with.
- (10) Right to receive report regarding the progress and development of the company at regular intervals.
- (11) Right to receive their money back on a priority basis at the time of liquidation of the company.

3.5 Debenture Trust Deed

Debenture is a debt for the company. The company mortgages / pledges its assets in favour of debenture holders against the debt raised . As per the Indian Companies Act, a contract / agreement is executed between the company and debenture holders and the said contract is registered with the Registrar of Companies. Thus, this contract / agreement that lays down the conditions of debenture issue, is also, known as Trust Deed / Trust Agreement.

The debenture holders of a company are scattered over different places and they are unorganized. In such circumstances, to safeguard the interests of debenture holders, their representatives are nominated as trustees of debenture holders and they represent the vast group of debenture holders. These debenture trustees earn the faith of debenture holders and work in a neutral manner to safeguard the interest of debenture holders.

When a situation arises about the fixed or floating charge, the action is taken in accordance with the Trust Deed.

Once a Trust Deed is registered with the Registrar, any amendment in the same can be made with the approval of the Debenture holders' General Meeting.

The following particulars are included in a Trust Deed :

- (1) Primary information of the company
- (2) Description of Debenture Issue
- (3) Information of Security / assets mortgaged:
- (4) Particulars of the appointment of Debenture Trustees
- (5) Events of Defaults
- (6) Obligations of Company
- (7) Miscellaneous :
 - Amendment made in any matter of Trust Deed
 - Company is liable for payment of stamp duty on Trust Deed
 - Provision for meeting of debenture holders and resolutions of grievances, objections and resolution thereof.

3.6 Procedure for Transfer of Debenture

Procedure for Transfer of Debenture is as under :

- (1) Obtain form specified by the company and fill in the requisite details in the same
- (2) Name and Addresses of the seller and the purchaser of the debenture, details of debentures, certificate serial numbers quantity of debentures and prices of debentures. Both parties are required to sign the form.
- (3) The seller of the debenture has to declare that he is selling the debenture voluntarily and he has to sign it a second time.
- (4) The debenture transfer form, along with debenture certificate, is submitted at the registered office of the company.
- (5) The company secretary will examine the form and compare the signature with the specimen signature.
- (6) It will be ensured whether the requisite stamp duty has been paid and endorsement will be done to that effect in the transfer register.
- (7) A meeting of the Board of Directors is held to discuss the transfer of Debentures and a resolution is passed for it.
- (8) On the basis of resolution of the Board of Directors, the Company Secretary enters the name of the purchaser or issues a new certificate and dispatches the same to the purchaser.

3.7 Difference between Share and Debenture

Sr. No.	Points	Share	Debenture
(1)	Meaning	A joint stock company divides its capital in small parts. Each part is called a share.	When a joint stock company borrows money from public is called a debenture
(2)	Capital	It is owner's capital	It is a borrowed capital
(3)	Return	The company pays dividend on a share from profit	Company pays interest on the debenture amount.

(4)	Rate of Return	The rate of dividend is unspecified.	The rate of interest is specified. Interest is payable whether there is any profit or not.
(5)	Ownership	Shareholders are owners of a company.	Debenture holders are creditors of a company.
(6)	Risk	The risk is higher in share.	The risk is less in debentures.
(7)	Right of Vote	Shareholders have voting right.	Debenture holders have no voting right.
(8)	Stamp Duty	The stamp duty on transfer of shares is payable at a lesser rate.	The stamp duty on transfer of debentures is payable on a higher rate.
(9)	Redemption	The share holders cannot get their money back as long as the company is in existence. At the time of liquidation, they get their money at the end.	The debenture can be redeemed as per its type. Debenture holders have the first right to receive their money in case of liquidation.
(10)	Charge on Assets	There are no charges of Assets.	Issue of debentures creates charge on assets of the company.
(11)	Payment out of Capital	Dividend on shares cannot be paid out of capital of the company.	Interest on debentures can be paid out of capital, as per provisions.
(12)	Control	Shareholders have control over the administration of the company.	Debenture holders have no control over the administration of the company. However they can appoint debenture trustees to safeguard their interests.
(13)	Demand for Liquidation	Shareholders cannot demand a liquidation of the company.	Debenture holders can demand a liquidation of the company.

What you have learnt in this chapter

In this modern period the efforts are made to collect money through debentures to get profit from the trading of equity.

Definition of Debenture : It is a document issued by the Company which bears the seal of the company informing about the acceptance of money as debt of the company. In this instance the company obtains a money as loan with a promise to return the specific amount after the stipulated period.

Types of Debentures : (1) Mortgage Debenture (2) Fully Convertible Debenture (FCD) (3) Partly convertible Debenture (PCD) (4) Non Convertible Debenture (NCD).

The Procedure to Issue Debentures : (1) Resolution by Board of Directors (2) Resolution by General Meeting of the Company (3) Permission from SEBI (4) Issue of Prospectus (5) Appointment of Trustees for Debentures (6) Agreement with underwriters (7) Opening an account with a Scheduled Bank (8) Registration with the Stock Exchange (9) Preparing Allotment Register for Debentures (10) Debenture Certificates

The Rights of the Debenture Holders : Debenture holders are creditors of the company, so there is the relation of debtor and creditor between the company and debenture holders. Their rights are; to obtain interest at the decided rates, to get money back on completion of the duration, to obtain copies of the documents of the company to obtain the information about how the company is functioning in compliance with the Trust Deed, to appoint the debenture trustees, to see that securities/properties mortgaged are properly maintained, to initiate legal proceedings if trust deed is violated, to obtain the information of the progress of the company at various times, to get the money at priority basis at the time of dissolution of the company.

Debenture Trust Deed : According to the provisions of the Indian Companies Act the agreement between debenture holders and company is executed and registered with the Registrar. An agreement is prepared with the consent of both the parties mentioning the terms and conditions. This deed is known as Trust Deed. The debenture holders appoint their representative to protect their interests and risk. People who represent the mass of debenture holders is known as debenture trustee.

The Procedure for the Transfer of Debentures : A form should be filled up with all details; the primary details of the purchaser and seller of the debentures, the details of the debenture if it is a voluntary sale the seller should declare and sign, the form. It should then be deposited with the Registered Office. The Secretary will verify the signatures. The required stamp duty should be paid after the resolution is passed at the meeting of directors. The secretary will add the name of the purchaser in the debenture and issue the new debenture certificate.

The difference between Share and Debenture : The points of differences : (1) Meaning (2) Capital (3) Return (4) the rate of return (5) ownership (6) Risk (7) Right of vote (8) Stamp (9) To get the money back (10) The charge over the property (11) The payment from the capital (12) Control (13) The demand for the dissolution.

Exercise

1. Select the suitable option from the options given :

- (1) Debentures means
(A) The Capital of the owner (B) The debt capital
(C) Property (D) Expenditure
- (2) At the time of dissolution of a company, the debenture holders acquire the right to get money back.
(A) Priority Right (B) The right of Last Payment
(C) Responsibility (D) No any right or zero rights
- (3) What is the fundamental right of the debenture holder ?
(A) The right to vote in the company
(B) To remain present at the meeting of the company
(C) The right as the member of company
(D) To get the interest and money back after a stipulated time

- (4) What is the name of the agreement between a company and debenture holders ?
 (A) Debenture Trust Deed (B) The Agreement of acquiring Trust
 (C) The Agreement of Guarantor (D) The Agreement of protection of Rights.
- (5) Who appoint the trustee of debenture ?
 (A) The company itself (B) The Assembly of Directors
 (C) General Assembly (D) The Assembly of debenture holder
- (6) Who represents the mass of debenture holders ?
 (A) Group of Director (B) Chairman of the Company
 (C) Debenture holders (D) Debenture Trustee
- (7) What is the status a debenture holder in the company ?
 (A) Creditor (B) Debtor (C) Creditor - Debtor (D) Share Holder
- (8) Who can the debenture holders appoint as their protector of rights ?
 (A) Debenture Trustee (B) Administrative Officer
 (C) Advocate (D) Share Holder

2. Answers the following questions in one sentence :

- (1) What is a debenture ?
- (2) Define the meaning of convertible debenture
- (3) What is the meaning of mortgage debenture ?
- (4) What is the meaning of certificate of debenture ?
- (5) What is a debenture Trust Deed ?
- (6) Who is known as a debenture trustee ?
- (7) Mention two rights of a debenture holder.

3. Answers the following questions in brief :

- (1) Give definition of debenture
- (2) What is partly convertible debenture ?
- (3) Mention the rights of the debenture trustee.

4. Answers the following question to the point :

- (1) State the concept of debentures.
- (2) Discuss any two types of debentures.
- (3) State the procedure of the issue of debentures.
- (4) Discuss Debenture Trust Deed.
- (5) Clarify the procedure of transfer of debenture.

5. Answers the following questions in detail :

- (1) State the meaning of debenture and explain its types
- (2) Discuss the procedure for the issue of the debentures, as per the provisions of the companies Act, 2013
- (3) Explain the difference between shares and debentures.

