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Updates

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Mandatory fund raising through issuance of Debt Securities

One of the serious concerns for listed Companies is to meet with the regulatory mandates in an ever-changing regulatory environment. Many-a-times regulatory changes will have drastic impact on the business itself. The recent mandate introduced by SEBI directing Large Listed Entities (please see definition below) to mandatorily raise 25% through issuance of Debt Securities vide Circular bearing no. SEBI/HO/DDHS/CIR/P/2018/144 dated November 26, 2018 needs an examination in this background.

In lines with the Union Budget announcement for 2018-19 requiring SEBI to consider mandating, beginning with large entities, to meet about one-fourth of their financing needs from the debt market, SEBI has issued this instant Circular.

This Circular is brought into force form April 01, 2019 except for Companies following calendar year as financial year. In which case, it would come into force from January 01, 2020.

The Circular is applicable to Listed Companies other than Scheduled Commercial Banks, who meets the following conditions.

- specified securities or debt securities or non-convertible redeemable preference share are listed on a recognized stock exchange
- outstanding long-term borrowing (original maturity of more than 1 year) is over Rs 100 crores or above. But excludes external commercial borrowings and inter-corporate borrowings between a parent and subsidiary(ies)
- credit rating of AA and above, based on plain bonds where no structuring/ support built in is provided.

Those Listed entities who meet the above conditions are recognized as Large Corporates (LC). The LC is mandatorily required to raise not less than 25% of its incremental borrowings, during the financial year subsequent to the financial year in which it is identified as a LC, by way of issuance of debt securities, as defined under SEBI (Issue and Listing of Debt Securities) Regulations, 2008. Herein, incremental borrowings are borrowings done during a particular Financial Year excluding ECBs and Inter-Corporate Borrowings between parent and subsidiaries.

A listed Company to meet the requirements of this Circular needs to check on the following:

- Whether they qualify as a LC for a particular FY
- if yes, raise 25% of incremental borrowing in the subsequent financial year.
- A company which is recognised as LC for FY 2019 and FY2020, the incremental borrowing is required to be met by FY2021 and FY2022. If it fails, then an explanation needs to be given to Stock Exchange annually.

From FY2022, for purposes of calculating compliance, incremental borrowings need to be met over continuous block of two years.

It should be noted that if a LC fails to meet the requirements subsequent to FY2022, then a penalty of 0.2% of the shortfall is attracted.

Please consider the following table quoted in said Circular for better understanding:

Assuming a LC meets the criteria as set forth above:

Current FY	2022	2023	2024	2025
Outstanding borrowing as on March 31st of previous FY	8001	400	80	120
Whether framework is applicable for current FY?	Yes	Yes	No	Yes
Incremental Borrowing in the current FY (a)	400	200	40	100
Mandatory borrowing through debt securities in the current FY (b) = 25% of (a)	100	50	Not Applicable	25
Block for compliance of the mandatory borrowing through debt securities	FY 2022 and FY 2023	FY 2023 and FY 2024	Not Applicable	FY 2025 and FY 2026

Actual borrowings done through debt securities in the current FY (c)	50	75	10	25
Shortfall of previous FY {for first year of the previous block} carried forward to current FY (d)	-	50	25	Nil
Quantum of (d), which has been met from (c) (e)	-	50	10	Nil
Shortfall, if any, in the mandatory borrowing through debt securities for the current FY {after adjusting for any shortfall in borrowing for previous FY, carried forward to current FY} **(f)= (b)-[(c)-(e)]**	50	25	Not Applicable	Nil

Fine, to be paid {in case the shortfall of previous FY, if any, is not adjusted completely against the debt securities borrowings of current FY} 0.2% of [(d)-(e)]	Nil	Nil	0.2% of Rs 15 crore = Rs 3 lakhs	Nil
Compliance Status	For previous block - NA For current block - Shortfall of Rs 50 crore carried forward to FY 2023	For previous block - Rs. 50 cr of borrowing shortfall for FY 2022 adjusted towards debt market borrowings of FY 2023. Complied For current block - Shortfall of Rs. 25 crore carried forward to FY 2024	For previous block - Rs. 10 cr of borrowing shortfall for FY 2023 adjusted towards debt market borrowings of FY 2024. Thus, remains a borrowing shortfall of Rs. 15 crore for FY 2023. Thus, fine of Rs. 3 lakh to be paid by XYZ. For current block - Framework not applicable.	For previous block- Framework not applicable. For current block - Complied with by the end of first year

Resultantly, a listed entity has a choice either to keep its borrowings below 100 Crores in FY or mandatorily raise 0.25% of the incremental borrowings through issuance of debt securities from FY2020.

As an impact of this mandate, the listed companies qualifying as LC needs to factor for various additional costs involved in raising debt under Debt Regulations, 2018 and the consequent disclosures to be made.

Other than the above factors, on perusal of the above table it is clear that a listed company needs to plan for debt requirement for two consecutive years.

Favorable points- Mandatory Debt issuance:

It is relevant to note that on examination of recent private placement data given out by NSE, it suggests the Coupon rate of Companies having ratings AA and above is around 7.4% to 9.1% annually depending on various factors. When this is compared with the Business loan rates of 13.55% (starting rates) as quoted by a loan aggregator, it seems in this perspective the Corporate Bond market is cheaper to bank loans.

Further, RBI has allowed the FPIs to participate in debt issues which are listed and the said participation would not amount to External Commercial Borrowings. Thus, the investor base for debt market is also widened and FPI can also participate subject to the limits applicable to them. This helps listed companies to easily raise debt from debt market successfully.

For these reasons and although only time can tell us if this circular will have an impact on the bank credit rate (seeing that around 38.25% of total bank credit limit is extended to private corporate sector[1]), this mandate seems to be a boon in disguise to Large Entities who qualify under this Circular prescribing mandatory debt issuance.

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