

Capital Markets Hotline

July 09, 2010

RBI DIRECTIVES FOR ISSUANCE OF SHORT TERM NCDs

The Reserve Bank of India ("RBI") has issued directions¹ ("Directions"), to regulate the issuance of non-convertible debentures of maturity upto one year ("NCDs") by corporates. The Directions will become effective from August 2, 2010.

Background

It was observed that at times such short term NCDs are issued by corporate with call / put options attached to it, which impart a demand-liability like character to these instruments. The High Level Co-ordination Committee on Financial Markets ("HLCCFM") had taken a view that these instruments need to be regulated by RBI as they have systemic implications and such instruments are money market instruments as per the provisions of the Reserve Bank of India Act, 1934 ("RBI Act"). Accordingly, the draft guidelines for regulation of such short term NCDs were placed on the RBI's website on November 3, 2009 for comments before notifying it on June 23, 2010 under section 45W of the RBI Act.

The regulations

Following are the key provisions introduced by the Directions:

Definition - NCD for the purpose of these Directions has been defined to mean a debt instrument issued by a corporate (including NBFCs²) with original or initial maturity up to one year and issued by way of a private placement ("Short Term NCDs").

Issuer - These Directions are applicable to issuance of Short Term NCDs by any corporate viz. private, public and listed entities including financial institutions like NBFCs.

Eligibility - A corporate³ shall be eligible to issue Short Term NCDs if it fulfills the following criteria, namely,

1. the corporate has a tangible net worth of not less than Rs. 4 crore (approximately USD 870,000), as per the latest audited balance sheet;
2. the corporate has been sanctioned working capital limit or term loan by bank/s or all-India financial institution/s; and
3. the borrowal account of the corporate is classified as a standard asset by the financing bank/s or institution/s.

Terms of Short Term NCDs

- i. **Maturity** – Short Term NCDs shall not be issued for maturities of less than 90 days from the date of issue. The exercise date of option (put/call), if any, attached to such Short Term NCDs, also shall not fall within the period of 90 days from the date of issue. Further, the tenor of the Short Term NCDs shall not exceed the validity period of the credit rating of the instrument.
- ii. **Size** – Short Term NCDs may be issued in denominations with a minimum of Rs.5 lakh (face value) and in multiples of Rs.1 lakh. The aggregate amount of such NCDs issued by a corporate shall be within such limit as may be approved by the board of directors of the corporate or the quantum indicated by the Credit Rating Agency for the rating granted, whichever is lower.
- iii. **Coupon** – Short Term NCDs may be issued at face value carrying a coupon rate or at a discount to face value as zero coupon instruments as determined by the corporate.

Subscribers to Short Term NCDs

As per the guidelines such Short Term NCDs can be issued by the corporates to individuals, banks, primary dealers (PDs), other corporate bodies including insurance companies and mutual funds registered or incorporated in India and unincorporated bodies, non-resident Indians and Foreign Institutional Investors (FIIs). Investments by banks/PDs shall be subject to the approval of the respective regulators.

The provisions of these Directions have to be read in conjunction with the exchange control regulations and accordingly issuance of such Short Term NCDs to non residents should be in compliance with the external commercial borrowings norms.

Prerequisites for issuing NCDs

- i. **Credit Rating** - A corporate intending to issue Short Term NCDs shall obtain credit rating for issuance of such instruments from one of the rating agencies, viz., CRISIL or ICRA or CARE or FITCH Ratings India Private Limited or

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such other agencies registered with SEBI or such other credit rating agencies as may be specified by the RBI from time to time, for the purpose. Further, the minimum credit rating has to be P-2 of CRISIL or such equivalent rating by other agencies.

ii Debenture Trustee - Every corporate issuing Short Term NCDs shall appoint a Debenture Trustee ("DT"), registered with SEBI, for each issuance of such instruments. However, no specifications have been laid out in the Directions in terms of nature and extent of security to be created to cover such Short Term NCDs. DT shall submit to the RBI such information as required by it from time to time.

iii Disclosure - The corporate shall disclose to the prospective investors, its financial position as per the standard market practice. The auditors of the corporate shall certify to the investors that all the eligibility conditions set forth in these directions for the issue of NCDs are met by the corporate. However, it may not be mandatory under law for corporates to issue a detailed offer document to prospective investors or file the same with RBI prior to issuance of Short Term NCDs.

iv Physical / Dematerialised - While option is available to both issuers and subscribers to issue/hold NCDs in dematerialised or physical form, they are encouraged to issue/hold NCDs in dematerialised form. However, banks, FIs and PDs are required to make fresh investments in NCDs only in dematerialised form.

v Other laws - The requirements of all the provisions of the Companies Act, 1956 and the SEBI (Issue and Listing of Debt Securities) Regulations, 2008, or any other law, that may be applicable, shall be complied with by the corporate. Further, the total amount of NCDs proposed to be issued has to be completed within a period of two weeks from the date on which the corporate opens the issue for subscription.

Analysis

These Directions for regulation of Short Term NCDs have been framed in lines of the guidelines for issuance of commercial papers ("CPs") and have been notified by RBI with an object to regulate the financial system of the country, without creating too many fetters on the fund raising options available with the corporate.

It is believed that allowing banks to participate in such Short Term NCDs issued by corporates would increase the demand for NCDs and the funding options available to corporates. Similarly, eligibility criteria for issuers (net worth requirement), credit rating of the instruments and periodic reporting to RBI are expected to ensure soundness of such instruments so issued and avoid unnecessary shocks in the financial markets.

¹ Direction IDMD.DOD.09/11.01.01(A)/ 2009-10 dated June 23, 2010

² Non Banking Financial Companies

³ For the purpose of Directions, corporate has been defined to mean a company as defined in the Companies Act, 1956 (including NBFCs) and a corporation established by an act of any Legislature.

- Deepak Jodhani & Vaidhyanadhan Iyer

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