DEBENTURE REDEMPTION RESERVE

CA. Simardeep Singh

Debenture Redemption Reserve (DRR) derives its statutory authority through Section 117C of the Companies Act, 1956. Section 117C (1) provides that, "Where a company issues debentures after the commencement of this Act, it shall create a debenture redemption reserve for the redemption of such debentures, to which adequate amounts shall be credited, from out of its profits every year until such debentures are redeemed." Hence, every debenture issue brings along an obligation for the company to create DRR. Further, since the Section requires that the amount to be credited as DRR will be carved out of profits of the company only, there is no obligation on the part of the company to create DRR if there is no profit for the particular year.

However, even though the Act provides that 'adequate' amounts are to be credited, it does not provide the meaning of 'adequate'. This was taken care of vide MCA Circular No. 9/2002 and the extent of adequacy had been defined in the said circular. Since it had already been 11 years since that circular, the requirements with regards to adequacy were reviewed and MCA issued another circular No. 4/2013. The circular provides the following:

1. No DRR is required for debentures issued by A11 India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures. For other Financial Institutions {FIs) within the meaning of Section 4A of the Companies Act, 1956, DRR will be as applicable to NBFCs registered with RBL

2. For NBFCs registered with the RBI under Section 45-IA of the RBI (Amendment) Act, 1997,'the adequacy' of DRR will be 25% of the value of debentures issued through public issue as per present SEBI (Issue and Listing of Debt Securities) Regulations, 2008, and no DRR is required in the case of privately placed debentures.

3. For other companies including manufacturing and infrastructure companies, the adequacy of DRR will be 25% of the value of debentures issued through public issue as per present SEBI (Issue and Listing of Debt Securities), Regulations 2008 and also 25% DRR is required in the case of privately placed debentures by listed companies. For unlisted companies issuing debentures on private placement basis, the DRR will be 25% of the value of debentures.

Additional Requirements Stipulated by MCA Circular

MCA Circular has further introduced a new requirement with regards to the investment of a certain proportion of the debentures redeeming in the following financial year. It provides that every company required to create/maintain DRR shall deposit or invest, as the case may be, a sum which shall not be less than 15% of the amount of its debentures maturing during the year ending on the 31st day of March next following in any one or more of the following methods, namely:

(a) in deposits with any scheduled bank, free from charge or lien;

(b) in unencumbered securities of the Central Government or of any State Government;

(c) in unencumbered securities mentioned in clauses (a) to (d) and (ee) of section 20 of the Indian Trusts Act, 1882;

(d) in unencumbered bonds issued by any other company which is notified under clause (fl of section 20 of the Indian Trusts Act, 1882.

Further, the amount so deposited or invested shall not be utilized for any purpose other than for the repayment of debentures maturing during the year referred to above, provided that the amount remaining deposited or invested, as the case may be, shall not at any time fall below 15% of the amount of debentures maturing during the 3lst day of March of that year.

Since many companies recycle their borrowings by raising a set of debentures and repaying the other set, it would an added burden on them to create earmarked investments, when they don't actually need their own funds and plan to repay by borrowing. Though such a requirement will act as a security cushion for the debenture holders, it is also bound to create pressure on the working capital requirements of the companies coming under the said requirement.