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LARGE ENTITIES MANDATED TO ISSUE DEBT SECURITIES FOR 25% OF THEIR FINANCING NEEDS FROM NEXT FINANCIAL YEAR

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Introduction

The government and the regulators in tandem have introduced a slew of coordinated measures to reduce dependence on the banking system and strengthen the Indian corporate bond market. On 1 February 2018, the Ministry of Finance stipulated in its Union Budget announcement that "*SEBI will also consider mandating, beginning with Large Corporates, to meet about one-fourth of their financing needs from the bond market.*" Consequently, on 20 July 2018, the Securities and Exchange Board of India (SEBI) issued a discussion paper titled "Designing a Framework for Enhanced Market Borrowings by Large Corporates". Based on the feedback received in response to the discussion paper and consultation with market participants, SEBI issued a circular titled "Fund raising by issuance of debt securities by large entities" dated 26 November 2018 (Circular).

Salient Features of the Circular

- **Applicability of the Circular and type of borrowings covered**: Large Corporates are required to raise upto 25% of their incremental borrowings through debt securities during the financial year (FY) subsequent to the financial year in which they were identified as Large Corporates. The Circular specifies incremental borrowings to mean any borrowing made in a particular financial year, of an original maturity exceeding one year (irrespective of whether it is for refinancing/repayment of an existing debt) and shall exclude external commercial borrowings and inter-corporate borrowings between a parent and its subsidiary. The incremental borrowings may be raised by way of issuance of debt securities as per the SEBI (Issue and Listing of Debt Securities) Regulations, 2008 (SEBI ILDS).

- **Interpretation of Financial Year**: For entities that follow April-March as their annual accounting period, the provisions of the Circular shall be applicable from 1 April 2019 and for entities that follow the calendar year as the annual accounting period, the provisions of the Circular shall be applicable from 1 January 2020.

- **Definition of "Large Corporate"**: A listed entity (apart from a scheduled commercial bank) qualifies as a "Large Corporate" if:

  - its specified securities, debt securities or non-convertible preference shares are listed on a recognised stock exchange as per the terms of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015;

- it has an outstanding long-term borrowing (excluding external commercial borrowings and inter-corporate borrowings between a parent and its subsidiary) of INR 100 crores or above with original maturity exceeding 1 year; and

- it has a credit rating of "AA" and above, of its unsupported bank borrowings or for the non-structured, non-supported bonds issued by such an entity.

➢ **Incremental borrowing norms**: The Circular seeks to implement the incremental borrowing norms in a phased manner.

- For the FY 2020 and 2021, the incremental borrowing norms shall be applicable to Large Corporates on an annual basis. Therefore, if a listed entity is identified as a Large Corporate on the last day of FY 2019 or FY 2020, it would be required to comply with the incremental borrowing norms. In the event that the Large Corporate is unable to comply with this requirement, it shall provide an explanation for such shortfall to the stock exchanges.

- From FY 2022, the requirement for mandatory incremental borrowing by a Large Corporate in a particular financial year will need to be met over a continuous block of 2 years. According to the Circular, if a listed entity is identified as a Large Corporate on the last day of the FY "T-1", the requirement for incremental borrowing will accordingly be required to be fulfilled for FY "T" by FY "T+2". For example, if a listed entity ABC is identified as a Large Corporate on 31 March 2023, then ABC must fulfil the requirements under the incremental borrowing norms for FY 2024 by FY 2026.

➢ **Penalty**: If at the end of FY T+2 there is a shortfall in the requisite borrowing, i.e., the actual borrowing through debt securities, is less than 25% of the incremental borrowings for FY 'T', then a fine of 0.2% of the shortfall in the borrowed amount shall be levied and payable to the stock exchanges.

➢ **Disclosure requirements**: A listed entity which has been identified as a Large Corporate shall make the following disclosures to the stock exchanges:

- Disclose that they have been identified as a Large Corporate within 30 days from the beginning of the FY; and

- Furnish details of the incremental borrowings made by the Large Corporate during an FY within 45 days from the end of that FY.

The disclosures are required to be certified by the company secretary and the chief financial officer of the listed entity. Further, such disclosures shall form part of the audited annual financial results of the listed entity.

➢ **Responsibilities of stock exchanges**: The stock exchanges shall collate information about the Large Corporates (as disclosed on their platform) and submit such information to the Board of the SEBI within 14 days from the last date of submission of the annual financial results. Further, the stock exchanges shall also be entrusted with collection of the fine, leviable in the event of a shortfall in incremental borrowing obligations of the listed entity identified as a Large Corporate. The proceeds of such penalty is required to be remitted to the Investor Protection and Education Fund of SEBI within a period of 10 days, from the end of the month in which such fine was collected.

Comment

The Circular comes at a time when the Indian financial system is reeling under a Lehman-esque crisis caused largely due to overdependence on traditional bank finance and finance from non-banking financing companies. By mandating that Large Corporates raise 25% of their incremental borrowings through issuance of debt securities, the Circular aims to reduce reliance on traditional forms of finance. Further, it also opens up avenues for greater development and deepening of the fledgling corporate bond market in India.

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