Deposits: Better but bitter!

Introduction

The Companies Act, 2013 (**"2013 Act"**) has replaced the erstwhile Companies Act, 1956 (**"1956 Act"**). Sections 73 to 76 under Chapter V of the 2013 Act, along with the Companies (Acceptance of Deposits) Rules, 2014 (**"Deposit Rules"**) provide the statutory framework and have significantly raised the benchmark for companies that wish to invite or accept deposits from the public. Following its notification, certain issues relating to "deposits" have caused concern and seem to have become bone of contention for companies (both public[1] and private). Companies have always been attracted towards financing through deposits and, at times, problems have arisen in the context of such deposits. In order to control the malpractices, the 2013 Act has introduced strict provisions under the deposit regime.

This newsletter describes selective changes introduced by the 2013 Act which companies will need to adhere to.

1. Acceptance of deposits

Per the 2013 Act and Deposit Rules, the eligibility criterion for a company to accept deposits is pegged at its minimum net worth or turnover**.** The definition of "deposit" under the new Act includes *"any receipt of money by way of deposit or loan or in any other form by a company, but does not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India."* [2]A public company having a net worth of at least INR 1,000 million (*about $16.2 million*[3]) or turnover of at least INR 5,000 million (*about $81.4 million)* would be eligible to accept deposits from persons other than its members.[4] Enhancement of investor protection measures under the new Act has led to certain additions[5] in the framework for accepting deposits. Private companies can accept deposits only from its members, unlike the earlier law where they could do so from directors and their relatives also. Such restriction on acceptance of deposits do not apply to certain types of companies which include banking, non-banking financial companies and[6] housing finance[7] or a company specified by the Central Government, after consultation with the Reserve Bank of India.

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[1] Section 2(71) of the 2013 Act defines "public company". It is one which has seven shareholders and a minimum paid-up capital of INR 500,000 (*about $8,175*) and is not necessarily listed

[2] Section 2(31) of the 2013 Act

[3] 1$ = INR 61 approximately

[4] Section 76 of the 2013 Act

[5] The 2013 Act requires detailed reporting and description of financial position of the company. It also asks for extent of the deposit insurance and credit rating of the company

[6] Section 45I of Reserve Bank of India Act, 1934 defines this as: (i) a financial institution which is a company; (ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme of arrangement or in any other manner, or lending in any manner; (iii) such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify

[7] A housing finance company must be registered with the National Housing Bank established under the National Housing Bank Act, 1987

2. Key amendments under the 2013 Act

2.1 Scope of "deposits"

The definition of "deposit" is different under the old and the new law. The 2013 Act has substantially modified it and has brought financing arrangements under the scope of deposits. Many items of loans and other receipts that were not deposits earlier are now treated as such. The following will be construed as deposits pursuant to the Deposit Rules:

- Loan from members;
- Loan from a director if he has not given loan out of his own funds;
- Loan from relatives of directors;
- Share application money pending allotment for more than 60 days;
- Secured debentures and compulsorily convertible debentures convertible within five years from the date of issue.

Thus, this wide new definition has resulted in share application monies, certain types of debentures, security deposit, advance against goods/property, loans from shareholders being treated as deposit under various circumstances. Optionally convertible debentures will no longer be excluded. Further, the Deposit Rules provide that bonds or debentures must be secured by a first charge over the assets of the company in order to qualify for exclusion. Thus, companies will be unable to issue unsecured optionally convertible debentures as that would render them as deposits, if and when converted into equity. Any amount received in the course of, or for the purposes of, the business of the company is excluded from the definition of deposits. The new Act puts certain additional conditions[8] on such amount for it to be excluded such as:

- Amount received as an advance for supplying goods or provisions of services;
- Amounts received as advance for property under an agreement or arrangement;
- Amount received as security deposit for the performance of the contract for supply of goods or provisions of services;
- Amounts received as advance under long term projects for supply of capital goods.

Under the old law, compliance requirements with the applicable rules were not stringent and, therefore, companies had a greater flexibility. But, the new law and the Deposit Rules impose greater obligations on qualifying companies who will accept deposits. It will also be necessary to assess whether payments will come within the ambit of the exclusions of the definition which will prevent them from accepting certain types of payments.

2.2 Public Deposits & Repayment

Rule 19 of Deposit Rules deals with the requirement with respect to repayment of deposits accepted or invited under the previous Act. These must be repaid in a year, i.e. till March 2015. Further, companies are required to file a statement of all unpaid deposits within three months from the commencement of the new Act or from the date on which such

[8] Rule 2(1)(xii) of Deposit Rules

payments are due. If deposits are not repaid by that time then it has penal implications in the nature of fine and imprisonment.[9] The new Act has sought to execute a break from the earlier regime, by requiring all deposits accepted before the commencement of the 2013 Act to be refunded within a specified time frame. However, the repayment provisions appear to be somewhat ambiguous. On one hand, section 74 provides a mandatory requirement that deposits accepted before April 1, 2014 and which remain unpaid must be repaid within a predetermined period, yet there is no clarity whether "deposits" refers to the definition under the earlier law or the new one. This creates a grey area and is open to interpretation until clarified by the concerned authorities.

2.3. Deposit Insurance

The new regime provides for safeguarding the interest of the depositors by virtue of deposit insurance. Under the new Act deposit insurance, creation of reserve account and credit ratings must be procured for deposit thereby increasing the compliance costs for companies. For deposits accepted under the previous Act, there will be an obligation on a company to file a statement with the Registrar of Companies with details about all the deposits and the interest due thereon.[10] The deposit insurance contract should specifically provide that in case company defaults in repayment of principal amount and interest thereon, the depositor shall be entitled to the repayment of principal amount of deposits plus interest thereon by the insurer up to the aggregate monetary ceiling as per the contract. Thus, it makes raising finance through deposits costly.

It is also mandatory for companies to provide, *inter alia*, additional information to the members for acceptance of deposits. Such information would include particulars of the charge created or to be created for securing such deposits (*if any*). The 2013 Act, unlike the previous Act, requires that the summary of the financial position of the company for the last three years must be provided to members. Thus, the concept of deposit insurance has strengthened the mechanism of investor protection in the interest of the depositors and must be welcomed.

Conclusion

It is quite evident that the 2013 Act along with Deposit Rules has ushered in some significant changes with regard to securities application money, compulsory credit rating, optionally convertible debentures, creation of security and investor protection. The additional compliance requirements will make companies spend more and thus is less cost effective. Obligation to maintain deposit insurance is a positive move in the direction of investors' protection. Keeping in sync with the overall theme of enhanced corporate governance of India Inc, the deposit provisions have become stricter and their violation will attract serious penal consequences (including fine and/or imprisonment). Ambiguities with regard to repayment

[9] Section 74 of the 2013 Act specifies fine of atleast INR 10 million (*about $164,000*) to INR 100 million (*about $1.63* million). In addition to the fine on the company, fine may also be imposed on officers in default who could be punished with imprisonment up to seven years or with fine of atleast INR 2.5 million (*about $ 40,875*) to INR 20 million (*about $327,000),* or with both

[10] Section 74 of the 2013 Act

have caused anxiety in the investor market. Hopefully, clarification by circulars will put an end to them.

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