

### Acceptance of Deposits – Regulatory framework u/s 73

#### **1. Conditions for accepting deposits from Members under Section 73**

Sub-section (2) of section 73 lays down following conditions for acceptance of deposits from members:

An ordinary resolution needs to be passed in a general meeting of the Company. Circular in the prescribed form DPT-1 containing the details of credit rating, if any obtained, total number of depositors, financial position of the Company, details of amount due towards previously accepted deposits etc. shall be issued on the authority and in the name of the Board of Directors. Publication of such circular in English and vernacular newspaper having wide circulation in the state where the registered office of the Company is situated and placement of website is not mandatory for companies except an eligible company as referred in sub-section (1) of section 76 of the Act. Such circular needs to be filed with the Registrar 30 days before the date of issue. The date of issue of advertisement is the date of issue of the newspaper and the effective date of issue of circular is the date of dispatch of circular.

The circular shall be uploaded on the company website, if any. But it is silent as to within what time it should be uploaded on the company website. The intent is to upload at the time of dispatch of circular to the members.

Clause (c) of sub-section (2) of section 73 says that 15% of deposits maturing during the financial year and financial year following should be deposited in a scheduled bank.

The Companies (Amendment) Bill, 2016 proposes to substitute clause (c) of sub-section (2) of section 73 with the following:

"(c) depositing, on or before the 30th day of April each year, such sum which shall not be less than twenty per cent. of the amount of its deposits maturing during the following financial year and kept in a scheduled bank in a separate bank account to be called deposit repayment reserve account;"

A certificate needs to be given to the effect that the Company has not committed any default in repayment of deposits or payment of interest on deposits accepted either before or after commencement of this Act. The wording of this clause gives impression that the condition is not committing a default at all and curing earlier default may not enable the Company to accept deposits.

The Companies (Amendment) Bill, 2016 proposes to amend clause (e) of sub-section (2) of section 73. The revised clause (e) reads as under:

"(e) certifying that the company has not committed any default in the repayment of deposits accepted either before or after the commencement of this Act or payment of interest on such deposits and where a default had occurred, the company made good the default and a period of five years had lapsed since the date of making good the default;"

It is not mandatory to give security for deposits as there can be unsecured deposits as well. When the Company is giving a security for repayment of deposit or interest thereon, such security needs to be given by way of charge on assets as referred in Schedule III (assets standing in the Balance Sheet) excluding intangible assets. Such security shall cover the amount which remains uncovered by deposit insurance. (The provisions relating to deposit insurance are discussed below). Further, this amount of deposits and interest shall not exceed the market value of the assets as valued by a registered valuer. To comply with this, whenever debentures are redeemed, assets given as security shall be valued again and the security cover may be reduced to avoid non-compliance. One further difficulty arises in valuation of assets. The explanation II to rule 6 states that till section 247 is notified, 'valuation of stocks, shares, debentures, securities etc. shall be conducted by an independent merchant banker who is registered with the Securities and Exchange Board of India or an independent chartered accountant in practice having a minimum experience of ten years.'. This clause is specifying only financial assets and not other assets like land, machinery for which valuation rules differ. However, as the Rule is wide in scope due to 'etc.', such assets may be valued by the functionaries mentioned in the Rule. Further discussion on the same is made in commentary on section 76.

It should be noted that the rate of interest on deposits shall not exceed the maximum rate of interest prescribed by the Reserve Bank for acceptance of deposits by non-banking financial companies.

## 2. Deposit Insurance

Dr. J. J. Irani Committee deliberated on the need for companies to take risk cover/ insurance for depositors. "It was felt that while risk cover may not be possible for equity investors, the insurance option should be explored for deposits with companies. It was felt that while the Banking companies and NBFCs were regulated by the RBI in the interest of the depositors, there was no similar mechanism in the case of deposits with other types of companies. Depositors, being in the nature of unsecured creditors, also do not get adequate protection under law in the event of liquidation or winding up of the company. It was also not feasible to develop a separate regulatory mechanism for this modality of mobilizing finance. However, some protection would be available to the depositors if the companies seeking deposits were also compelled to obtain insurance coverage for deposits. The Committee felt that this was a mechanism which would compel scrutiny into the credit-worthiness of the companies by the insurance companies in the interest of the depositors and hence recommend the same." In order to protect the interest of deposit holders, the Government has accepted the proposal and introduced compulsory insurance for due repayment of principle and interest to the extent of Rs. 20,000.

In consideration of these recommendations, the clause (d) of sub-section (2) of section 73 and the Rules thereunder require a Company to buy a deposit insurance policy, at its own cost, to secure repayment of deposit including interest amount upto Rs. 20,000 or the amount of deposit, whichever is lower. Such contract of deposit shall be entered into at least 30 days before issue of circular/ advertisement or 30 days before the date of renewal as the case may be. However subsequently, the Ministry has notified vide Notification No. F. No 1/8/2013-CL-V dated 06.06.2014 that the companies may accept the deposits without deposit insurance contract till the 31.03.2015.

In the absence of any deposit insurance product, the above provision is further amended vide Companies (Acceptance of Deposits) Amendment Rules, 2015 dated 31.03.2015 that the companies may accept deposits without deposit insurance contract till the 31.03.2016 or till the availability of a deposit insurance product, whichever is earlier. The date of 31.03.2016 was further extended till 31.03.2018.

In case the company makes any default in complying with terms and conditions of the insurance contract which results in lapse of such contract, it shall immediately make good such default or enter into a new contract within 30 days. It seems that this period will start running from the date on which company comes into the knowledge of the default. In case of non-compliance, the company shall repay the deposits within 15 days. The penal rate of interest in case of not complying with this provision is 15% and this default will attract all other liabilities under the Act,

The Companies (Amendment) Bill, 2016 proposes to omit clause (d) of sub-section (3) of section 73 related to deposit insurance.

### **3. Appointment of trustee for depositors**

In order to facilitate creation of security in favour of the depositors, Rule 7(1) requires mandatory appointment of one or more trustees by the companies inviting deposits under sub-section (2) of section 73 or any eligible company before it issues a circular or advertisement inviting secured deposits. Such Companies are required to obtain a written consent from the trustees before their appointment. A statement shall be published in the circular or circular in the form of advertisement with reasonable prominence to the effect that the trustees for depositors have given their consent to the company to be so appointed. The company is required to execute a deposit trust deed in Form DPT-2 at least seven days before issuing the circular or circular in the form of advertisement as provided in Rule 7(2).

### **4. Eligibility of trustees**

Rule 7(3) explicitly provides that following persons, including a company that is in the business of providing trusteeship services, shall not be eligible to be appointed as a trustee for the depositors, if such person or Company:

- (a) is a director, key managerial personnel or any other officer or an employee of the depositor company or of its holding, subsidiary or associate company or a depositor in the company;

- (b) is indebted to the depositor company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;
- (c) has any material pecuniary relationship with the depositor company;
- (d) has entered into any guarantee arrangement in respect of principal debts secured by the deposits or interest thereon;
- (e) is related to any person specified in clause (a) above.

## 5. Removal of trustee from the office

Rule 7(4) provides that a trustee for depositors shall not be removed from office after the issue of circular or advertisement and before the expiry of his term, except with the consent of all the directors present at a meeting of the board. If the depositor company is required to have independent directors, at least one independent director shall be present in such meeting of the Board where the proposal to remove the trustee is taken up.

## 6. Duties of trustees

The duties of the trustee for depositors is enumerated in Rule 8 as under:

- (a) ensure that the assets of the company on which charge is created together with the amount of deposit insurance are sufficient to cover the repayment of the principal amount of secured deposits outstanding and interest accrued thereon;
- (b) satisfy himself that the circular or advertisement inviting deposits does not contain any information which is inconsistent with the terms of the deposit scheme or with the trust deed and is in compliance with the rules and provisions of the Act;
- (c) ensure that the company does not commit any breach of covenants and provisions of the trust deed;
- (d) take such reasonable steps as may be necessary to procure a remedy for any breach of covenants of the trust deed or the terms of invitation of deposits;
- (e) take steps to call a meeting of the holders of deposits as and when such meeting is required to be held;
- (f) supervise the implementation of the conditions regarding creation of security for deposits and the terms of deposit insurance;
- (g) do such acts as are necessary in the event the security becomes enforceable;
- (h) carry out such acts as are necessary for the protection of the interest of depositors and to resolve their grievances.

Further, in terms of Rule 9, the trustee for depositors shall call a meeting of all the depositors up on-

- (a) requisition in writing signed by at least one-tenth of the depositors in outstanding value;
- (b) the happening of any event, which constitutes a default or which, in the opinion of the trustee for depositors, affects the interest of the depositors.
- (c)

## 7. Relief to Private Companies

The Ministry of Corporate Affairs has, vide Notification no. GSR No. 464(E) dated 05.06.2015, notified that the clause (a) to (e) of sub-section (2) of section 73 (issuance of circular, filing of circular with Registrar, creation of deposit repayment reserve account, deposit insurance and certifying on default in repayment) of the Act shall not apply in case of private company which accepts from its members (either equity or preference shareholder), monies not exceeding 100% of aggregate of the paid up share capital and free reserves, and such company shall file the details of monies so accepted to the Registrar in such manner as may be specified. Any amount received in terms of the provisions of this section shall not be exempted from the definition of deposit and accordingly the compliances as per the provisions of the Companies (Acceptance of deposit) Rules, 2014 regarding acceptance of deposit needs to be complied. As the exemption is limited to clause (a) to (e), clause (f) regarding creation of security needs to be complied with in case of secured deposits.

## 8. Repayment of deposits and remedies thereof

In case the Company fails to repay the deposits as per the terms and conditions of the agreement, the depositor may apply to the Tribunal, where he may also claim loss for damages, apart from his due amount. Tribunal is empowered to give any other orders as it may deems fit on such application. Tribunal may also give orders which may be in the interest of company like granting moratorium etc. The company does not have any powers to approach to the Tribunal for getting any relief. The only power to the Company to do so is in section 74 relating to deposits accepted under section 58A of the Companies Act, 1956 and not for deposits accepted under this Act.

The remedy available for depositor in case of default by a company in repayment of deposit or non-payment of interest is to approach the Tribunal. Courts will not entertain any other remedies unless he approaches the Company Law Board at the first instance. The above principle was observed by the Andhra Pradesh High Court in case of Nagarjuna Finance Ltd. v. Reserve Bank of India<sup>26</sup>. This position is further strengthened by virtue of section 430.

One another remedy being made available to the depositors is that of filing a class action suit. Clause (ii) of sub-section (3) of section 245 provides that not less than 100 depositors or such percentage of depositors as may be prescribed, whichever is less or depositors holding such percentage of deposits as may be prescribed may file a class action suit in the Tribunal. This same stand is recommended in the report of the Standing Committee on Finance (2011-12) in its 57th Report made a remark that "It has been felt that since creditors can enforce their claims through contracts/ agreements with borrower companies, they may not be given statutory right for class action. On the other hand since depositors do not have any contractual rights and are mainly of unsecured nature, they are being proposed to be empowered with right to file class action petitions before Tribunal."

Further, it would be pertinent to note that several state governments have separately enacted certain laws for protecting the interest of the depositors e.g. the Maharashtra Protection of Interest of Depositors (in Financial Establishments) Act, 1997, the Pondicherry

Protection of Interests of Depositors in Financial Establishments Act, 2004 and the Tamil Nadu Protection of Interest of Depositors (in Financial establishments) Act, 26 (2010) 159 1999. These Acts additionally protects the interest of the depositors. The Constitutional validity of these Acts was challenged in *New Horizon Sugar Mills Ltd. V. Government of Pondicherry Tr. Addl. Sec [(2012) 175 Comp Cas 475 (SC)]* where in Supreme Court held that these laws are valid since they safeguard the interest of common citizen against exploitation by unscrupulous persons. Similarly Supreme Court held in *Soma Suresh Kumar v. Government of Andhra Pradesh* held that provisions of Andhra Pradesh [(2013) 180 Comp Cas 277 (SC)] Protection of Depositors of Financial Establishments Act, 1999, are constitutionally valid.

A question germane to the above discussion is if an amount becomes a deposit due to non-compliance of conditions laid down in rule 2 (1) (c), whether the person who has given the deposit be considered as a 'depositor' and be entitled to make application to Tribunal under the provisions of sub-section (3) of section 73. The definition of 'depositor' given in the rule 2 (1) (d) is not supporting the contention that there could be any person other than members under Section 73 and other depositors under Section 76 can have the right to apply to CLB. Further, as held in the case of *V Srinivas and Another v. Machines & Machine Tools (P.) Ltd. [(2003) 47 CLA 220 (CLB)]* unless the deposits are accepted after complying with the provisions of deposit rules, the person shall not be treated as depositor.

## **9. Offence & Compoundability**

The contraventions under section 73 are made punishable under section 76A, in addition to the payment of the amount of deposit and the interest due, minimum fine of Rs. One Crore which may extend to Rs. 10 Crores for the company and for the officer in default, punishment which may extend to seven years or with a fine of Rs. 25,000/- which may extend to Rs. Two crores or with both. As the offence for the company is punishable with fine only, it will be compoundable by Tribunal as per the provisions of Section 441 and the offence by officer in default will be compoundable with permission of Special Court.

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