



news flash

July 2016



ACCEPTANCE OF DEPOSITS BY COMPANIES

The Ministry of Corporate Affairs (“MCA”) vide Notification dated 29 June 2016 has notified Companies (Acceptance of Deposits) Amendment Rules, 2016 (“Amendment Rules”) thereby amending Companies (Acceptance of Deposits) Rules, 2014 (“Rules”). The Amendment Rules have come into force from 29 June 2016.

Background:

Sections 73 to 76 of Chapter V the Companies Act, 2013 (“Act”) contain provisions governing the acceptance of deposits by companies. All companies covered under the provisions of the Act and the Rules are required to comply with conditions such as issuance of circular to its members, filing a copy of the circular to the Registrar of Companies, depositing such sums as may be prescribed under the Act, providing deposit insurance and so on.

Amendment Rules:

A. Deposits

The Rules provide that a deposit includes *any receipt of money by way of deposit or loan or in any other form, by a company subject to certain exclusions as provided for in the Rules*. The Amendment Rules have *inter alia* modified the list of exclusions, whereby the following amounts would not be included as deposits:

- (i) Any amount raised by way of issue bonds, or specified secured debentures or debentures compulsory convertible into shares of a company within a period **10 years**. The Rules earlier provided for a period of 5 years.
- (ii) Any non-interest bearing amount received and held in trust. The Rules earlier stated that any non-interest bearing amount received **or** any amount held in trust.
- (iii) The Rules provided that certain amounts received in the course of, for the purpose of the business of the company would not be construed as deposits. The Amendment Rules have added the following categories of amounts to the said exclusions –
 - (a) Any advance towards consideration for providing future services in form of a warranty or maintenance contract as per a written agreement/ arrangement provided that the period for the provision of such services does not exceed the period as per common business practise or five years from the date of acceptance of such services, whichever is less.

contd...

- (b) Any advance received and allowed by any from sectoral regulatory or in accordance with the directions of Central or State Government;
- (c) as an advance for subscription towards publication in print or in electronic form to be adjusted against receipt of such publications.

In addition to the earlier exclusions as provided in the Rules, the Amendment Rules have now stated that the following amounts would not be considered as ‘deposits’-

- (i) Any amount raised by way of issuing non-convertible debentures not constituting a charge on the assets of the company and listed on a recognised stock exchange as per the regulations issued by the Securities and Exchange Board of India (“SEBI”);
- (ii) Any amount received by way of subscription in respect of a chit under the Chit Fund Act, 1982;
- (iii) Any amount received by the company under any collective investment scheme in compliance with regulations issued by SEBI;
- (iv) Any amount received by a company from Alternate Investment Funds (“AIFs”), Domestic Venture Capital Funds (“VC Funds”) and Mutual Funds registered with SEBI in accordance with SEBI’s rules and regulations;
- (v) An amount of Rupees Twenty-Five Lakhs or more received by a *start-up company*, by way of a *convertible note* (convertible into equity shares or repayable within five years from the date of issue) in a single tranche, from a person.

The terms ‘start-up company’ and ‘convertible note’ have been defined in the Amendment Rules, as follows-

‘Start-up company’ means a private company incorporated under the Companies Act, 2013 or Companies Act, 1956 and recognised as such in accordance with notification number G.S.R. 180(E) dated 17th February, 2016 issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry;

‘Convertible note’ means an instrument evidencing receipt of money initially as a debt, which is repayable at the option of the holder, or which is convertible into such number of equity shares of the start-up company upon occurrence of specified events and as per the other terms and conditions agreed to and indicated in the instrument.

B. Persons from whom deposits can be accepted

Section 73(2) of the Act provides that a company may accept deposits from its members subject to certain conditions prescribed therein. The earlier position as per the Rules was that such companies could accept or renew any deposits from its members, if the amount of deposits together with the amount of other deposits outstanding as on the date of acceptance or renewal of such deposits exceeds 25% of the aggregate of the paid-up share capital and free reserve of the company.

The Amendment Rules have now increased the earlier limit of 25% to **35%** of the aggregate of the paid-up share capital and free reserve of the company. Further, the Amendment Rules now provide that a private company may accept its member's monies upto 100% of paid-up share capital, free reserve and securities premium account and shall make the requisite filings with the Registrar of Companies.

C. Credit Rating

Earlier, '*eligible companies*' as defined in the Rules were required to obtain a credit rating for the deposits accepted by these companies at least once a year from specific credit rating agencies specified in the Rules.

Now the Amendment Rules provide that the credit rating shall not be below minimum investment grade or other specified credit rating for fixed deposits from any one of the approved credit rating agencies as specified for Non-Banking Financial Companies in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998, issued by the Reserve Bank of India shall apply. Such an *eligible company* shall have to obtain the credit rating at least once a year and file the same with the Registrar of Companies.

D. Circular in the Form of Advertisement Inviting Deposits

As per the Rules, earlier every '*eligible company*' as defined in the Rules intending to invite deposits was required to issue a circular in the form of an advertisement in the prescribed form in English language in an English newspaper and in vernacular language in a vernacular newspaper having wide circulation in the State in which the registered office of the company is situated. The Amendment Rules now specifically provide that the aforesaid English newspaper must have country wide circulation and that in addition to publishing the advertisement in the newspapers the circular must also be placed on the website of the company, if any.

E. Deposit Insurance Contract

The Rules initially provided that every company as referred to section 73(2) of the Act and '*eligible companies*' as defined in the Rules could accept deposits without a deposit insurance contract till 31 March 2016 or till the availability of the deposit insurance product. Now pursuant to the Amendment Rules, the time limit for accepting deposits without the deposit insurance contract has been extended till **31 March 2017** or till the availability of the deposit insurance product, whichever is earlier.

F. Disclosures

As per the Amendment Rules, additional disclosures are required to be made in the financial statements by companies, as follows-

- (i) companies other than private companies have to disclose in their financial statements (by way of notes), the money received from its directors; and
- (ii) private companies shall disclose in their financial statements (by way of notes) the money received from its directors, or from the relatives of directors.

G. Disclaimers

Earlier the Rules did not provide for any disclaimers in the prescribed form i.e. form for circular in the form of advertisement inviting deposits. However, the Amendment Rules now provide for an insertion of a disclaimer in the prescribed form for the exclusion of the liability of the Central Government and Registrar of Companies with respect to the financial soundness of any deposit scheme or the correctness of the statements made in the prescribed form. Further the disclaimer provides that the depositors must exercise due diligence prior to investing in the deposit schemes.

Conclusion:

It can be seen that pursuant to the Amendment Rules, the MCA has newly included certain categories in the list of exclusions for deposits as well as modified the existing list of exclusions. Further, in our view, one of the key amendments is the exclusion of amounts received by a company from AIFs, VC Funds and Mutual Funds registered with the SEBI from the category of 'Deposits'. Hence, in our view, AIFs, domestic VC Funds and Mutual Funds may now subscribe to optionally convertible debentures of companies, without these being viewed as deposits.

DISCLAIMER

This news flash has been written for the general interest of our clients and professional colleagues and is subject to change. This news flash is not to be construed as any form of solicitation. It is not intended to be exhaustive or a substitute for legal advice. We cannot assume legal liability for any errors or omissions. Specific advice must be sought before taking any action pursuant to this news flash.

For further clarification and details on the above, you may write to the Corporate team comprising of (among others) Mr. Vaishakh Kapadia (Partner) at vkapadia@almtlegal.com; Ms. Manali Kshirsagar (Associate) at mkshirsagar@almtlegal.com; and Mr. Vinit Shah (Paralegal) at vshah@almtlegal.com.