

## *Companies Act*

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### *Investor Education Fund*

#### **Provisions relating to Investor Education and Protection Fund - An Overview**

*A new section 205C was inserted by the Companies (Amendment) Act, 1999 in the Companies Act, 1956 empowering the Central Government to establish a fund to be called the 'Investor Education & Protection Fund', with the avowed purpose of protecting the interests of investors and educating them in matters connected with investment.*

*In this article, the author takes stock of the new statutory provisions and the rules made thereunder and explains the procedural details connected with the establishment of this fund, especially the deposit of the specified categories of amounts that are to go into it. The author also clarifies certain aspects of the statutory provisions, which are likely to give rise to ambiguity and uncertainty and pleads that the Department of Company Affairs would do well to bring out appropriate clarifications—EDITOR*

#### **Introduction**

1. A new section 205C was inserted in the Companies Act, 1956 ('the Act') by the Companies (Amendment) Act, 1999 (the Amendment Act) with effect from October 31, 1998 which empowers the Central Government to establish a fund to be called 'Investor Education & Protection Fund' (the Fund). The main objective behind the introduction of section 205C is to compel companies to transfer to the fund all the amounts specified in sub-section (2) of section 205C, that were tendered by them but have not been claimed by the investors. Sub-section (3) of section 205C empowers the Central Government to prescribe rules for the fund. Therefore, in exercise of the powers so conferred, the Central Government has made ~~the Rules, namely, the 'Investor Education and Protection Fund (Awareness & Protection of Investors) Rules, 2001'~~. These rules were published in the Official Gazette on October 1, 2001 and, as such, are effective from that date.

#### **Categories of amounts which are to be credited to the Fund**

2. As per section 205C the following amounts have to be credited to the fund by companies :—

- (a) amounts in the unpaid dividend accounts of companies;
- (b) the application money received by companies for allotment of any securities and due for refund;

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- (c) matured deposits with companies;
- (d) matured debentures with companies; and
- (e) the interest accrued on the amounts referred to in clauses (a) to (d).

The aforesaid amounts have to be transferred to the Fund only if they have remained unclaimed by investors even after the expiry of a period of seven years from the date on which they became due for payment.

### **Position before the commencement of Companies (Amendment) Act, 1999**

3. Before the Amendment Act came into force, *i.e.*, before October 31, 1998, section 205A(1) required the companies to transfer the unpaid/unclaimed dividend to a special bank account to be called 'Unpaid Dividend Account of ..... Company/Company (Private) Limited' within 7 days, after the expiry of a period of 42 days, prescribed for dividend payment [the Companies (Amendment) Act, 2000 has reduced the period for dividend payment from 42 days to 30 days]. Section 205A(5) in turn required that any amount which was transferred to the unpaid dividend account and remained unclaimed by shareholders even after the expiry of a period of three years from the date of such transfer shall be transferred to the general revenue account of the Central Government.

Therefore, from the above submissions, we can notice two major changes which are as follows :—

- (i) Earlier, the companies were required to transfer only the unclaimed amounts in respect of dividend payment only but now they are obliged to transfer unclaimed amounts in respect of—application money received for allotment of securities and due for refund; and matured deposits and matured debentures also.
- (ii) The period for transfer of unclaimed dividend has been increased from three years to seven years.

It may be noted here that section 205A, which was inserted in the Act by the Companies (Amendment) Act, 1974, had the legal effect of making companies merely a custodian in the nature of a trustee until the dividend amount was either paid to the shareholder or was transferred to the special account in accordance with the provisions of section 205A(1). In other words, after the amendment in 1974, the companies ceased to have any legal or beneficial interest in the dividend amount, the moment the dividend was declared. In a similar way, after the commencement of the Companies (Amendment) Act, 1999 the companies are merely custodians for other unclaimed amounts also, *viz.*, unclaimed application money, unclaimed matured deposits and unclaimed matured debentures. Therefore, these unclaimed amounts cannot be treated by companies as their own and as such they cannot mix the same with their own funds. In other words these amounts are independent of and unrelated to the company's own assets and liabilities.

**No claims shall lie against the Fund**

4. The *Explanation* to section 205C(2) clearly states that no claims shall lie against the fund or the company in respect of individual amounts which were unclaimed for a period of seven years from the date they first became due for payment and which have consequently been transferred to the fund by the companies. In view of this we can infer that the amount once transferred to the fund can neither be claimed back by the company nor by the investors.

Therefore, we can say that to some extent the above provision is not investor-friendly because before the introduction of section 205C, shareholders had a right to claim the unclaimed dividend amount which had been transferred to the general revenue account of the Central Government. For the purpose, the shareholders had to follow the procedure prescribed under section 205B of the Act. Now this right is no more available to investors even in respect of unclaimed dividend payments also. However, the unclaimed dividend amounts which were transferred by companies to the general revenue account of the Central Government before October 31, 1998 can still be claimed by shareholders as the provisions of section 205C do not come in the way of such claims.

**Contradiction between Section 205A(5) and proviso to section 205C(2) of the Act**

5. It is worthwhile to note here that section 205A(5), which exclusively deals with the transfer of unpaid dividend amount to the fund, provides that the period of seven years is to be reckoned from the date of transfer of unpaid dividend to the unpaid dividend account of the company, opened in any scheduled bank, whereas the proviso to section 205C(2) provides that the period of seven years is to be reckoned from the date when the amount (read 'dividend') became due for payment.

*For example* - If a company declares dividend at AGM held on November 1, 2001, then the dividend becomes due for payment on November 1, 2001 itself and, therefore, as per the proviso to section 205C(2) the unclaimed dividend, if any, should be credited to the fund on the expiry of seven years from the aforesaid date, *i.e.* on or after November 1, 2008 (latest by November 30, 2008 as per rule 3 of the Rules). On the other hand, if the same company pays dividend through dividend warrants dated November 10, 2001 and the warrants are dispatched on 10th itself (*i.e.*, within 30 days of declaration) then as per section 205A(1), all the amount that is unclaimed by shareholders as on November 30, 2001 (*i.e.*, on expiry of 30 days from the date of declaration) will have to be transferred to the Unpaid Dividend Account, opened by the company in any scheduled bank, within 7 days thereof and suppose the amount is so transferred on December 1, 2001, then, as per the provisions of section 205A(5), the period of seven years will be reckoned from December 1, 2001.

Therefore, in this case the unpaid dividend will have to be credited to the fund, on or after December 1, 2008 (latest by December 30, 2008 as per rule 3 of the Rules). Therefore, there seems to be a repugnancy between the provisions of section 205A(5) and the proviso to section 205C(2) as far as transfer of unclaimed dividend to the fund is concerned. Therefore, if we follow the rule of harmonious construction of interpretation of statutes, then it would mean that transfer of unclaimed dividend should be made to the fund in accordance with the provisions of section 205A(5) as the said sub-section exclusively deals with the transfer of unclaimed dividend amount and other unclaimed amounts should be transferred in accordance with proviso to section 205C(2). However, in view of the aforesaid repugnancy it would be appropriate if the Department of Company Affairs (DCA) issues a suitable clarification in this regard.

#### **Procedure for credit of unclaimed amounts to the fund**

6. Rule 3 of the Investor Education and Protection Fund (Awareness & Protection of Investors) Rules, 2001 (the rules) deals with the procedure for crediting unclaimed amounts to the Fund.

6.1 *Deposit of unclaimed amounts with bank by company* - Rule 3(i) provides that any amount required to be credited by a company to the Fund shall be remitted into any of the specified branches of Punjab National Bank (PNB), within a period of thirty days of such amount becoming due for credit to the fund. Rule 3(i)(a) and (b) provide that the company shall tender the amount to PNB along with challan (in triplicate) giving full description of the nature of amount tendered and its 'head of account'. The bank will return two copies of the challan duly stamped to the company as token of having received the amount.

*Head of account* :- For the purpose of filling the challan it is necessary to understand the system of head of account. As per rule 4(i), the major head of payment will be: '0075 - Miscellaneous General Services' and the minor head will be: '104- Unclaimed and unpaid dividends, deposits and debentures etc., of investors in companies'.

*Sub-heads* are as follows :—

- (a) Unpaid dividend
- (b) Unpaid application money received by companies for allotment of securities and due for refund
- (c) Unpaid matured deposits
- (d) Unpaid matured debentures
- (e) Interest accrued on (a) to (d).

As from the (e) above the category of payment will not be clear, provision has been made for *detailed heads* which are as follows :

- (i) Interest on unpaid dividend.

- (ii) Interest on unpaid application money received by companies for allotment of securities and due for refund.
- (iii) Interest on unpaid matured deposits.
- (iv) Interest on unpaid matured debentures.

**6.2 Filing with ROC by company** - Rule 3(ii)(b) provides that whenever any company credits to the fund any unclaimed amounts, it shall file one copy of the challan (duly stamped by bank) with the concerned ROC. The company shall also furnish to the ROC a statement in Form 1 to the Rules, duly certified by a chartered accountant or a company secretary or a cost accountant practicing in India or by the statutory auditors of the company.

**6.3 Procedure to be followed by ROC and DCA** - Rule 3(c)(i) provides that on receipt of the statement from companies, the ROC shall enter the details of receipt in a register and reconcile the amount so remitted and collected, with the concerned Pay and Accounts Officer on a monthly basis. Rule 3(c)(iii) requires, that every ROC shall furnish an abstract of such receipts during each month to the DCA within 7 days after the close of the month. Rule 3(c)(iv) requires that DCA shall maintain a consolidated abstract of receipts and shall reconcile the same on a quarterly basis with principal pay and accounts office of the DCA.

**6.4 Record to be kept by companies** - Rule 3(c)(i) requires that each company crediting any unclaimed amount to the fund shall keep a record relating to folio No., certificate No., etc. in respect of persons whose unclaimed payments have been credited to the fund. Such record shall be kept for a period of three years and the committee or sub-committee, formed by the Central Government under section 205C(4) to administer the Fund, shall have powers to inspect such record.

It is worthwhile to note here that section 205A(6) requires that whenever a company makes any transfer to the Fund of any unpaid or unclaimed dividend, it shall furnish a statement to ROC in the prescribed form setting forth in respect of all sums included in such transfer, the nature of the sums, the names and last known addresses of all the persons entitled to receive the sum, the amount due to each of them etc. Now as per the Rules (Rule 3) only Form 1 to the rules has to be filed with ROC and no such statement is to be filed. It may be noted that filing of such statement was very useful in the past as shareholders had a right under section 205B to claim their unpaid (unclaimed) dividends from ROC which had been transferred to the General Revenue Account of the Central Government. Therefore, in such cases the statement was used for verification purposes. However, as the *Explanation* to the present section 205C(2) specifically states that no claims shall lie against the Fund, the filing of aforesaid statement in accordance with section 205A(6) will not serve any purpose now. In view of the above-mentioned contradiction between the provi-

sions of section 205A(6) and rule 3 it is desirable that the DCA issues a clarification in this regard.

### **Constitution of Committee and its functions**

7. Section 205C(4) empowers the Central Government to constitute a committee to administer the Fund. As per Rule 7 the committee shall consist of ten members excluding the chairperson who is secretary to the DCA. The functions of the committee shall be to promote investors' education, awareness and protection by means of education programs through the media; organising seminars and symposia; registration of voluntary associations, institutions or other organizations engaged in investor education and protection; projects for investor education and protection including research activities; coordinating with institutions engaged in investor education, awareness and protection activities. For the purpose of efficient and speedy discharge of its functions, the committee may appoint one or more sub-committees consisting of its members. The committee shall furnish its activity report, for every six months, to the Central Government.

### **Whether the amendment is prospective or retrospective**

8. From a perusal of section 205C or the Rules made thereunder it is not clear, as to whether the amendment is prospective only or it has retrospective effect also. In other words, as regards unclaimed amounts, the following three situations are possible :

- (i) the amount becomes due for payment after October 31, 1998 and, thus, unclaimed amounts are to be transferred to the fund on or after October 31, 2005.
- (ii) the amount becomes due for payment before October 31, 1998 and remains unclaimed for a period of seven years from the due date of payment and such seven years period has completed only after October 31, 1998.  
*For example, if the fixed deposit of an investor matured in February 1995 and the maturity proceeds remained unclaimed for seven years, i.e., up to February 2002, then a question arises as to whether the amount of such unclaimed fixed deposit needs to be transferred to the Fund or not.*
- (iii) the amount becomes due for payment before October 31, 1998 and remains unclaimed even after October 31, 1998 but the seven years period had completed before the Amendment Act came into force i.e., before October 31, 1998.

*For example, if the fixed deposit of an investor matured in February 1990 and remained unclaimed even after October 31, 1998 but as the seven years period had already completed in February 1997, i.e., before the Amendment Act came into force, it is doubtful as to whether such amounts also needs to be transferred to the fund.*

It is worthwhile to note here that, unless otherwise stated, it is presumed that all the laws/amendments made in the laws are prospective in operation. Moreover, when the provision relating to transfer of unclaimed dividend to the General Revenue Account of the Central Government was introduced in the Companies Act, 1956 by the Companies (Amendment) Act, 1974, section 205A(2) clearly stated that, '*Where the whole or any part of any dividend, declared by a company before the commencement of the Companies (Amendment) Act, 1974 remains unpaid at such commencement, the company shall, within a period of six months from such commencement, transfer such unpaid amount to the account referred to in sub-section (1)*'. Now, at present both section 205C and the Rules framed thereunder are silent as to whether such amounts have to be transferred to the fund or not. Therefore, in order to clear the doubts as to whether the amounts mentioned at (ii) and (iii) above have to be transferred to the fund or not, it would be appropriate if the DCA issues a suitable clarification in the matter.

### **Interpretation of section 205C(2)(e) of the Act**

9. Clause (e) of sub-section (2) of section 205C requires that the interest accrued on the amounts referred to in clauses (a) to (d) of said sub-section shall also be credited to the fund. It is not clear as to what is meant by the term '*interest accrued*' used in clause (e) and as such it is open to several interpretations. Probably, the term '*interest accrued*' has the following meanings when it is read in conjunction with clauses (a) to (d) of section 205C(2) :

- (i) *Interest on unpaid dividend* - Section 205A(4) provides that a company shall be liable to pay interest at the rate of 12 per cent per annum to the shareholders if it fails to transfer the unpaid dividend amount to a special bank account within the prescribed time-limit. Therefore, most probably clause (e) refers to the aforesaid interest payment when it states, '*interest accrued on amounts referred to in clause (a)*'.
- (ii) *Interest on unclaimed applications money* - As per the SEBI Guidelines, in case of a public or rights issue, the process of allotment of securities and refund of excess application money has to be completed within 30 days of the close of the issue. In case a company fails to dispatch the refund orders within 30 days period, it has to pay interest at the rate of 15 per cent per annum to the investors. Therefore, most probably clause (e) refers to the aforesaid interest when it states, '*interest accrued on the amounts referred to in clause (b)*'.
- (iii) *Interest on unclaimed matured deposits* - Generally, fixed deposit schemes of all the companies are of two kinds - '*cumulative*' and '*non-cumulative*'. Under a '*cumulative*' scheme interest is paid to investors along with the maturity proceeds whereas in case of a '*non-cumulative*' scheme, interest is paid at quarterly/half-yearly

intervals as per the terms and conditions of the scheme. Now, if we read clause (e) of section 205C(2) in conjunction with clause (c), it will mean 'interest accrued on matured deposits'. Therefore, there is no doubt in the fact that the whole amount *i.e.*, principal together with the interest accrued thereon, which has remained unclaimed at the time of maturity in case of a 'cumulative' scheme, needs to be transferred to the Fund. However, it is not clear as to whether, in case of 'non-cumulative', scheme the companies have to transfer to the fund only the principal amount of unclaimed deposits or unclaimed instalments of quarterly/half-yearly interest payments also.

- (iv) *Interest on unclaimed matured debentures* - Just as in the case of matured deposits (under the non-cumulative option), it is not clear in the case of debentures also, as to whether clause (e) of section 205C(2) refers only to the interest that is paid along with the maturity proceeds of debentures or it also includes the interest paid on debentures at regular intervals (say, every year on 31st March and 30th September) which has remained unclaimed by debenture holders. If the interest paid on debentures at regular intervals is also to be transferred to the Fund, then a question arises as to from which date the period of seven years is to be reckoned *i.e.*, whether it is to be reckoned from the date of payment of each and every individual instalment of interest or from the date of maturity of debentures.

Another area of uncertainty is there in the case of debentures that are redeemable in more than one instalment. For example, suppose A company XYZ Ltd. has issued debentures of face value of Rs. 150 each, redeemable in three equal annual instalments of Rs. 50 per debenture at the end of 8th, 9th and 10th year from the date of allotment. In such a case a question arises as to, from which date the period of seven years is to be reckoned, whether it is to be reckoned from the date of payment of each and every individual redemption instalment or from the date of payment of final redemption instalment.

In order to resolve all these controversial issues, regarding various possible interpretations of section 205C(2)(e) of the Act, it would be appropriate if the DCA issues suitable clarification in the matter.

#### **Interest earned by companies on unclaimed amounts**

10. The RBI issued a circular in May 2000 advising all the Scheduled Commercial Banks to open fixed deposit account in respect of unpaid/unclaimed dividend lying in the special banking account, opened in the form of current account in case a request is made by a company. As prior to the issue of the aforesaid circular, the special banking accounts for unclaimed dividend payments were required to be maintained in the form of a current account, the companies were not entitled to receive any interest on the funds lying idle in such accounts and consequently this practice resulted in a loss to the companies.

*Lacunae in section 205C* - Although section 205C very clearly states that all the amounts *viz.*, unclaimed application money, unclaimed matured deposits and unclaimed matured debentures as well as interest accrued on such sums have to be transferred to the Fund at the expiry of seven years from the date they became due for payment, yet there is no provision in the said section for transfer of such amounts to any special banking account just as there is a provision in section 205A(1), for transfer of unpaid (unclaimed) dividend to a special banking account within seven days after the expiry of a period of thirty days from the date of declaration of dividend. However, in view of the provisions of section 205C, it seems implied that once any of the aforesaid amounts *viz.*, amount towards redemption proceeds of debentures etc., is transferred to the current account opened with any scheduled bank the same cannot be withdrawn by the company for its business purposes.

Moreover, as the aforesaid circular issued by the RBI only deals with the conversion of unclaimed dividend amount lying in current account into a fixed deposit account and not with the amounts lying in other current accounts *viz.*, unclaimed amount towards redemption proceeds on debentures etc., it would be appropriate if a similar facility is provided for other unclaimed amounts also. This is essential since as per clauses (b), (c) and (d) of sub-section (2) of section 205C, these unclaimed amounts have also to be transferred to the fund at the expiry of seven years from the date they became due for payment.

Now a question arises as to whether the amount of interest earned by a company by converting amount lying in the current account into fixed deposit account in the aforesaid manner is also to be transferred to the fund. The answer to this is 'NO' because the term used in section 205C(2)(e) is '*interest accrued*' and not '*interest earned*'. Moreover only those amounts are to be transferred to the fund which accrue to investors but have not been claimed by them. As the interest earned by the company through fixed deposit of unclaimed amount belongs to the company and is appropriated by it as its interest income, it is not bound by section 205C(2)(e) to transfer the same to the fund.

#### **Problem relating to transfer of unclaimed amount of matured Fixed Deposits**

11. Almost all the companies, which invite fixed deposits from the public accept deposits throughout the year. So, when deposits are accepted on a daily basis they also mature on a daily basis. Therefore, if there are numerous unclaimed deposits, the seven year period in respect of each individual deposit will complete on a different date, due to which the companies will face a big problem in transferring the amount of unclaimed deposits to the fund inasmuch as that they will have to keep on transferring such unclaimed matured deposits to the fund quite frequently throughout the year. As rule 3 states that the unclaimed amounts have to be transferred to the Fund within 30 days of such amount

becoming due for credit to the fund probably most of the companies accepting fixed deposits will have to transfer unclaimed matured deposits to the fund around twelve times in a year which will be very cumbersome, time-consuming and expensive. Therefore, in order to avoid inconvenience it will be appropriate if a provision is made in the rules that all the unclaimed matured deposits that have completed the seven years period during a particular financial year, are to be transferred to the Fund within one month of the close of that financial year.

### **Conclusion**

**12.** In a country like India, with a population of more than one billion, and that too consisting of a large middle class which invests a considerable part of its hard-earned money in the capital market and where there is no dearth of fly-by-night operators, manipulators of markets as well as stock market scams-that wipe out thousands of crores of market capitalisation and ruin lakhs of investors with one stroke, the need for investor education and protection is apparent. Thus, the establishment of Investor Education & Protection Fund by the Central Government is a step in the right direction. However, only time will tell what success the managers of the Fund attain in achieving the objectives for which the Fund has been established.