

NIDHIS: AN ANALYSIS OF LEGAL PROVISIONS

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Abstract: “Artha” (money or economics) is of a great importance in any civilization. Financial activities gave birth to different modes means and methods. Emergence of companies is one of these means of financial activities. In India to regulate and promote company activities we have different rules, regulations, laws and regulatory authorities. With the development of the society and world scenario Indian company laws also evolved. The most important and basic law for companies is Companies Act, 1956, and afterwards it has changed into Companies Act, 2013.

NBFCs (Non-Banking Financial Companies) are significant in Indian corporate sector. Some of the Non-Banking Financial Companies are known as Nidhi Companies under section 620 A of Companies Act, 1956. This is indeed a great effort to curb the irregularities and corrupt practices prevalent in last few decades. In new Companies Act, 2013 section 406 is provided for Nidhi Companies. Nidhi is not a new concept. It has been there in India since centuries ago. “Nidhi” means treasure. Since ancient times culture of Nidhis has been there. Power corrupts and misuse of the powers by the directors is not a new thing. There are many examples of misuse of the powers given to the directors. As stated by Sabanayagam committee (2000) that irregularities were there in Nidhi companies because of mismanagement and poor control by the controlling authorities (specially the directors of such companies). In case of Nidhi Companies, more attention is needed when it comes especially to the term of directors of such companies. New provisions are providing for a term of 5 years for the directors of Nidhi Companies. Chennai fund case or famous Sharadha Scam and many more are the burning examples where we could see the irregularities and the corruption, because of which depositors or small investors got so affected that many of them have committed suicide.

Director’s position is significant in a company so as the term of the directors. The discussion is indicating towards the issues in this regard. The paper is about an analysis of the legal provisions for Nidhis especially in light of different cases and guidelines provided by RBI, DCA and MCA.

Index Terms- Nidhis, Director's term, NBFCs.

Introduction

“Artha” (money or economics) is of a great importance in any civilization. Financial activities gave birth to different modes means and methods. Emergence of companies is one of these means of financial activities.

In India to regulate and promote company activities we have different rules, regulations, laws and regulatory authorities. With the development of the society and world scenario Indian company laws also evolved. The most important and basic law for companies is Companies Act, 1956, and afterwards it has changed into Companies Act, 2013.

NBFCs (Non-Banking Financial Companies) are significant in Indian corporate sector. A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares, stocks, bonds, debentures, securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.¹

A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in instalments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).² Some of the Non-Banking Financial Companies are known as Nidhi Companies under section 620 A of Companies Act, 1956. This is indeed a great effort to curb the irregularities and corrupt practices in corporate sector. In new Companies Act, 2013 section 406 is provided for Nidhi Companies. Basically Nidhis are a part of the ‘unorganised sector’ of our financial system.

Nidhi is not a new concept. It has been there in India since centuries ago. “Nidhi” means treasure. Since ancient times culture of nidhis has been there. Two things needed to be discussed firstly was it needed to have provision for Nidhi Companies and secondly if the provisions for Director’s term are proper.

¹See: <https://www.rbi.org.in/Scripts/FAQView.aspx?Id=92> (Last accessed on 07/05/2018.)

²*ibid*

Provisions relating to Nidhi Companies-

The Companies Act, 1956 has provided for the establishment of Nidhi Companies under section 620 A of the Act of 1956. The Central Government is given authority to notify about NBFCs (Non-Banking Financial Companies) as Nidhi Companies as a different category under it. In the Act along with the provision for Nidhis, Mutual Benefit Societies are also mentioned as a category of NBFCs.

The special category or sub category more precisely; is created with the intension to regularize as well as signify the age old concept of Nidhis in a legal manner. After the 1974 amendment few powers have been given to the Regional Directors in this regard for speedy process under section 297 (1) of the Companies Act 1956.³ Companies Act of 2013 has provided under section 406 for Nidhi Companies.⁴

According to The Companies Amendment Act, 2017 Published on 3 January 2018, under section 406 of The Companies Act 2003, the following section shall be substituted,

...(the) '406. (1) In this section, "Nidhi" or "Mutual Benefit Society" means a company which the Central Government may, by notification in the Official Gazette, declare to be a Nidhi or Mutual Benefit Society, as the case may be. (2) The Central Government may, by notification in the Official Gazette, direct that any of the provisions of this Act specified in the notification— (a) shall not apply to any Nidhi or Mutual Benefit Society; or (b) shall apply to any Nidhi or Mutual Benefit Society with such exceptions, modifications and adaptations as may be specified in the notification. (3) A copy of every notification proposed to be issued under sub-section (2), shall be laid in draft before each House of Parliament, while it is in session, for a total period of thirty days, and if, both Houses agree in disapproving the issue of notification or both Houses agree in making any modification in the notification, the notification shall not be issued or, as the case may be, shall be issued only in such modified form as may be agreed upon by both the Houses. (4) In reckoning any such period of thirty days as is referred to in sub-section (3), no account shall be taken of any period during which the House referred to in sub-section (3) is prorogued or adjourned for more than four consecutive days. (5) The copies of every notification issued under this section shall, as soon as may be after it has been issued, be laid before each House of Parliament.⁵

NBFCs which have been incorporated with the intention to function as Nidhis will be classified as Loan Companies and the directions as applicable to Loan Companies will be made applicable to them till such notification.⁶

When it comes to the relevance of the provisions for Nidhi Companies and to find out if the director's term (provided for not more than 10 years) may lead to corrupt practices and it also an opportunity to doubt the workings of a director.

In India there are 245 Nidhi Companies have been registered on MCA Portal.⁷ Interest of people with rural background and few resources Nidhi Companies are really advantageous. Nidhi Companies are more popular in the southern part of India particularly

³See: http://www.mca.gov.in/Ministry/annual_reports/annualreport2007/Eng/CHAPTER3.pdf (Last accessed on 07/05/2018).

⁴ Companies Act, 2013, Section 406. (1) In this section, "Nidhi" or "Mutual Benefit Society" means a company which the Central Government may, by notification in the Official Gazette, declare to be a Nidhi or Mutual Benefit Society, as the case may be. (2) The Central Government may, by notification in the Official Gazette, direct that any of the provisions of this Act specified in the notification—

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⁵ From the Gazette of India, The companies Amendment Act, 2017 No. 1 OF 2018 Published on 3 January 2018. (Last accessed on 06/05/2018).

⁶See: http://shodhganga.inflibnet.ac.in/bitstream/10603/112744/10/10_chapter%203.pdf (Last accessed on 07/05/2018).

⁷See: http://www.mca.gov.in/MCA21/dca/RegulatoryRep/pdf/Nidhi_Companies.pdf (Last accessed d on 07/05/2018).

in Tamilnadu. They are old institutions, some of which have existed for 75 to 100 years. Out of 123 Nidhis in 1995, 97 were in Tamilnadu of which 70 were in Chennai city alone.⁸

For controlling the irregularities and make recommendations of NBFCs especially of Nidhi Companies following committees have been appointed

Viswanatha Shastri Committee in 1965

Banking Commission in 1972

James Raj Committee in 1975

Chakravarthy Report in 1987

Dr. A.C. Shah Committee in 1992

Sabanayagam Committee in 2000

Sabanayagam committee has constituted exclusively for Nidhi Companies. According to this committee's recommendations share market capitalization benefits have not reached that effectively to the rural population in India. For this purpose Nidhi companies are of great help.

What is Nidhi?

Nidhi is a company formed with the exclusive object of cultivating the habit of thrift, savings and functioning for the mutual benefit of members by receiving deposits only from individuals empowered to issue directions to them in matters relating to their deposit acceptance activities. However, in recognition of the fact that these Nidhi Companies deal with their shareholder-members only, RBI has exempted the notified Nidhi Companies from the primary provisions of the RBI Act and other directions applicable to NBFCs.

A Nidhi company is classified at present as "Mutual Benefit Financial Company" by RBI. These companies, being a part of NBFCs, are regulated by RBI for deposit purposes and by DCA for its functioning matters and matters relating to funds. According to DCA Notification dated September 29, 2003 it is mentioned that, Nidhi Companies can't offer interest on fixed and recurring deposits which exceeds the maximum rate of supervision of MCA enjoy exemption from core provisions of the RBI Act so as to prevent interest prescribed by the RBI that the NBFCs can pay on their public deposits.

Every company incorporated as Nidhi shall have the last words "Nidhi Limited" as part of its name. Except as provided under the provisions of Nidhi Companies Rules 2014, no Nidhi Company shall have any object in its Memorandum of Association other than the object of cultivating the habit of thrift and savings amongst its members, receiving deposits from and lending to, its members only, for their mutual benefit.

Nidhi Company is not allowed to issue preference shares, on and after the commencement of Companies Act, 2013. After incorporation as a Nidhi company, it shall be a public company and with a minimum paid up equity share capital of five lakh rupees.

Nidhis are also allowed to get few exemptions from certain provisions of the Companies Act as per the MCA notification of June 2015.⁹ Every company incorporated as Nidhi shall have the last words "Nidhi Limited" as part of its name. It's a provision to avoid the confusion regarding the structure and the nature of a company. This is an important provision because there has been so many irregularities and misuses done by the companies with many frauds. Except as provided under the provisions of Nidhi Companies Rules 2014, no Nidhi Company shall have any object in its Memorandum of Association other than the object of cultivating the habit of thrift and savings amongst its members, receiving deposits from and lending to, its members only, for their mutual benefit. A Nidhi Company shall ensure that its membership is not reduced to less than two hundred members at any time.

A minor cannot be a member of Nidhi Company. A Nidhi Company is not allowed to have a body corporate or trust as member. Ratio of net owned funds to deposits should not be more than 1:20. Unencumbered term deposits of not less than 10% of the outstanding deposits. A Nidhi Company shall not declare dividend exceeding 25% or such higher amount as may be specifically approved by the Regional Director for reasons to be recorded in writing and further subject to the following conditions-

- a) An equal amount is transferred to general reserve;
- b) There has been no default in repayment of matured deposits and interest and

⁸See: Gorden,E and K.Natarajan, Op.Cit., p.257 cited in the chapter III titled Concept Of Non-Banking Financial Companies -A Bird's Eye View, available on http://shodhganga.inflibnet.ac.in/bitstream/10603/112744/10/10_chapter%203.pdf Last accessed d on 07-05-2018.

⁹See: <https://indiakorplaw.in/2015/06/mcas-exemption-notification-for.html> (Last accessed on 07/05/2018.)

iii) It has complied with all rules as applicable to Nidhi Companies¹⁰

All the above provisions are significant in restoring the sanctity of the institutions like Nidhis, but they are not flawless. Initially the relevance of the Nidhis was questioned and through different committees especially the Sabnayagam committees' recommendations clearly favour the existence of such companies. New Companies Act, 2013 has incorporated provisions mostly following the Sabnayagam Committee recommendations as it is. But there are still flaws on part of Director's term especially.

Rules relating to the directors under Nidhi Rules, 2014

Rule 17 Rules relating to Directors states that

- (1) The Director shall be a member of Nidhi.
- (2) The Director of a Nidhi shall hold office for a term up to ten consecutive years on the Board of Nidhi.
- (3) The Director shall be eligible for re-appointment only after the expiration of two years of ceasing to be a Director.
- (4) Where the tenure of any Director in any case had already been extended by the Central Government, it shall terminate on expiry of such extended tenure.
- (5) The person to be appointed as a Director shall comply with the requirements of sub-section (4) of section 152 of the Act and shall not have been disqualified from appointment as provided in section 164 of the Act.

Penalty for noncompliance is very less. According to Rule 24 Penalty for non-compliance is provided for a company if it contravenes any of the provisions of the rules prescribed in the Rules, the company and every officer of the company who is in default shall be punishable with fine which may extend to five thousand rupees, and where the contravention is a continuing one, with a further fine which may extend to five hundred rupees for every day after the first during which the contravention continues. All this may lead to corrupt practices.

The recent scams and hype in the chit fund frauds is an indicator of serious need for finding the grey areas of the provisions and their implementation for such financial set ups.

Instances Involving irregularities on part of Directors of the companies-

Irregularities are quite common in Nidhis in the form of frauds involving crores of rupees of public. With the study of few cases we can easily understand the gravity of the misuse of powers by the directors of these companies.

The observations of *Khalid J. in Reserve Bank of India v. Peerless General Finance and Investment Co. Ltd*¹¹

..."[I] share my the mushroom growth of financial companies all over the country. Such companies have proliferated. The victims of the schemes that are attractively put forward in public media, are mostly middle class and lower middle class people. Instances are legion where such needy people have been reduced penniless because of the fraud played by such financial vultures. It is necessary for the authorities to evolve fool-proof schemes to see that fraud is not allowed to be played upon persons who are not conversant with the practice of such financial enterprises who pose themselves as benefactors of people."

Chennai Fund Fraud is also an example of such irregularities where Rs. 3400 crore were involved. This is an evident instance of the involvement of the Directors, managing Directors of the companies in serious misuse of powers.¹²

*Mrs Ratnakumari and M. Ramakrishna v M/s Chrompet Saswatha Nidhi Ltd and The Manager, Canara Bank*¹³

The nidhi company has not paid the deposits even after the term. In this case it was held that the applicants should get their deposits and also they are entitled to the interest on the deposited amount.

*Reserve Bank of India vs Kuber Mutual Benefits Ltd.*¹⁴

This is also a case where directors were involved in all irregularities of the company. They promised an unusual 24-40% rate of interest on deposits, much higher than any bank and promised for other benefits like cars etc. for the winner of lucky draw. It involved 3,400 crores of 30 companies. The Reserve Bank of India filed a complaint against the company and Its Directors under

¹⁰See:<http://www.slideshare.net/EquiCorp/nidhi-company-rules-2014-an-analysis-wrt-nidhi-company-registration> Last accessed on 07/05/2018.

¹¹[1987] 61 Comp Cas 663; AIR 1987 SC 1023

¹²See:<http://www.outlookindia.com/magazine/story/the-chennai-fund-fraud/202638> (Last accessed on 07/05/2018.)

¹³CA No 1 of 2014 CA Nos 8&9 of 2002 CA Nos CSN, 2-5/45QA/SRB/2001 and See: <http://www.clb.nic.in/b> (Last accessed on 07/05/2018.)

¹⁴2002 (2) AWC 1666 b

Section 58B read with Section 58C of the Act for violation of the provisions of the Act. Kuber Mutual Benefits Ltd. with registered office at Kuber Bhawan, Begam Bridge Road, Mcerut (respondent company) is directed to be wound up.

This case is again an example of taking undue advantages of legal loopholes by misusing the powers and position of higher authority as directors in the company.

In *K. Varadan And Ors. vs The Ambattur Saswatha Nidhi*¹⁵, the petitioners collectively holding in excess of 10% of the issued capital of the Ambattur Saswatha Nidhi Limited aggrieved on account of certain acts of mismanagement and asking for appointment of an independent director for better management of the affairs of the company. The representative of the petitioners has complained of the acts of mismanagement in the affairs of the Company as the Company has been lending monies, on the security of properties in and around Ambathur, to persons without any credit worthiness and adequate securities in violation of Clause 2 of the object clause of Memorandum of Association, resulting in delayed repayment of loans availed by the borrowers. The respondents misappropriated the funds of the Company by writing off the loans extended to the friends and relatives of the directors. The respondents have abused their fiduciary position and failed to perform their fiduciary responsibilities and duties of protecting the interests of the Company.

The respondents with a view to enhance their holdings, wrongfully obtained shares from the small investors by effecting the transfers in their name, without proper execution of the transfer forms, and by allotment of shares in connivance with a staff member employed by the Company. The board of directors have misused their position to enrich themselves and the employees through unfair means. The respondents have violated various statutory provisions of the Act by allotting the shares in favour of the relatives without obtaining any approval from the board of directors. They did not serve any special notice in terms of Section 257 for appointing a person other than the retiring director nor accepted any deposit from the person or from the members, proposing him to the office of director.¹⁶

Sardha Scam

In this high profile scam, in the name of Financial services, Infrastructure management, Automobiles manufacturing industry with the genre of Deposit Mobilising Company a huge fraud has done with over 1.7 million depositors and Rs. 200 to 300 billion (US\$4–6 billion) and it collapsed in April 2013. It was noticed as Ponzi scheme and it was also estimated that about US\$150 billion involved in these funds from eastern India. Thiripura Chits Private Limited case¹⁷ and many other cases are alarming signals for the corporate sector.

These conditions led to the changes in the laws and rules relating to these types of companies and schemes.

Conclusion

Power corrupts and misuse of the powers by the directors is not a new thing. There are many examples of misuse of the powers given to the directors. As stated by Sabanayagam committee that irregularities were there in Nidhi companies because of mismanagement and poor control by the controlling authorities (including the directors of such companies). In case of Nidhi Companies, more attention is needed when it comes to specially the directors of the companies. Chennai fund case or famous Sardha Scam and many other are the instances of irregularities and the corruption. Because of which depositors or small investors got so affected that many of them have committed suicide.

The new provisions and rules for Nidhi Companies are really a ray of hope. The DCA had issued modified guidelines in November 1, 1999 empowering the Government to appoint special officers to monitor the affairs of companies in case of a default in making refund of deposits to more than 10 depositors; to conduct special audit by the auditors appointed by the Government to ensure that a Nidhi Company maintains contingent fund by transferring 0.5 per cent of each deposit to such a fund and to keep the entire amount in the contingent fund in any nationalised bank.¹⁸

This provision is important as it gives a clarity and permeability about the financial condition of the company, to have a proper control over its functioning. It also prohibits a person to hold the post of director in a Nidhi Company for a period of more than 10 years, provided that such director shall be eligible for reappointment after a period of two years of ceasing to hold the post of director.

¹⁵2007 135 CompCas 322 CLB, 2007 77 SCL 153 CLB

¹⁶ *Ibid*

¹⁷See: https://timesofindia.indiatimes.com/city/coimbatore/investors-lodge-complaint-against-chit-fund-firm/articleshow/61537969.cms?utm_source=Articleshow&utm_medium=Organic&utm_campaign=Related Stories (Last accessed on 07/05/2018.)

¹⁸See: <http://www.thehindubusinessline.com/2000/03/22/stories/142208yz.htm> (Last accessed on 07/05/2018.)

Director's position is so significant in a company. They are the decision makers of the company. In case of *Moriarty v. Regent's Garage & Engg Co.*¹⁹ *Mc CARDIE LJ.* said that

...“[a] director is in fact a director or controller of the company's affairs. He is not a servant”

Frauds under a company usually indicate about the irresponsible and fraudulent behaviour of the directors of that company. If the term of the director is less or quite limited then there are lesser chances of their involvement in frauds. Being biased is so common behaviour. By misusing the position directors can give benefits to their near and dear ones. Hence there should be a provision for a lesser term for the directors. It should not be more than 5 years. As provided for the Independent Directors under Companies Act, 2013.

The political will is there with our regulatory authorities and all are contributing to the development of corporate sector. Corrupt practices are not that hidden and gradually coming under scrutiny quite often. People are more aware towards the unusual behavioural patterns in the corporate world and are more vigilant for their investments. All this is going to facilitate a healthy environment in favour of companies as well as small investors and depositors.

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ABBREVIATIONS

NBFCs	Non-Banking Finance Companies
DCA	Department of Corporate Affairs
CLB	Company Law Board
RBI	Reserve Bank of India
MCA	Ministry of Corporate Affairs

¹⁹ [1921] 1 KB 423.