

Lending Rules For Directors

Dr S. Chandrasekaran explains the provisions of granting loans to a director

The definition of “Director” has undergone a modification in the Companies Act, 2013 to mean only persons appointed to the Board of Directors and not any other person occupying a position of director. The Act has also introduced a new provision on “duties of directors”. One of the duties of the directors is that he shall act in good faith in order to promote the objects of the Company for the benefit of its members as a whole and in the best interest of the Company, its employees, the shareholders, the community and for the protection of environment.

Directors’ Responsibility Statement:

One of the major responsibilities of the directors is the preparation of annul accounts taking into consideration accounting policies and standards. The new Act has now introduced one more responsibility for the directors of listed companies, which stipulates not only the introduction of internal financial controls but also ensuring that such controls have been complied with. The intention behind such a move is that the directors have to protect the funds of the company which shall be utilised only for its bona fide business activities.

Loans:

The term “loan” as such has certain basic ingredients both for borrowing and lending, namely:

(a) it has to be returned; (b) with some extra amount; and (c)

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with time limit. There are certain companies registered with Reserve Bank of India with the objective of lending which are called as “Loan Companies.” For all other companies, lending of loan is an ancillary to its main objects. A company may have to lend money from time to time for business purposes as well as to its employees, directors and so on. The Board has to be very cautious while advancing loans within the framework of internal financial controls; extending loans for business purposes to some entities may be intertwined with the interest of one or more of the directors in such entities.

The same principle should also extend to providing any guarantee or security in connection with any loan taken by a director or any other person/entity with which such director has some interest directly or indirectly.



Loans to Directors and other entities having their interest:

At the time of its introduction, the Act barred advance of any loan to any of its directors or to any other person whose interests converge with that of a director. The concept of loan extends to even those loans represented by a book debt. Therefore, a company cannot give any kind of loan to a director or give any guarantee or provide any security in connection with any loan to a director or to such other person. This condition of giving loan or extending any guarantee or security in connection with a loan is applicable to all companies including private companies and government companies. The earlier Act had specifically exempted private companies from such stringent condition.

Loans to Managing or whole time director:

The earlier version of the Companies Act had a gateway to extend loans to directors with prior approval of the central government, which has been dispensed with in the current Act.

The Act, however, considered relaxation to giving loans to managing or whole time directors but not for giving guarantee or providing security in connection with the loan taken by him. It provides that the bar on giving any loan to a managing director or whole time director shall not apply if such loan is (a) as a part of the conditions of service extended by the company to all its employees; or (b) pursuant to any scheme approved by the members by a special resolution.

The condition of giving loans to directors or "to any other person in whom the director is interested" can be classified into four groups: (a) his individual capacity; (b) firm; (c) private company and (d) body corporate. To sum up:

a) Individual Capacity:

- any director of the lending company; or

Yet another concept introduced in the Act which bars a company from giving any loan represented by a book debt. Book debt, also known as account receivable, means money owned to a company by customers who bought goods or availed services on credit.



- any director of its holding company; or
- any partner of any such director; or
- relative of any such director;

b) Firm:

- any firm in which any such director is a partner; or
- any firm in which the relative of any such director is a partner;

c) Private Company:

- any private company of which any such director is a director; or
- any private company of which any such director is a member;

Here, it specifies only the private company, therefore any public company of which any such director is a director or a member are exempt from the requirements of section 185.

d) Body corporate

In any body corporate at its general meeting, of which not less than 25% of the total voting power may be exercised or controlled by:

- any such director; or

- by one or more such directors together;

Loan represented by book debt and in ordinary course of business:

Yet another concept introduced in the Act which bars a company from giving any loan represented by a book debt. Book debt, also known as account receivable, means money owned to a company by customers who bought goods or availed services on credit. If any director or to any other person to whom the director is interested has purchased goods or availed services on credit then the amount due until settled is shown in the books of accounts of a company as book debt. It is unclear whether a company can extend the same credit facilities as extended to other customers to directors and to any person to whom the director is interested without qualifying from loan to Directors.

The Act has exempted a company which in the ordinary course of business provides loans or gives guarantees or securities for the due repayment of any loan and in respect of such loans an interest is charged at least at the rate stipulated by the Reserve Bank of India. The Act, however, does not specify whether if a company, which sells goods or provides services with a credit period without charging any interest, supplies goods or provides services to a director or to any person to whom the director is interested on the same terms and shown as book debt till such credit period lapses would be exempted or not!

However, if a company whose business is to lend loans and extends such facility to a director or to any person to whom the director is interested and charges interest at a rate not less the bank rate declared by Reserve Bank of India, such loan is exempted.

Subsequent Changes:

The Central Government on persistent demands extended certain

exemptions to private companies, government companies and the Nidhis. The exemption to private companies is conditional one and not a blanket exemption.

- **Exemption to Private Companies:**

a) If in the share capital of a private company no other body corporate has invested any money.

Body Corporate does not include a cooperative society registered under any law relating to cooperative societies and any other body corporate (not being a company as defined in this Act), which the central government may, by notification, specify in this behalf. Therefore if the above said corporations have invested in the share capital of any private company, then that private company is not covered under this exemption.

b) If the borrowings of such private company from banks or financial institutions or any Body Corporate is less than double its paid up share capital or Rupees 50 crores whichever is less; and

c) If the private company has not defaulted in the re-payment of its borrowings subsisting at the time of making transactions under this section.

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- **Exemption to Government Companies:**

The provision of giving loans or giving guarantees or providing securities to a director or to such other person shall not apply to Government Company in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government before making any loan or giving any guarantee or providing any se-

curity under the section.

- **Exemption to Nidhis:**

The exemption is also extended to Nidhi provided the loan is given to a director or his relative in the capacity as member and such transaction is disclosed in the annual accounts by a note.

Penal provisions:

The penalty for any contravention under this section shall make punishable to both the parties. The one who lends the loan or guarantee or security and also to the person who borrow the amount or on whose favour the guarantee or security is given.

The company which provides the loan shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty –five lakh rupees and to the director or the other person to whom any loan is advanced or guarantee or security is given or provided in connection with any loan taken by him or the other person, shall be punishable with minimum 6 months imprisonment or with minimum fine of five lakh rupees but which may extend to twenty –five lakh rupees, or both.

Conclusion:

The stringent provision of granting loans to a director or any such person with whom a director is interest is a welcome move, with the intention to have the financial statements drawn in a transparent manner without extending any favour to any of its directors. The Central Government's approval on granting loans to directors, related party transactions etc., having been done away with, such a move would certainly enhance the disclosure and governance in companies. ■



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