

BANNING OF UNREGULATED DEPOSIT SCHEME ORDINANCE, 2019

**Western India Regional Council
(Mumbai Branch)**

BACKGROUND – 1/2

- ❑ The Finance Minister had **announced in Budget 2016-17** that a comprehensive central legislation would be introduced to bring about the menace of unauthorised deposit taking schemes
- ❑ The “Banning of Unregulated Deposit Schemes and Protection of Depositors’ Interests Bill, 2015” and the Report of the Inter-Ministerial Group for identifying gaps in the existing regulatory framework for deposit-taking activities were introduced by the Department of Financial Services in 2017 for eliciting **public comments**
- ❑ Based on the public comments, the draft bill was modified and revised version was introduced in the Lok Sabha on July 18, 2018 and then **referred to the Standing Committee on Finance** on August 10, 2018

BACKGROUND – 2/2

- ❑ The Banning of Unregulated Deposit Schemes Bill, 2019 was **passed by Lok Sabha** on 13th February, 2019. However, it **could not be passed by Rajya Sabha**
- ❑ Since Parliament is not in session, **The Banning of Unregulated Deposit Schemes Ordinance, 2019** was promulgated by President of India via notification dated 21.02.2019
- ❑ **Article 123** of Indian Constitution gives President the power to promulgate Ordinances during recess of Parliament

OBJECTIVE

- ❑ The Ordinance has been promulgated to have a central legislation to **tackle the menace of illicit deposit taking activities** in the country
- ❑ It aims to **prevent such unregulated deposit schemes or arrangements at their inception** and at the same time makes soliciting, inviting or accepting deposits pursuant to an unregulated deposited scheme a punishable offence
- ❑ The said Ordinance also seeks to put in place a mechanism by which the depositors can be repaid without delay by attaching the assets of the defaulting establishments
- ❑ It seeks to **amend three laws**, i.e., the Reserve Bank of India Act, 1934, the Securities and Exchange Board of India Act, 1992 and the Multi-State Co-operative Societies Act, 2002

FEATURES – 1/3

- ❑ The Bill contains a **substantive banning clause** which bans Deposit Takers from promoting, operating, issuing advertisements or accepting deposits in any Unregulated Deposit Scheme

- ❑ The principle is that the Bill would ban unregulated deposit taking activities altogether, by **making them an offence ex-ante** rather than the existing legislative-cum-regulatory framework which only comes into effect **ex-post** with considerable time lags

- ❑ The Bill **creates three different types of offences**:
 - Running of Unregulated Deposit Schemes (section 3)
 - Fraudulent default in Regulated Deposit Schemes (section 4), and
 - Wrongful inducement in relation to Unregulated Deposit Schemes (section 5)

FEATURES – 2/3

- ❑ Provides for **severe punishment** and heavy pecuniary fines to act as deterrent
- ❑ Adequate provisions for **disgorgement or repayment of deposits** in cases where such schemes nonetheless manage to raise deposits illegally
- ❑ Provides for **attachment of properties / assets** by the Competent Authority, and subsequent realization of assets for repayment to depositors
- ❑ Clear-cut **time lines have been provided** for attachment of property and restitution to depositors

FEATURES – 3/3

- ❑ Enables **creation of an online central database**, for collection and sharing of information on deposit-taking activities in the country
- ❑ Amount due to depositors shall be **paid in priority over all other debts** and all revenues, taxes, cesses and other rates payable to appropriate Government or local authority
- ❑ Being a comprehensive Union Law, the Bill **adopts best practices from State laws**, while entrusting the primary responsibility of implementing the provisions of the legislation to the **State Governments**

DEPOSIT U/s 2(4) – 1/3

- ❑ Deposit means an amount of **money received by way of advance, loan or any other form**, with a promise to be returned, with or without interest, bonus, profit, etc.

- ❑ Further, the Ordinance defines certain amounts which shall **not be included in the definition of deposits** such as:
 - a) Loan from scheduled bank, co-operative bank or any other banking company
 - b) Loan or financial assistance from PFI or NBFC or Regional Financial Institution or Insurance company
 - c) Amount received/ guaranteed from an appropriate government or statutory authority
 - d) Amount from foreign government, foreign or international banks, multilateral financial institutions, foreign citizens, etc. subject to FEMA

DEPOSIT U/s 2(4) – 2/3

- Further, the Ordinance defines certain amounts which shall **not be included in the definition of deposits** such as:
 - e) Contribution towards capital by partners of firm or LLP
 - f) Amounts received by individual by way of loan from relatives or amounts received by firms by way of loan from relatives of partners
 - g) Amount received as credit by a buyer from a seller on sale of property
 - h) Amount received by an asset re-construction company
 - i) Amount accepted by a political party
 - j) Periodic payments by members of self-help groups
 - k) Any other amount within such ceiling prescribed by State Government

DEPOSIT U/s 2(4) – 3/3

- ❑ Amount received in the course of, or **purpose of business and bearing a genuine connection** to such business, including:
 - i. Payment, advance or part payment for supply or hire of goods or provision or services, and is repayable in the event the goods or services are not sold, hired or otherwise provided
 - ii. Advance received in connection with consideration of immovable property
 - iii. Security or dealership deposited for performance of contract for supply of goods or provision of services
 - iv. Advance under long-term projects for supply of capital goods

- ❑ If above amounts become refundable, amounts shall be **deemed to be deposits on expiry of 15 days** from day they become due for refund

- ❑ Where the said amounts become refundable, if deposit taker does not obtain necessary permission or approval under law, such amounts shall be deemed to be deposits

- ❑ **What about litigants deposit with court/ arbitrator pursuant to order?**

DEPOSIT TAKER U/s 2(6)

□ Deposit taker means:

- Individual or group of individuals
- Proprietorship concern
- Partnership firm (registered or not)
- LLP
- Company
- AOP
- Trusts
- Co-operative society or multi-state co-operative society
- Any other arrangement of whatsoever nature receiving or soliciting deposits

Note: HUF not covered

□ It does not include –

- A Corporation incorporated under an Act of Parliament or a State Legislature
 - Banking company, corresponding new bank, SBI, subsidiary bank, RRB, co-operative bank, or a multi-state co-operative bank
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UNREGULATED DEPOSIT SCHEME U/s 2(17) – 1/2

- ❑ **Scheme or arrangement** under which deposits are accepted or solicited by any deposit taker **by way of business** and which is **not a regulated deposit scheme** (as specified in First Schedule)
- ❑ One has to look at intent and activity. Whether the deposit is **for the purpose of business or by way of business**.
- ❑ Thus, this Ordinance only covers Deposit Schemes which are unregulated and which are accepted by any deposit taker by way of business, such as **illicit deposit/ ponzi schemes/ unregulated chit funds**

UNREGULATED DEPOSIT SCHEME U/s 2(17) – 2/2

□ Examples of Regulated Deposit Scheme include:

Securities &
Exchange Board
of India

Reserve Bank of
India

Insurance
Regulatory &
Development
Authority of India

State/ Union
Territory
Government

National Housing
Bank

Pension Fund
Regulatory &
Development
Authority

Employees
Provident Fund
Organisation

Central Registrar,
Multi-State Co-
operative
Societies

Ministry of
Corporate Affairs

□ **If a money lender who has obtained license under The Maharashtra Money-Lending (Regulation) Act, 2014 accepts deposits for onward lending, then whether it would be considered as an unregulated deposit?**

EFFECT OF PROHIBITION (SECTION 3) – 1/3

- ❑ **Section 3** of the ordinance prohibits unregulated deposit schemes
- ❑ Ban comes into effect from February 21, 2019
- ❑ For the ban to apply, it is necessary that there should be a **scheme of arrangement under which deposits are invited or accepted by way of business**
- ❑ It is pertinent to note that the term “by way of business” has not been defined anywhere in this ordinance
- ❑ Interplay between Section 2(4)(I) and 2(17), that is:
 - 2(4)(I): Amount received in course of or for the purpose of, business and bearing a genuine connection to such business should not be considered as deposit
 - 2(17): "Unregulated Deposit Scheme" means a Scheme or an arrangement under which deposits are accepted or solicited by any deposit taker by way of business and which is not a Regulated Deposit Scheme, as specified under column (3) of the First Schedule

EFFECT OF PROHIBITION (SECTION 3) – 2/3

- ❑ Since by way of business is not defined, it would generally mean that where a person is engaged in the activity of accepting deposits

- ❑ For example:
 - if a partnership firm engaged in the business of trading, accepts deposits from 1000 people promising a return of say 15% for funding its business, a question arises as to whether it constitutes **as by way of business**? If yes, then because it has been collected **for the purpose of business** and bears a genuine connection, it would not be considered a deposit

 - If a real estate developer accepts advance of 9% of price as refundable advance from customers and balance to be paid only if the purchaser opts to purchase the property

EFFECT OF PROHIBITION (SECTION 3) – 3/3

- ❑ No reference to savings provision in respect of deposits which were not regulated earlier but still validly enforceable under contractual law

- ❑ Prohibition is on the following acts:
 - Promotion of unregulated deposit scheme
 - Operation of unregulated deposit scheme
 - Advertisement soliciting participation or enrolment in unregulated deposit scheme
 - Acceptance of deposits in an unregulated deposit scheme

EFFECT OF PROHIBITION (SECTIONS 4, 5 & 6)

Regulated Deposit Scheme

No deposit taker, under such scheme shall commit any fraudulent default:

- a) In the repayment or return of deposit on maturity;
- b) In rendering any specified service promised against such deposit

Unregulated Deposit Scheme

- No person should knowingly make any false or deceptive promise or give misleading statements
- The following is deemed to be Unregulated Deposit Scheme:
 - a) Prize chit money;
 - b) Money circulation scheme

- ❑ Company A may offer a deposit or a timely loan to company B with low or affordable interest or stand guarantee for a non-performing loan taken by company A and expect directorships on the Board of company B or its valuable agency or dealerships.
- ❑ What if company B does not perform the bargain for opaque reasons and company A complains to the Regulator? Will company B be considered to be in fraudulent default?
- ❑ In my view, the scope of fraudulent default under section 4 cannot be stretched to such limits of corporate trickery but applied only to the deceitful non-payment of money lent to one entity by another entity.

RESTITUTION TO DEPOSITORS (SECTION 12 & 13)

- ❑ **Section 12:** Save as provided in SARFAESI, 2002 or IBC, 2016, any amount due to depositors from a deposit taker shall be paid in priority over all debts and all revenues, taxes, cesses, and other rates payable to the appropriate government or the local authority
- ❑ **Section 13:** Save as provided in SARFAESI, 2002 or IBC, 2016, an order of provisional attachment passed by the Competent Authority, shall have precedence and priority, to the extent of the claims of the depositors, over any other attachment for any authority competent to attach property for repayment of any debts, revenues, taxes, cesses and other rates payable to the appropriate Government or the local authority

OFFENCES AND PUNISHMENTS

Offence	Imprisonment	Fine (in Rs.)
Solicits deposits under Unregulated DS	1 year to 5 years	2 lakhs to 10 lakhs
Accepts deposits under Unregulated DS	2 years to 7 years	3 lakhs to 10 lakhs
Fraud in repayment of deposits or rendering specified service under Unregulated DS	3 years to 10 years	5 lakhs to 200% of aggregate funds collected
Fraud in repayment of regulated deposits	Up to 7 years	5 lakhs to higher of 25 crore or 3 times the amount of profit made out of such fraud
Person knowingly making false statement or concealing material facts	1 year to 5 years	Up to 10 lakhs
Repeated offenders	5 years – 10 years	10 lakhs to 50 crores
Failure to give intimation or furnish statements as per section 10	-	Up to 5 lakhs

INVESTIGATION OF OFFENCES BY CBI (SECTION 30)

Section 30:

- 1) On receipt of information under section 29 or otherwise, if the Competent Authority has reason to believe that the offence relates to a deposit scheme or deposit schemes in which:
 - a) the depositors, deposit takers or properties involved are located in more than one State or Union territory in India or outside India; and
 - b) the total value of the amount involved is of such magnitude as to significantly affect the public interest, the Competent Authority shall refer the matter to the Central Government for investigation by the Central Bureau of Investigation.
- 2) **The reference made by the Competent Authority under sub-section (1) shall be deemed to be with the consent of the State Government under section 6 of the 25 of 1946. Delhi Special Police Establishment Act, 1946.**
- 3) On the receipt of the reference under subsection (1), the Central Government may transfer the investigation of the offence to the Central Bureau of Investigation under section 5 of the Delhi Special Police 25 of 1946. Establishment Act, 1946.

Issue: Whether this Ordinance can override a Special Act?

STANDING COMMITTEE RECOMMENDATIONS – 1/3

- ❑ The Committee observed that the definition of ‘unregulated deposits’ is left for residual interpretation under the Bill. This could allow open-ended and subjective decisions by authorities while adjudicating offences related to such deposits. It recommended that unregulated deposits be more coherently defined and listed in a schedule to the Bill. – **Not considered in the Final Ordinance**
- ❑ The Committee observed that the informal banking sector has various financial arrangements, involving advances to startups and small entrepreneurs, that may fall under the definition of unregulated deposits by default. It recommended that such ambiguities be cleared to prevent harassment and misuse of these financing entities. – **Not considered in the Final Ordinance**

STANDING COMMITTEE RECOMMENDATIONS – 2/3

- The Bill states that unless otherwise provided by the SARFAESI Act, and the IBC, amounts due to depositors will be paid in priority over all other debts payable by the deposit taker. The Committee noted that repaying depositors' money is the most critical part of the process of restitution of depositors. Therefore, it recommended that: (i) exceptions under the SARFAESI Act and IBC be removed from the Bill, and (ii) a time-frame be specified for repayment of depositors' dues. – **Not considered in the Final Ordinance**
- The Bill creates three kinds of offences, namely: (i) running unregulated deposit schemes, (ii) fraudulent default in regulated deposit schemes, and (iii) wrongfully inducing depositors into unregulated deposit schemes. Under the Bill, all offences except: (i) fraudulent default in regulated deposit schemes, and (ii) failure to notify the central authority, maintaining the database of deposit takers, of a deposit-taking business are cognisable and non-bailable. The Committee recommended that all offences defined in the Bill should be made cognisable and non-bailable. – **Considered in the Final Ordinance**

STANDING COMMITTEE RECOMMENDATIONS – 3/3

- **Investigating agencies:** The Bill provides for the appointment of one or more government officers, not below the rank of Secretary to the state or central government, as the Competent Authority. If the Authority believes that any offence involves more than one state or union territory, or a significant amount of money, then they must refer the matter to the Central Bureau of Investigation (CBI) for investigation. The Committee noted that such matters may involve offences under various economic laws. Further, the CBI already has huge workload. It recommended that other investigating agencies such as the Serious Fraud Investigation Office also be involved depending on the subject matter. The central government should take suo motu cognizance of any offence which involves more than one state and refer it to the appropriate investigation authority. – **Not considered in the Final Ordinance**

FREQUENTLY ASKED QUESTIONS – 1/2

- ❑ An individual is working in a software company. He takes a loan from 2-3 friends amounting to Rs 1.5 Crore for construction of his house. He will repay them with appropriate interest after a specific period of time. Is he covered under this Ordinance?
- ❑ An individual is carrying on business. In order to meet day to day working capital needs, he has borrowed a loan from 3-5 people at different rates of interest amounting to Rs 10 Crores. Is he covered under this Ordinance?
- ❑ A company incorporated under Companies Act, 2013, collects deposits from various people, and is registered with SEBI under SEBI (CIS) Regulations. Are they also covered under this Ordinance and thereby cannot accept deposits from the public?
- ❑ A company registered under Companies Act, 2013, accepts deposits from Public in compliance with Chapter V of Companies Act. Post this Ordinance, will their regulator change? Do they need not report to Ministry of Corporate Affairs henceforth?

FREQUENTLY ASKED QUESTIONS – 2/2

- ❑ A company registered under Companies Act, 2013 runs a chit business. The said Chit is registered under Section 2(d) of Chit Funds Act, 1982 with the State Government? Newspapers state that Chit is also banned. Is it true?
- ❑ A company operating selling goods under Multilevel marketing techniques. They recruit agents by accepting deposits to sell such goods. Is such deposit taking permitted under Ordinance?
- ❑ An LLP registered under LLP Act, 2008 is engaged in construction of residential flats. They take loans from the prospective customers and allot them completed flats post construction against such loans. Are they covered under the term 'deposit'?
- ❑ An LLP registered under LLP Act, 2008 has taken loan from relatives of partners. Is such loan covered by 'deposit'?

ISSUES UNDER THIS ORDINANCE - 1/3

- ❑ In pith and substance, the ordinance is a law to regulate and impose ban on money-lending and money lenders and this is exclusive domain of the State under Entry 30 of the State List provided under the Seventh Schedule to the Constitution. In my view, the enacted ordinance cannot root its source from the following entries of the Union List, being 45 – Banking; 46 – Bills of exchange, cheques, promissory notes and other like instruments. Even under the Concurrent list the Parliament is unable to establish its source. Therefore, the **entire ordinance is unconstitutional and vulnerable to a serious challenge.**
- ❑ The exhaustive definition of the term “Deposit” contained in sub-section (4) of section 2 of the Ordinance includes amounts received by a firm by way of loan from the relatives of its partners in clause f. The said **clause does not mention “relative of partner of LLP”**. This seems to be an unintended omission.

ISSUES UNDER THIS ORDINANCE - 2/3

- ❑ Unless a minimum exemption threshold is granted, the ordinance could deal a **blow to small groups of women** across the country engaged in micro-level money-saving and operating lending & repaying network among themselves. Many such women groups may not want to graduate to open, politicised self-help groups.
- ❑ The inclusive definition of the term “Person” contained in sub-section (10) of section 2 of the Ordinance includes “a Hindu Undivided Family” but the definition of “deposit taker” contained in sub-section (6) of section 2 of the Ordinance does not mention “a Hindu Undivided Family”. This seems to be an **unintended omission**.

ISSUES UNDER THIS ORDINANCE - 3/3

❑ Companies seem let off the hook

Section 4 does not provide in itself any exemption for any deposit-taking business, section 27 keeps companies safe from the strict requirement of section 4. Section 27 is read as follows:

“27. Cognizance of offences

Notwithstanding anything contained in section 4, no Designated Court shall take cognizance of an offence punishable under that section except upon a complaint made by the Regulator:

Provided that the provisions of section 4 and this section shall not apply in relation to a deposit taker which is a company.”

It is strange that an exemption from the scope of section 4 is not found in section 4 as a proviso, for example, but is discovered in another section relating to cognizance of offences. It will be of doubtful validity that a proviso to one section can be read effectively as a proviso to another section and be permitted in law to state things unrelated to the section to which it is appended. The Courts may likely interpret section 27 as being restricted to non-corporates rather than taking a blanket view that section 4 does not cover companies as deposit-takers.

ANY
QUESTIONS
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THANK YOU