

New Legislation For Deposit Schemes



The Banning of Unregulated Deposit Schemes Ordinance, 2019 ("Ordinance") has been effected on 21 February 2019. It aims to prohibit unregulated deposit schemes at their inception and makes soliciting, inviting or accepting deposits pursuant to an unregulated deposit scheme a punishable offence.^[1]

The Standing Committee Report of January 2019 observes that the rationale behind formulating this legislation is to ban illicit/unregulated deposits altogether, to prevent fraud and to provide for a mechanism for banning unregulated deposit schemes in order to protect the interests of depositors.

Currently, the Protection of Interest of Depositors Act already exists in various states in India. In Maharashtra, the Maharashtra Protection of Interest of Depositors (in Financial Establishment) Act, 1999, provides for protection of interest of the depositors and enables the government to attach the money and properties of the defaulter financial institutions and their constituents. However, the Ordinance is a central legislation and has introduced several new measures including classification of deposits into regulated and unregulated and has now banned all types of unregulated deposit schemes. It governs not just the deposit takers but also person soliciting unregulated deposits.

Banning unregulated deposit schemes

The Ordinance bans all types of unregulated deposit schemes, prohibits deposit takers from any form of advertisement, solicitation, participation or enrolment in or acceptance of deposits in pursuance of an unregulated deposit scheme and prohibits persons from wrongfully inducing depositors to invest in or become a member/ participant of any unregulated deposit scheme. With respect to regulated deposit schemes, the Ordinance also penalizes entities that have fraudulently defaulted on repayment or returning the deposit amount on maturity to the depositor.

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Not all Deposits are Unregulated Deposits

For the deposits to be classified as unregulated, an essential element is that such deposits should be taken by the deposit taker by way of business. The deposit taker includes every person soliciting the deposits who is not necessarily the actual deposit taker, thereby widening the scope of the definition of deposit taker.

Authorities

The Ordinance provides for constitution of Competent Authority and Designated Court for amongst other things to conduct investigation or inquiry and to have jurisdiction over matters to which the provisions of this Ordinance apply, respectively. The Ordinance provides for a quicker redressal mechanism as the Designated Court is required to complete the adjudication process within 180 days of being approached by the Competent Authority.

Centralized online database

The Ordinance provides for designation of an authority to create and maintain an online centralized database for information on Indian deposit takers. Every deposit taker is required to intimate the designated authority about commencement or operation of its business. Based on the information available, if the Competent Authority has a reason to believe that the deposits are being solicited / accepted pursuant to an unregulated deposit scheme, it may direct the deposit taker to furnish such undertaking/information as it considers necessary.

Sharing of Information

"Thus, transactions which took place prior to the promulgation of the Ordinance shall continue to be governed by the law as it existed before the promulgation of the Ordinance."

For effective implementation of Ordinance, the Competent Authority and various other governmental authorities including regulators, income tax authorities or investigative agencies are required to share information / documents in respect to any offence under the Ordinance. The principal officer of any banking company having knowledge of any deposit taker acting in

contravention of the provisions of the Ordinance is also required to forthwith inform the Competent Authority.

Priority of depositor's claim

Excluding claims under Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) and Insolvency and Bankruptcy Code, 2016, any amount due to the depositors from a deposit taker is required to be paid in priority over all other debts and all revenues, taxes and other rates payable to appropriate government or local authority and any order of provisional attachment passed by the Competent Authority shall have precedence to the extent of claims of the depositors over any other attachment by any authority competent to attach property for repayment of debts, revenue, taxes and other rates payable to appropriate government or local authority.

Directions to newspapers/publications

Where any newspaper or publication contains any statement/information or advertisement, soliciting deposit for any Unregulated Deposit Scheme, the Government can direct such newspaper, publication to publish a full and fair retraction free of cost.

Prospective effect

The Ordinance has a prospective application and not retrospective. Thus, transactions which took place prior to the promulgation of the Ordinance shall continue to be governed by the law as it existed before the promulgation of the Ordinance.

Offences and penalties

The Ordinance provides for offences committed by the deposit takers which include;

- advertising, operating or accepting money for unregulated deposit schemes and fraudulently defaulting on repayment the same;
- fraudulently defaulting on repayment and failure to render service under regulated deposit schemes;
- wrongfully inducing depositors to invest in unregulated deposit schemes by willingly falsifying facts;
- failure to file intimation by deposit taker about its business or to furnish statements/ information to the competent authority.

The penalties provide for fines ranging from Rs. 2 lakhs to Rs. 50 Crores / thrice the amount of profits made out of frauds and imprisonment of 1 year upto 10 years. The penalty provisions of this Ordinance are stringent as compared to Maharashtra Protection of Interest of Depositors (in Financial Establishment) Act, 1999.

Overriding effect

The provisions of this Ordinance have an overriding effect over all the other State and the Central legislations save and except the Insolvency and Bankruptcy Code, 2016 and the SARFAESI Act and must be read in addition with any other law for the time being in force.

"It is advisable for depositors and deposit takers to consult or take legal advice before making and accepting any deposits, respectively."

Clarifications – so far

There have been a lot of speculations/ interpretations on the type of transactions which would be subject to the Ordinance. On perusal of newspaper articles available in public domain, it appears that the Ministry of Finance by various tweets, has clarified the following -

- Individual, firm, companies, limited liability partnerships (LLPs), etc. are allowed to take any loan and deposits in the course of its business.
- Individual can raise a quick loan from relatives or friends for marriage or medical emergency or business needs or any other personal reasons.
- Small and medium enterprises, proprietors, LLP and partnerships are allowed to take unsecured loans in the course of or for the purpose of its business from unrelated parties and enterprise.

Conclusion

Saradha and the Rose Valley chit fund in West Bengal are examples of unregulated deposit schemes. The Central Government's attempt to curb such unregulated deposits through the Ordinance reflects recognition of the need for greater legal protection to be offered for depositors at a pan India level. However, the Ordinance poses certain challenges such as:

- Every deposit taker (regulated or otherwise) is required to intimate the Competent Authority about its business including companies accepting deposits under the Companies Act, 2013. This is an additional compliance for a deposit taker.
- The Competent Authority has wide powers including directing the deposit taker (regulated or otherwise) to furnish information.
- A person (transferee) acquiring a property from a deposit taker, can be subject to show cause proceeding by the Designated Court if there is a reasonable cause to believe that the property has not been transferred in good faith and for incommensurate consideration.
- The deposit to be qualified as unregulated deposit scheme requires the deposit to be accepted by the deposit taker by way of business. The term 'by way of business' hasn't been defined yet.

For depositors seeking redressal, they will still have to consider the redressal mechanism under the Protection of Interest of Depositors Act as the Competent Authority, Designated Court and online database under the Ordinance are yet to be constituted. Once these authorities are constituted, it is preferable for depositors go under this Ordinance as it has a quicker redressal system and stringent penalties.

It would be helpful if the Ministry provides formal clarifications for the above discussed issues. In the meantime, it is advisable for depositors and deposit takers to consult or take legal advice before making and accepting any deposits, respectively.

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[1] See our earlier newsletter on ordinances at http://hariani.co.in/newsletters/65946_ORDINANCES_AND_THEIR_CONSEQUENCES.pdf

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