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THE BANNING OF UNREGULATED DEPOSIT SCHEMES ORDINANCE 2019

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Background

The President of India has promulgated the Banning of Unregulated Deposit Schemes Ordinance on 21 February 2019 (Ref. No. 7 of 2019) (Ordinance). The Central Government had tabled a bill in the Lok Sabha (lower house of the Indian Parliament) which proposed to ban unregulated deposit schemes. While the bill was passed by the Lok Sabha, it could not be taken up for consideration in the Rajya Sabha (upper house of the Indian Parliament) during the term of the current government, and accordingly, the President of India promulgated the Ordinance on largely the same lines as the bill that was passed by the Lok Sabha. It may be noted that the Ordinance will have to be presented before Parliament within six weeks of the Parliament reconvening, for the Parliament to approve the Ordinance and pass the same as a Parliamentary legislation.

The press release accompanying the Ordinance notes that the intention behind the Ordinance is “to have a central legislation to tackle the menace of illicit deposits taking activities in the country”, and to make deposit taking activity in the country seamless.

The Ordinance has come into force with effect from 21 February 2019.

Key aspects of the Ordinance include:

- Imposing a comprehensive ban on unregulated deposit taking activities by nipping such unregulated deposit schemes or arrangements at inception.
- Making the soliciting, inviting, or accepting of deposits pursuant to an unregulated deposited scheme a punishable offence.
- Creating a mechanism for repayment to duped depositors by attaching the assets of deposit takers.
- Implementing a reporting, monitoring and enforcement mechanism to curb unregulated and fraudulent deposit taking.

Key Highlights of the Ordinance

- Key definitions
 - ‘Deposit’ has been defined as “an amount of money received by way of an advance or loan or in any other form, by any deposit taker with a promise to

return whether after a specified period or otherwise, either in cash or in kind or in the form of a specified service, with or without any benefit in the form of interest, bonus, profit or in any other form." However, the following items have been excluded from the ambit of a deposit:

- loans from banks, financial institutions and non-banking financial companies (NBFC);
 - amounts received from the government or a statutory authority, or where repayment is backed by the government;
 - amounts received in accordance with the Foreign Exchange Management Act 1999;
 - capital contributions made by a partner to a partnership firm or to a limited liability partnership (LLP);
 - loan received by an individual from his relatives;
 - loan received by a partnership firm from relatives of the partners (notably, loans received by an LLP from relatives of its partners are considered deposits);
 - amounts received as credit by a buyer from the seller in relation to the sale of any property (movable or immovable);
 - amounts received by an asset reconstruction company registered with the Reserve Bank of India (RBI) under the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act 2002;
 - deposits made to, or accepted by political parties under the Representation of People Act 1951;
 - periodic payments made by members of self-help groups within ceilings prescribed by the appropriate government (i.e., Central Government or State Government, as the case may be);
 - any other amount collected for such purposes and subject to such ceilings as the State Government may prescribe (it is relevant to note that the power to prescribe the purpose and ceilings vests solely with the State Government and not the Central Government); and
 - amounts received in the course of, or for purposes of, business, and bearing a genuine connection to business, including (but not limited to) amounts received as adjustable / refundable advances or security deposits in relation to: (a) supply or hire or provision of goods and services (as the case may be); (b) immovable property; (c) performance of contract of supply of goods or provision of services; and (d) long-term projects for supply of capital goods. It must be noted that the aforementioned will be a 'deemed deposit' upon expiry of 15 days from the date on which they become due for refund, or where the amounts become refundable due to the deposit taker not obtaining necessary permissions and approvals under law, which may be required.
- For purposes of a company and an NBFC, the term 'deposit' has the meaning ascribed to such term in the Companies Act 2013 (Companies Act) and the Reserve Bank of India Act 1934 (RBI Act) respectively.

- 'Deposit taker' has been defined to mean an individual, group of individuals, proprietorship concern, partnership firm, LLP, company, association of persons, trusts (whether registered or not), cooperative society or a multi-state cooperative society, or any other arrangement of whatsoever nature. However: (a) corporations incorporated pursuant to an Act of the Parliament or any State legislature, and (b) banks (including cooperative banks) have been excluded from the being 'deposit takers'.
- 'Regulated Deposit Scheme' means a deposit scheme regulated by various regulators as set out in First Schedule to the Ordinance. These regulators include the Securities and Exchange Board of India (SEBI), the RBI, Insurance Regulatory and Development Authority of India (IRDA), Ministry of Corporate Affairs, National Housing Bank, Pension Fund Regulatory and Development Authority and the Employees Provident Fund Organisation. Accordingly, these schemes include: (a) collective investment schemes of a collective investment management company registered with the SEBI; (b) deposit schemes of NBFCs registered with the RBI or any other deposit scheme registered under or regulated by the RBI Act; (c) contracts of insurance regulated by the IRDA; and (d) deposits accepted or permitted under the Companies Act.
- 'Relative' for purposes of the Ordinance has the same meaning as provided under the Companies Act.
- 'Unregulated Deposit Scheme' means a scheme or arrangement under which deposits are accepted or solicited by a deposit taker by way of a business (and notably not for purposes of business), and such deposit is not regulated by any sectoral regulator or ministry.

Offences and punishments

| OFFENCE | IMPRISONMENT | FINE (INR) |
|--|--------------------------|---|
| Direct or indirect promotion, operation, advertising, solicitation, participation or enrolment in, or acceptance of deposits in pursuance of an unregulated deposit scheme | One year to five years | <u>Minimum:</u> 200,000 <u>Maximum:</u> 1,000,000 |
| Accepting deposits under an unregulated deposit scheme | Two years to seven years | <u>Minimum:</u> 300,000 <u>Maximum:</u> 1,000,000 |
| Accepting deposits under an unregulated deposit scheme and fraudulently defaulting in repayment of such deposit | Three years to ten years | <u>Minimum:</u> 500,000 <u>Maximum:</u> Two times the aggregate of unregulated deposits accepted |
| Fraudulent default in repaying deposits made under a regulated deposit scheme | Up to seven years | <u>Minimum:</u> 500,000 <u>Maximum:</u> Higher of (a) 250,000,000; and (b) three times the profits |

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| | | made from fraudulent default |
| Knowingly making any statement, promise or forecast which is false, deceptive or misleading in material facts or concealing material facts to induce another person to invest in, or participate in any unregulated deposit scheme | One year to five years | <u>Maximum:</u> 1,000,000 |
| Repeat offender (except the offence set out below) | Five years to ten years | <u>Minimum:</u> 1,000,000 <u>Maximum:</u> 500,000,000 |
| Failure by a deposit taker to intimate the Repository Authority (<i>defined below</i>) about its business within the prescribed time in the prescribed manner | N/A | <u>Maximum:</u> 500,000 |

- In the event the above offences have been committed by a deposit taker who is not an individual, every person who was in charge of, and was responsible for the conduct of the business of such deposit taker, as well as the deposit taker, will be guilty of the offence and be liable to be proceeded against and punished accordingly, unless he proves that the offence was committed without his knowledge, or that he had exercised all due diligence to prevent the commission of such offence.
- Further, any director, manager, secretary, promoter, partner, employee, or any other officer of the deposit taker will be deemed to be guilty of an offence and be liable to be proceeded against and punished accordingly if it is proved that the offence has been committed with the consent or connivance of, or is attributable to any negligence on the part of, such person.

➤ Enforcement mechanism

- Appropriate governments have been empowered to designate officers not below the rank of Secretary as the Competent Authority (Competent Authority).
- The Competent Authority has the power to provisionally attach properties of the deposit taker, or the person soliciting deposits on behalf of the deposit taker. In relation to such attachment of properties, the Competent Authority will have all powers of a civil court under the Code of Civil Procedure of 1908, including summoning witnesses and calling for evidence.
- The appropriate government can constitute courts to enforce the provisions of the Ordinance (Designated Courts). Designated Courts will have exclusive jurisdiction over matters to which the Ordinance applies. Appeals from the Designated Courts will lie to the jurisdictional High Court.

- Designated Courts can pursuant to following the due process as set out in the Ordinance, confirm, vary or cancel a provisional attachment order of the Competent Authority.
- Designated Courts may also attach the properties of any transferee who has received any amounts from a deposit taker with a *mala fide* intention to avoid compliance with the provisions of the Ordinance.
- All offences under the Ordinance are cognizable and non-bailable. Jurisdictional police have the powers to investigate offences (including search and seizure powers).
- Police may freeze accounts, properties, etc, for a period of 30 days as part of their investigation, and for a period beyond 30 days, pursuant to an order of the Designated Court.

➤ Reporting requirements

- The Ordinance contemplates the creation of a central online repository (i.e., an authority appointed by the Central Government) (Repository Authority) to maintain information on deposit takers operating in India.
- Every deposit taker is mandated to intimate the Repository Authority about its business within the prescribed time in the prescribed manner. The reporting requirements apply to all deposit takers, including those accepting a deposit under a regulated deposit scheme.
- Companies accepting deposits under the Companies Act are also required to comply with the reporting requirement under the Ordinance.
- Since no form or timeline for such reporting has been prescribed yet, there is presently a lack of clarity on the reporting mechanism.

➤ Restitution to depositors

- All repayments due to a depositor from a deposit taker will rank higher in priority to all debts and statutory liabilities other than as set out in the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act 2002 and the Insolvency and Bankruptcy Code 2016.
- Orders of provisional attachment of property made pursuant to the Ordinance will also enjoy similar priority ranking privileges as repayments due to a depositor.

➤ Other provisions

- All offences being investigated by the police under the Ordinance are required to be reported to the Competent Authority, who in turn is required to report the same to the Repository Authority and also to the Central Bureau of Investigation. This seems to complicate the scheme of the Ordinance by bringing in various regulators / authorities in the picture.
- Banks who believe that a client is a deposit taker acting in contravention of the Ordinance, have the obligation of reporting about such potential contravention to the Competent Authority.
- Newspapers which have published advertisements or statements promoting or inducing deposits as part of an unregulated deposit scheme may be directed by the appropriate government to publish a full and fair retraction, free of cost,

in such manner as may be prescribed.

Comment

While legislations at both central and state levels have attempted to regulate the taking of deposits, the country's millions have often been susceptible to schemes and arrangements that mislead and fraudulently induce the public to invest in dodgy schemes, which promise high returns or other benefits (often in the form of pyramid schemes and Ponzi schemes). It is in the wake of such schemes that the Ordinance has been promulgated.

Contrary to the reports by media outlets that the Ordinance is sweeping in its ambit and may present challenges to availing of emergency loans from acquaintances, the intent and language of the Ordinance is clear in that it primarily targets: (a) taking of deposits for unregulated deposit schemes by persons who are engaged in the business of deposit taking; (b) fraudulent default in repayment or servicing of regulated deposits; and (c) soliciting or misleading persons into making deposits in unregulated deposit schemes. The Ordinance does not affect persons who carry on a business other than that of deposit taking. For example, this Ordinance does not stop a trader operating a sole proprietorship concern from accepting monies as a loan from an acquaintance to manage liquidity, since the business of such sole proprietorship concern is not that of deposit taking but is that of trading.

It must be noted that while the Ordinance envisages a robust mechanism to crackdown on unregulated deposits, a significant portion of the implementation of the Ordinance has been delegated to the central and state governments, including the designation of relevant authorities, and constitution of courts. Moreover, relevant rules and regulations are yet to be introduced to provide clarity on the time lines and formats for the various reporting requirements. With elections to the Indian Parliament just round the corner, it will be interesting to see whether governments will hold off on putting in place the required rules and regulations, or choose to give teeth to the Ordinance before the elections.

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