The Banning of Unregulated Deposit Schemes Bill 2019

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Source: *Rajya Sabha TV Discussion*

Manifest Pedagogy

Ponzi schemes and Pyramid schemes not only affect the financial sector, but attack the savings of the poor through structuring and channelling them through various shell companies and money laundering routes. Thus, UPSC preparation has to look into regulatory roles of each institution be it RBI,SEBI or the parliament in protecting the common citizens of the country

In news

Banning of unregulated deposits and chit funds

Placing it in the syllabus

Banking sector reforms

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Ponzi Schemes Definition

A Ponzi scheme is a fraudulent investing scam promising high rates of return with little risk to investors. The Ponzi scheme generates returns for older investors by acquiring new investors

How it works?

A typical 'ponzi' scheme involves the operator collecting a large amount of money from investors and paying them returns from their own money or the money collected from subsequent investors, rather than from profit earned by the person or entity operating such a scheme

Major Examples of Ponzi Schemes

- **Sharadha chit fund scam: The Saradha Group financial scandal was a major financial scam and alleged political scandal caused by the collapse of a Ponzi scheme run by Saradha Group, a consortium of over 200 private companies that were believed to be running collective investment schemes popularly but incorrectly referred to as chit funds in Eastern India.**
- **Cryptocurrency as Ponzi scheme: Police personnel in India have cracked a crypto Ponzi scheme in the city of Pune that defrauded over 8,000 investors, seizing nearly $2 million worth of bitcoin in the process. The company called GainBitcoin that promised investors 10% returns in order to lure them into the crypto Ponzi scheme.**
- PACL: In August 2014, the Securities and Exchange Board of India (SEBI), the country's capital markets regulator, ordered PACL Ltd (pdf) to return the money it had pooled in from investors in the allegedly illegal scheme. This was primarily because PACL was not registered with the market regulator as a collective investment scheme, as mandated by the SEBI Act

SEBI on Ponzi scheme

- Recently SEBI has told the Supreme Court that ponzi schemes do not fall under its regulatory regime and it was for the state governments to act against them.
- It was also mentioned that the ponzi schemes were banned under the Prize Chit and Money Circulation (Banning) Act, 1978 and it was for the state governments to enforce the law.
- The market regulator said that Collective Investment Scheme within the domain of SEBI was not a banned activity but was authorised only upon registration/permission by it.

Alternative investment funds(AIF)

Alternative Investment Fund or AIF means any fund established or incorporated in India which is a privately pooled investment vehicle which collects funds from sophisticated investors, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investors.

AIF does not include funds covered under the SEBI (Mutual Funds) Regulations, 1996, SEBI (Collective Investment Schemes) Regulations, 1999 or any other regulations of the Board to regulate fund management activities.

Chit fund and Nidhi

A chit fund is a type of rotating savings and credit association system practiced in India. Chit fund schemes may be organized by financial institutions, or informally among friends, relatives, or neighbours. In some variations of chit funds, the savings are for a specific purpose.

According to the definition given by **Chit Funds Act 1982**, Chit means a transaction whether called chit, chit fund, chitty, kuri or by any other name by or under which a person enters into an agreement with a specified number of persons that every one of them shall subscribe a certain sum of money (or a certain quantity of grain instead) by way of periodical installments over a definite period and that each such subscriber shall, in his turn, as determined by lot or by auction or by tender or in such other manner as may be specified in the chit agreement, be entitled to the prize amount

Provisions of the bill

- The proposed bill aims to protect investors from fraudulent investment schemes, such as Ponzi schemes.
- It covers previously existing gaps in legislation that had been exploited by various parties to siphon large amounts of money away from small investors.
- The bill 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
- **Definition of Ponzi/ unregulated deposit scheme under the bill: Under the proposed bill, deposit-taking schemes are defined as unregulated if they are undertaken for business purposes, and additionally, are not registered with one of the nine regulatory authorities, whom the Bill has made responsible for overseeing such deposit-taking schemes**
- Under the proposed bill **a common type of scam involving unregulated deposits is a Ponzi scheme**, which involves a type of investment fraud wherein one party promises high returns on an investment with little to no risk. The early investors in a Ponzi scheme are repaid by the scheme acquiring new investors, and so on
- **Competent Authority: The proposed 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. Police officers receiving information about offences committed under the Bill will report it to the Competent Authority. Further,**

police officers (not below the rank of an officer-in-charge of a police station) may enter, search and seize any property believed to be connected with an offence under the Bill, with or without a warrant. The Competent Authority may:

1. Provisionally attach the property of the deposit taker, as well as all deposits received.
2. Summon and examine any person it considers necessary for the purpose of obtaining evidence, and
3. Order the production of records and evidence. **The Competent Authority will have powers similar to those vested in a civil court.**

- **Designated Courts:** It provides for the constitution of one or more Designated Courts in **specified areas.** This Court will be **headed by a judge not below the rank of a district and sessions judge**, or additional district and sessions judge. The Court will seek to complete the process within 180 days of being approached by the Competent Authority.
- **Powers of designated courts:** The Designated Court will have the power to:

1. Make the provisional attachment absolute.
2. Vary or cancel the provisional attachment.
3. Finalise the list of depositors and their respective dues, and
4. Direct the Competent Authority to sell the property and equitably distribute the money realised among the depositors. The Court will seek to complete the process within 180 days of being approached by the Competent Authority

- **The Central Database: The Proposed bill provides for the central government to designate an authority to create an online central database for information on**

deposit takers. All deposit takers will be required to inform the database authority about their business. The Competent Authority will be required to share all information on unregulated deposits with the authority

- **Offences: The proposed bill defines three types of offences, and penalties related to them.**

These offences are:

1. Running (advertising, promoting, operating or accepting money for) unregulated deposit schemes.
2. Fraudulently defaulting on regulated deposit schemes, and
3. Wrongfully inducing depositors to invest in unregulated deposit schemes by willingly falsifying facts.

- **Penalties**

1. Accepting unregulated deposits will be punishable with imprisonment between two and seven years, along with a fine ranging from three to 10 lakh rupees.
2. Defaulting in repayment of unregulated deposits will be punishable with imprisonment between three and 10 years, and a fine ranging from five lakh rupees to twice the amount collected from depositors.
3. Further, repeated offenders under the Bill will be punishable with imprisonment between five to 10 years, along with a fine ranging from Rs 10 lakh to five crore rupees

Limitations of the bill

- **Difficulty in reconciliation of provisions of IBC and the Unregulated Deposit Schemes**
- Overlap of regulatory functions and difficulty in application of the act, for example Maharashtra’s MPEG

act.

- Bill does not address the process in refunding of lost money
- Bill also does not address the scam related to digital payments involving multiple states, deposits outside India.
- Bill also does not address the in wallet deposits