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STANDING COMMITTEE ON FINANCE
(2015-16)

SIXTEENTH LOK SABHA

MINISTRIES OF FINANCE (DEPARTMENTS OF ECONOMIC AFFAIRS, FINANCIAL SERVICES) & CORPORATE AFFAIRS

EFFICACY OF REGULATION OF COLLECTIVE INVESTMENT SCHEMES (CIS), CHIT FUNDS, ETC.

TWENTY-FIRST REPORT

LOK SABHA SECRETARIAT
NEW DELHI

September, 2015, Bhadrapada, 1937 (Saka)

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(2015-2016)

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EFFICACY OF REGULATION OF COLLECTIVE INVESTMENT SCHEMES (CIS), CHIT FUNDS, ETC.

Presented to Speaker on *07 October, 2015*

Presented to Lok Sabha on __ August, 2015

Laid in Rajya Sabha on __ August, 2015

LOK SABHA SECRETARIAT
NEW DELHI

September, 2015, Bhadrapada, 1937 (Saka)

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SECRETARIAT

1. Smt. Abha Singh Yaduvanshi - Joint Secretary
2. Shri P.C. Tripathy - Director
3. Shri Ramkumar Suryanarayanan - Additional Director

INTRODUCTION

I, the Chairperson of the Standing Committee on Finance, having been authorised by the Committee, present this Twenty-First report on the subject "Efficacy of Regulation of Collective Investment Schemes, Chit Funds, etc".

2. The Committee heard the views of the representatives of the Ministry of Finance (Department of Financial Services), Ministry of Corporate Affairs, Reserve Bank of India (RBI) and Securities and Exchange Board of India (SEBI) at their Sitting held on 18 September, 2014.

3. The Committee heard the views of the representatives of All India Association of Chit Funds at their Sitting held on 25 June, 2015.

4. At their Sitting held on 16 July, 2015, the Committee took evidence of the representatives of the RBI, SEBI, Ministry of Finance (Departments of Economic Affairs and Financial Services), Ministry of Corporate Affairs, Ministry of Agriculture (Department of Agriculture and Cooperation), Ministry of Consumer Affairs, Food and Public Distribution (Department of Consumer Affairs).

5. The Committee also heard the views of the representatives of the Indian Institute of Corporate Affairs (IICA) at their Sitting held on 19 August, 2015.

6. The Committee at their Sitting held on 10 September, 2015 considered and adopted the draft report and authorised the Chairperson to finalise the same and present it to the Speaker/Parliament.

7. The Committee wish to express their thanks to the officials of the Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI), Ministry of Finance (Department of Economic Affairs and Financial Services), Ministry of Corporate Affairs, Ministry of Agriculture (Department of Agriculture and Cooperation) and Ministry of Consumer Affairs, Food and Public Distribution (Department of Consumer Affairs), All India Association of Chit Funds and Indian Institute of Corporate Affairs (IICA) for appearing before the Committee and furnishing the requisite material and information which were desired in connection with the examination of the subject.

8. For facility of reference, the observations/recommendations of the Committee have been printed in thick type in the body of the Report.

NEW DELHI
21 September, 2015
30 Bhadrapada, 1937 (Saka)

DR. M. VEERAPPA MOILY,
Chairperson,
Standing Committee on Finance

REPORT

Overview

Since the early eighties, several entities were operating financial schemes in the market which assured customers of very high returns. Unwary customers were allured / tempted to invest in such financial schemes, through misleading advertisements and aggressive publicity. In 1997, when these entities started defrauding in making payments to their customers/investors, there was a huge uproar. As a result of the discontentment expressed in the public, the Central Government decided to regulate these entities, which were engaged in the sale of agro bonds and plantation bonds, etc., as "collective investment schemes" through the Securities and Exchange Board of India (SEBI) Regulations, 1999. Despite enactment of laws such as the Prize Chits and Money Circulation Schemes (Banning) Act,1978 and the Chit Funds Act, 1982; and multi-regulatory mechanism, the recent financial scam reported in the State of West Bengal followed by certain other States re-inforced the general perception that large number of activities in the financial sector remained unregulated and unregistered and, therefore, completely outside the purview of any regulatory authority. The Standing Committee on Finance, therefore, selected the subject, “Efficacy of Regulation of Collective Investment Schemes, Chit Funds, etc” for detailed examination and report.

2. During the course of examination of the subject, the Committee heard the views of the concerned regulators, namely, RBI and SEBI as also all the concerned Ministries/Departments namely, Department of Financial Services, Economic Affairs, Ministry of Corporate Affairs, Agriculture & Cooperation and Consumer Affairs. The Committee also heard the views of other stakeholders such as the All India Chit Funds Association and the Investors' Grievances Forum and the Chamber of Tax Consultants, Mumbai and DG, IICA. In response to a Press Communique, representations/memoranda were also received on the subject from several investors/groups, which were also taken into account in the course of deliberations. During their Study Visit to Mumbai, Bengaluru and Hyderabad in January 2015 also, the Committee discussed various aspects relating to this subject with the representatives of State Governments of Maharashtra, Karnataka, Telangana and Andhra Pradesh. Thus,

this Report has been finalised after comprehensive deliberations with different stakeholders. This Report, among other things, deals with issues related to collection of monies; acceptance of deposits by the financial institutions; regulation of chit funds; ponzi schemes; collective investment schemes; direct selling schemes etc.

(i) <u>Collection of Monies *vs* Acceptance of Deposits</u>

3. Section 45 I (c) (vi) of the Reserve Bank of India Act, 1934 defines 'financial institution' as follows:-

> "Financial institution" means any non-banking institution which carries on as its business or part of its business any of the following activities, namely:- collecting, for any purpose or under any scheme or arrangement by whatever name called, monies in lumpsum or otherwise, by way of subscriptions or by sale of units, or other instruments or in any other manner and awarding prizes or gifts, whether in cash or kind, or disbursing monies in any other way, to persons from whom monies are collected or to any other person, but does not include any institution, which carries on as its principal business:-
>
> (a) Agricultural operations; or
> (b) industrial activity; or
> (c) The purchase or sale of any goods (other than securities) or the providing of any services; or
> (d) The purchase, construction or sale of immovable property, so however, that no portion of the income of the institution is derived from the financing of purchases, constructions or sales of immovable property by other persons;
>
> Explanation- For the purposes of this clause, 'industrial activity" means any activity specified in sub-clauses (i) to (xviii) of clause (c) of section 2 of the Industrial Development Bank of India Act, 1964; Such institutions are not covered by the provision of 'deposits' under the Companies Act, 1956".

4. Asked to clarify the dichotomy of "collection of monies" and "deposits", the Department of Financial Services stated in a written reply as under:-

> "The term 'deposit' is generally understood as the financial instrument in the form of liability of a financial institution which is repayable on demand or after a fixed term. However, the word 'deposit' is not defined under the Chit Funds Act, 1982, the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 and the SEBI (Collective Investment Schemes) Regulations, 1999.
>
> …..An Non-Banking Financial Company (NBFC) collects deposits as a part of business activity with a view to obtaining regulated source of funding for its lending activities. The Collective Investment Scheme is offered by a collective investment management company with a view to pooling and utilising the money so collected to obtain income or profits for distribution amongst the investors. The

Chit Fund is an innovative financial instrument to manage both saving and borrowing needs of its members and therefore the collection of monies is restricted to a fixed number of members with a defined chit size. The Chit Fund is not allowed to take deposits from public. The collection of monies under the Money Circulation Schemes or Prize Chits is done for a purpose which is prohibited and illegal….

…..Therefore, the word 'deposit' cannot be used to denote money collected under different Acts as the purpose and the context under which the monies are collected are distinct and different".

5. The Secretary, Department of Financial Services in his deposition before the Committee added as follows:-

"there is a great deal of confusion about deposits. While admitting that there is a degree of regulatory overlap and gap both, I would like to say very briefly that 'deposits' on one hand are covered under Section 58 (A) of the Companies Act, 1956 the current Companies Act, and the rules made under that Act. The rules are called 'The Companies (Acceptance of Deposits) Rules'. Now, the Companies (Acceptance of Deposits) Rules exempt Non-Banking Finance Companies from the purview of the Companies Act or Section 58 (A). What it further means is that we are concerned with 'deposits' of public companies. I may also mention that the difference in the Companies Act between 'private companies' and 'public companies' is that 'private companies' can accept deposits only from its 'members', while 'public companies' can accept deposits from the 'members of the public'. We do regulate deposits from the Public Companies. We do not regulate deposits from the Non Banking Finance Companies. Now, Non-Banking finance Companies have been very widely defined under the Reserve Bank of India Act and that is where probably one of the reasons for confusion and for unscrupulous companies to take advantage of the gap in the law comes in. This, of course should not be confused with the fact that in most of the recent instances, it was not misuse of deposit; it was a flagrant violation of the Prize Chits and Money Circulation (Banning) the Act itself".

6. While agreeing to the view expressed by the Committee that the existing ambiguity in classification of monies / deposits creates confusion amongst the investors, RBI in a written reply stated that:-

"The law is clear regarding the definition of deposit and exclusion of subscription to chits from the definition of deposit. The distinction between a chit [which is permissible under Chit Funds Act, 1982] and a prize chit [which is illegal under Prize Chits and Money Circulation Schemes (banning) Act, 1978 (Banning Act)] is also clear. Prize chit has an element of speculation and all members do not get

the prize. In chits, every member gets a prize before the end of the term of the chit.

It is, however, true that a small investor is not able to make a distinction between what is a deposit, what is a subscription to chit, what is a prize chit, etc. It would make it easy for an investor to seek redress of his grievance if the aggrieved investor had one authority to which the complaint could be addressed. Irrespective of whether the money invested falls within the definition of deposit or subscription to chit, etc., the State Government machinery should be able to deal with the companies collecting such moneys and not fulfilling the promises".

7. The Governor, RBI who deposed before the Committee on 24 May, 2013 added, among other things, as under:-

"The Reserve Bank is deeply distressed by the several scams in the non-banking financial sector in various parts of the country that come to light off and on. As you had said, thousands of low income households have been lured into these nefarious schemes by unscrupulous and fraudulent operators by promising unviable and exorbitant rates of interests. Many of these households have lost their entire life savings because of such schemes going bust. This tragedy is a reflection of the lack of effective regulation and enforcement of laws. At a more fundamental level, this is also a reflection of the extent of financial exclusion which puts poor households at the mercy of such nefarious schemes.

It is important to note in this context that a non-bank financial sector is large, diverse and complex. Some of it is in the corporate sector and much of it is unincorporated. Some of the deposits raised by these companies are legal and some are illegal. Different segments of the sector are regulated by different agencies. As you had said, the larger public is understandably bewildered by this complexity. The public does not know how to determine what is legal and what is illegal; what is safe and what is unsafe and the way to look for interest is cheated by unscrupulous operators".

8. The RBI further stated in a written reply as under:-

"As a matter of public policy, Reserve Bank has decided that only banks should be allowed to accept public deposits and as such since 1997, RBI has not issued any Certificate of Registration for NBFCs authorizing acceptance of public deposits.

Non-NBFCs are governed by the provisions of Sections 58A to 58B of Companies Act, 1956 and Companies (Acceptance of Deposits) Rules, 1975. New Companies Bill has stringent restrictive provisions regarding acceptance of deposits by companies".

9. When specifically asked as to why RBI cannot immediately stop such companies from advertising in Press soliciting deposits, RBI responded in a post-evidence reply as follows:-

> "The power of RBI to regulate or prohibit issue of prospectus or advertisement soliciting deposits under Section 45J of the RBI Act is applicable to Non-Banking Institutions, namely, corporations, companies and co-operative societies. As regards companies other than NBFCs are concerned, the provisions relating to advertisement inviting deposits is contained in Section 58A of Companies Act, 1956. As regards NBFCs, the question of prohibiting them from advertisement for inviting deposits arises only with respect to companies which are entitled to accept deposits. There are only 257 NBFCs which are entitled to accept deposits and they are regulated by RBI. Prohibiting companies which are not entitled to accept deposits from issuing advertisements soliciting deposits would be superfluous. Further, under Section 45J of RBI Act, RBI may prohibit issue of advertisements soliciting deposits as defined under RBI Act and not soliciting moneys from the public in any other manner".

10. During the oral evidence held on 24 May, 2013, the Governor, RBI explained, among other things, about the RBI's jurisdiction over unauthorised collection of deposits as follows:-

> "There are two parts:
>
> Unauthorised acceptance of deposits by companies, and unauthorised acceptance of deposits by unincorporated bodies. As far as companies are concerned, two types of violations are possible. The first is collection of deposits by companies registered with the Reserve Bank but have not been authorised to collect deposits. The second is collection of deposits by companies that ought to have registered with the RBI but have not. The RBI Act vests the responsibility for pursuing such violations and for filing cases against them exclusively with the Reserve Bank. Appropriate action has been initiated by RBI including filing of cases in the court in several cases.
>
> Coming to unincorporated bodies, acceptance of deposits by unincorporated bodies is absolutely prohibited by the Reserve Bank Act. The obligation or the power to pursue violation of this provision rests concurrently with the Reserve Bank and the State Governments concerned. However, the Reserve Bank has consistently been requesting the State Governments to pursue such cases because of their relative comparative advantage, wider reach, and deeper penetration, and the backing they have of the police machinery.
>
> In fact, with a view to facilitating quick redressal of grievances coming from such unauthorised acceptance of deposits, the Reserve Bank has been urging State Governments to pass the Protection of Interest of Depositors Act. Such a law would enable the States to attach the money and properties of the defaulter financial institutions, its promoters, partners, directors or any officials of the

financial establishment. I might also add that we have made a similar request to the West Bengal Government even before the recent scam broke out. So far 17 States and one Union Territory have passed the Act. The provisions of the Act have been effectively used by some State Governments to recover funds raised by such entities and refund them to the depositors".

11. In this regard, RBI in a post-evidence reply added that:-

"…A third category of violation could be by the non-bank non-financial companies which may raise deposits beyond permissible limits. Since such companies fall under the purview of Ministry of Corporate Affairs, the Registrar of Companies may take suitable action".

(ii) <u>Financial Sector and Legislative Reforms Commission (FSLRC) recommendations</u>

12. The Financial Sector and Legislative Reforms Commission (FSLRC) was set up by the Ministry of Finance on 24 March, 2011 to review and rewrite the legal institutional architecture of the Indian Financial Sector. The Commission in its report submitted on 22 March, 2013, recommended, among other things, that any activity involving deposit taking must require authorization from RBI and be regulated by it. Both the Ministries of Finance and Corporate Affairs have, however, not furnished such an important information related to the recommendations made by the FSLRC in their background notes submitted to the Committee.

13. Asked whether the Government was proposing legislative changes in the near future to give effect to the said recommendation that all deposit taking requires the RBI's approval, the Department of Financial Services in a post-evidence reply stated, among other things, that:-

"…The Working Group on Banking, established by the FSLRC, has made some specific recommendations with respect to deposit taking agencies. Some of the key recommendations are as follows:

(i) The definition of banking must be guided by the principle that all deposit taking activities (where the public places deposits with any entity, which are redeemable at par with, assured rates of return) must be considered as banking. Consequently entities undertaking such activities must obtain a bank license and /or be subject to the regulatory purview of the banking regulator (Page-182, Vol.-I of the Report of the FSLRC).

(ii) Any entity that accepts deposits has access to clearing and to the RBI repo window is a bank. The primary activity of a bank is to accept deposits. Once

an entity accepts deposits, it will have access to clearing and discount window of RBI (Page-182, Vol.-I).

(iii) Any co-operative society accepting deposits exceeding a specified value must fall within the regulatory purview of the banking regulator. Co-operative banks are currently regulated under Part V of the Banking Regulation Act, 1949 (BR Act), but many provisions in the BR Act are not applicable to them. This Working Group recommends that such exclusions be removed. Co-operative banks must be treated at par with banking companies (Page-183, Vol.-I).

(iv) On the issue of companies accepting deposits, the members of the Working Group deliberated at length. It was pointed out to the Working Group that the RBI had, in its presentation before the Commission submitted that; "Only banks, statutory corporations, companies and co-operative societies regulated by the RBI should be allowed to accept deposits from public" (Page-183, Vol.-I)

(v) On the issue of NBFCs, this Working Group recommends that deposit taking NBFCs must obtain a license to operate as a bank and will fall within the regulatory purview of the banking regulator. The class of NBFCs that do not accept deposits from public will not be regulated by the banking regulator (Page-183, Vol.-I).
These recommendations are under consideration. The Ministry of Finance would take its decisions after due consultations with concerned stakeholders and experts".

14. In this regard, the Ministry of Corporate Affairs in a post-evidence reply submitted that:-

"Banking Companies and Non-Banking Financial Companies (NBFCs) are currently regulated and supervised by RBI. Acceptance of Deposits is a financial activity. There may be certain entities which are engaged in both financial as well as non-financial activities. Therefore, at times, it becomes difficult to identify the actual regulator. Raising of money from public needs to be allowed in a responsible, accountable and transparent manner. Further, it needs unification and harmonization of the legal and regulated treatment of all those entities, which are engaged in acceptance of deposits from public whether it is a NBFC or non-NBFC. RBI has stratified NBFCs into two categories namely, those taking public deposits and those not accessing public deposits. The Companies taking public deposits are comprehensively regulated for protection of depositors' interest. However, out of 12,348 NBFCs registered with RBI, only 265 accept public deposits. [FSLRC Report- p-154/ vol I].

Therefore, it is agreed in principle that the RBI to be a single regulator for Deposit taking activities for all entities.

There may not be any need for amendment to corresponding provisions in the Companies Act, 2013 because such deposit acceptance activities are regulated through a rule making mechanism.

Since the FSLRC report has recommended wide ranging changes and the recommendations are under examination in the Ministry, outcome of such examination may take some time. However, the specific recommendation as mentioned above…..is agreed to in principle by the Ministry. It appears that the FSLRC has recommended that RBI should regulate "banking and payment systems" only and the activities of 'NBFC' should be regulated by the 'Unified Financial Authority' (which will subsume SEBI/IRDA/PFRDA)".

15. In this regard, RBI in a post-evidence reply stated the following:-

"It will not be possible for RBI to regulate all activities involving collection of money from the public. Specialized regulators, such as SEBI, IRDA, Registrar of Chits, etc., are necessary for regulating different forms of financial business. The present definition of the term 'deposit; under RBI Act is reasonable and the regulatory jurisdiction of RBI should be extended only to companies and corporations which are permitted by RBI to accept deposits. It is the Reserve Bank's objective that in the medium term we must move towards a financial structure where deposit taking is restricted exclusively to the banking sector which is much more tightly regulated".

16. While acceding to a suggestion made by the Committee that the advertisement for accepting/inviting deposits should also display a disclaimer about the nature and security of 'deposits', the Ministry of Corporate Affairs in a post-evidence reply submitted *inter alia* that:-

"(i) Rule 4 of Companies (Acceptance of Deposits) Rules, 1975 provides for the form and particulars of advertisements to be issued by companies inviting/accepting deposits under such rules….

(ii) However, the concern and suggestion of Honourable Committee to require display of these declarations in a more prominent manner is noted for necessary action"

(iii) <u>Coordination Mechanisms</u>

17. In order to plug the loopholes in regulation and the propensity of some to design "deposit products" that do not strictly fall within the definition of deposits as given under the RBI Act, or conduct activities that do not strictly fall under any regulator, RBI has stated to have taken a number of steps which include:-

(a) increased information sharing and coordination between regulators by strengthening the State Level Coordination Committee (SLCC), increasing the frequency of their meetings from half yearly to Quarterly, having sub-committees of SLCCs in each state that can address state specific issues and meet between

two SLCC meetings, passing the Chairmanship of the SLCC to the Chief Secretaries of the States, besides others;

(b) strengthening market intelligence in the RBI by having dedicated officials in a Market Intelligence Unit in each Regional Office of the Bank, suggesting to all state regulators to have nodal officers in place for ready and easy contact, enhancing the membership of the SLCC to include any other state specific regulator / agency, having separate SLCCs for the states in the North East where RBI has its presence; and

(c) encouraging the State Government to enact the State Law on Protection of Interests of Depositors (in Financial Establishments), wherever not enacted.

18. In this regard, the Ministry of Corporate Affairs (MCA) stated among other things as follows:-

"a) Prosecution and legal action initiated by MCA for violations against listed companies are being filed/initiated in consultation with SEBI.

(b) Coordinated action is taking place between MCA and SEBI against vanishing companies in accordance with directions of the Central Coordination and Monitoring Committee (CMC) which is co-chaired by Secretary, MCA and Chairman, SEBI. Further, Secretary, MCA is also an ex-officio Member on the SEBI Board, where issues of mutual concern are discussed.

(c) The Ministry has also been providing continued access to SEBI, RBI and other regulators, as external user agencies of the MCA21 database, which enables them to access documents, such as Balance Sheets, Annual Returns, change of directors, change in registered office, details of charges, etc. filed by all companies, including finance companies in the MCA-21 database….

..The Coordination and Monitoring Committee (CMC) on Vanishing Companies is meeting regularly to take stock of the inputs given by Regional Task Forces. Through these efforts, the number of such companies has been reduced from 238 to 87".

(iv) <u>Dispersed Regulation of entities raising monies from public in different forms</u>

19. The existing laws related to regulation and control of the deposit collection activities are discussed below:-

Entities which raise monies from public fall under the jurisdictions of various regulatory bodies. For example, the Non-Banking Financial Companies (NBFCs) are under the regulatory and supervisory jurisdiction of the Reserve Bank of India (RBI) under the provisions of the RBI Act, 1934; Chit Funds and Money Circulation Schemes are under the domain of State Governments; and Collective Investment Schemes come under the purview of the Securities and Exchange

Board of India (SEBI) under the provisions of the SEBI Act, 1992 and deposit taking activity by non- NBFCs are regulated under the Companies Act.

The Reserve Bank of India Act, 1934

In terms of Section 45-IA of the RBI Act, 1934, it is mandatory that every Non-Banking Financial Companies (NBFCs) NBFC should be registered with RBI to commence or carry on any business of non-banking financial institution as defined in Clause (a) of Section 45-I of the RBI Act, 1934. RBI has been empowered to impose penalty on NBFCs for violation of the provisions of the RBI Act, 1934. The RBI also files complaints with the Economic Offences Wings (EOW) of the State Police Authorities for curbing unauthorized acceptance of public deposits.

The Chit Funds Act, 1982

Chit funds are classified as Miscellaneous Non-Banking Financial Institutions under the RBI Act, 1934….. The Chit Funds Act, 1982 is a model law brought out by the Ministry of Finance (Department of Financial Services) to regulate the conduct of chit funds for adoption by all the State Governments…..all the administrative and regulatory powers are with the State Authorities under the Act…. the said Act has been brought into force in the 27 States (except the State of Jammu and Kashmir) and 7 Union Territories of India…..

The Prize Chits and Money Circulation Schemes (Banning) Act, 1978

Any schemes for "money circulation" or "prize chits" are banned by the Prize Chits and Money Circulation Schemes (Banning) Act, 1978. This is a central Act, handled by the Department of Financial Services in the Ministry of Finance. Enforcement action is with the State Governments who are authorised to notify rules under the Act in consultation with the RBI. Most of the schemes where complaints are received fall in this category.

The expression "money circulation scheme" is defined to mean any scheme for making of quick or easy money as consideration for a promise to pay money on any event or contingency related to the enrolment of members into the scheme. Similarly, the Act also defines a "Prize Chit" as a scheme for collection of money and awarding a prize by drawing lots and refunding part of the contributions to persons who do not win the prize. However, the Prize Chit does not include "conventional chit" covered under the Chit Funds Act, 1982. In the case of multi-level marketing schemes, there is promise to pay money related to enrolment of members and, hence, provisions of the Prize chits and Money Circulation Schemes (Banning) Act, 1978 are attracted in such cases.

Neither the Chit Fund Act nor the Banning Act is based on any law corresponding to the said activity prevalent in UK or USA. Any fraudulent investment scam that pays returns to investors from their own money or from money paid in by subsequent investors – rather than from any profit it actually makes is regarded

in both UK and USA as Ponzi scheme. Ponzi schemes are dealt with as a conspiracy to commit fraud in UK and USA and steps are taken accordingly.

Direct Selling involving "Multilevel Marketing"

Several companies engage 'direct selling agents' to sell various goods such as cosmetics, consumer durables and nutrition supplements etc direct to households. Many such companies adopt 'Multi-level marketing techniques' to recruit agents on payment of deposits. The arrangement could take the form of 'money circulation'. The Department of Consumer Affairs being in charge of 'domestic trade' is responsible for regulating such schemes.

The Companies Act, 2013

To curb the financial frauds committed by the companies registered under the Companies Act, 2013 , adequate statutory provisions already exist in the Act, such as, Prohibition on acceptance of deposits from public (Section 73), Damages for fraud (Section 75), Acceptance of deposits from public by certain companies (Section 76), Power to call for information, inspect books and conduct inquiries (Section 206), Conduct of inspection and inquiry (Section 207), Investigation into affairs of company (Section 210), Seizure of documents by inspector (Section 220) and on penalties and prosecutions, etc.

Section 73 of the Companies Act requires that deposits, which can be obtained by a Company from public or from its own members, have to be in accordance with the provisions of the Act and rules thereunder. Apart from the fact that it does not apply to Financial Companies, its applicability to the so called "Chit Fund Companies" also poses the following difficulties:-

(i) Under Section 11AA of SEBI Act, the amounts collected from members of Collective Investment Scheme (CIS) are not 'deposits' but 'contributions and payments';

(ii) For conventional Chit Funds, 'collections' are permitted under the Chit Funds Act, 1982;

(iii) In case of 'Ponzi' Schemes, the act of collection constitutes an independent offence of 'money circulation' under the Prize Chits and Money Circulation Schemes (Banning) Act 1978. Parallel action under section 58A is not legally sustainable.

Securities Exchange Board of India (SEBI) Act, 1992

On July 18, 2013, September 16, 2013 and March 28, 2014 the Hon'ble President of India promulgated the Securities Law (Amendment) Ordinance. Subsequently, the Securities Law (Amendment) Ordinance was substituted by Securities Law Amendments Act, 2014 on August 22, 2014 with minor changes, wherein, inter alia, proviso of deemed collective Investment was inserted under Section 11AA of SEBI Act, 1992. The amended Section 11 AA of SEBI Act is provided as under:

SEBI Act defines Collective Investment Scheme (CIS) under Section 11AA of the SEBI Act, 1992 as a scheme or arrangement having the following fundamental features:

11AA. (1) Any scheme or arrangement which satisfies the conditions referred to in subsection (2) [or sub-section (2A)] shall be a collective investment scheme.

Provided that any pooling of funds under any scheme or arrangement, which is not registered with the Board or is not covered under sub-section (3), involving a corpus amount of one hundred crore rupees or more shall be deemed to be a collective investment scheme.

(2) Any scheme or arrangement made or offered by any *person* under which,—

(*i*) the contributions, or payments made by the investors, by whatever name called, are pooled and utilized for the purposes of the scheme or arrangement;

(ii) the contributions or payments are made to such scheme or arrangement by the investors with a view to receive profits, income, produce or property, whether movable or immovable, from such scheme or arrangement;

(iii) the property, contribution or investment forming part of scheme or arrangement, whether identifiable or not, is managed on behalf of the investors;

(iv) the investors do not have day-to-day control over the management and operation of the scheme or arrangement.

[(2A)] Any scheme or arrangement made or offered by any person satisfying the conditions as may be specified in accordance with the regulations made under this Act.]

(3) Notwithstanding anything contained in sub-section (2) [or sub-section (2A)], any scheme or arrangement—

i) made or offered by a co-operative society registered under the Co-operative Societies Act, 1912 (2 of 1912) or a society being a society registered or deemed to be registered under any law relating to co-operative societies for the time being in force in any State;

ii) under which deposits are accepted by non-banking financial companies as defined in clause (f) of section 45-I of the Reserve Bank of India Act, 1934 (2 of 1934);

iii) being a contract of insurance to which the Insurance Act, 1938 (4 of 1938), applies;

iv) providing for any Scheme, Pension Scheme or the Insurance Scheme framed under the Employees Provident Fund and Miscellaneous Provisions Act, 1952 (19 of 1952);

v) under which deposits are accepted under section 58A of the Companies Act, 1956 (1 of 1956);

vi) under which deposits are accepted by a company declared as a Nidhi or a mutual benefit society under section 620A of the Companies Act, 1956 (1 of 1956);

vii) falling within the meaning of Chit business as defined in clause (d) of section 2 of the Chit Fund Act, 1982 (40 of 1982);

viii) under which contributions made are in the nature of subscription to a mutual fund;

ix) such other scheme or arrangement which the Central Government may, in consultation with the Board, notify;

shall not be CIS.

Any money pooling activity which is otherwise regulated by some other Authority or Regulator does not come under the ambit of CIS.

Clause (3) of notes on Clauses of Securities Law Amendment Bill 2014 states that "*It is also proposed to insert a new clause (ix) in sub-section (3) of the said clause, to empower the Central Government to exclude, by notification, in consultation with the Board, any scheme or arrangement from falling under the ambit of Collective Investment Schemes. This is proposed in light of deeming provision inserted in sub-section (1), to ensure that money pooling activities which are otherwise regulated by some other authorities or regulators do not come under the ambit of Collective Investment Schemes to ensure that there are no regulatory overlaps*".

In addition to the above amendments with respect to Section 11AA of SEBI Act following amendments were also passed:

i) Power to call for information from any person in relation to an investigation;
ii) Power to conduct search and seizure with approval of designated court in Mumbai.

<u>Regulation of public deposit taking activity</u>

(i) Unincorporated entities not to accept deposits: Section 45S of the RBI Act, 1934 prohibits acceptance of deposits by individuals and unincorporated entities. Implementation and enforcement of the provisions of RBI Act is to be done by RBI as well as the State Governments.

(ii) Section 36 of the Companies Act, 2013: Section 36 of the Companies Act, 2013 provides penalty for fraudulently inducing persons to invest money in shares or debentures.

(iii) Regulation 3 of the SEBI Collective Investment Scheme Regulations, 1999: provides that no person other than a Collective Investment

Management Company shall carry on or sponsor or launch a collective investment scheme.

State Laws

At the instance of the RBI, 15 State Governments have enacted State laws for protection of the interests of depositors in financial establishments. The State laws also provide for attachment and sale of properties belonging to such financial establishments for the purpose of repayment of deposits collected from public by such financial establishments. The Department of Financial Services in July, 2012, advised the State Governments, which have not enacted laws to protect the depositors on the lines of law of Tamil Nadu {The Tamil Nadu Protection of Interests of Depositors (in Financial Establishments) Act, 1997} to enact the specific law for protection of depositors in the financial establishments in the States so that there is no vacuum in regulation of deposit taking activity by financial institutions in the States. The West Bengal Government has passed The West Bengal Protection of Interests of Depositors (in Financial Establishments) Bill, 2013 and sent in May, 2013 to the Government of India for granting assent of the President. Since then the Bill has got Presidential assent.

…State Acts do not prohibit acceptance of deposits from public but merely make non-payment of the deposits or interest on deposits as an offence. Hence, unincorporated financial establishments violate section 45S of the RBI Act, 1934 by accepting public deposits and if there is default in repayment of deposit or interest the State law becomes applicable".

Constitutional Validity of State Laws in collection of deposits

20. On being asked to explain the constitutional validity of State Laws related to collection of deposits, the Department of Financial Services submitted in their post-evidence reply as follows:-

"The issue of constitutional validity of State Law in the matter of collection of deposits by financial establishments was raised in the case No. Civil Appeal No. 2341 of 2011 [Arising out of S.L.P.(Civil) No. 7285/2011] of K.K. Baskaran versus State of Tamil Nadu in the Supreme Court. The Division Bench of the Supreme Court held in its judgment dated 4th March, 2011 that the Tamil Nadu Protection of Interests of Depositors (In Financial Establishments) Act, 1997 (in short "The Tamil Nadu Act") is constitutionally valid. The main submission of the counsel for the appellant in challenging the Tamil Nadu Act, which was also the main submission in challenging the Maharashtra Act, 1999, was that the said Act is beyond the legislative competence of the State Legislature as it falls within entries 43, 44 and 45 of List I of the Seventh Schedule to the Constitution. The entries 43, 44 and 45 are as follows:

43. Incorporation, regulation and winding up of trading corporations, including banking, insurance and financial corporations, but not including co-operative societies.

44. Incorporation, regulation and winding up of corporations, whether trading or not, with objects not confined to one State, but not including universities.

45. Banking.
It was also submitted that the impugned Act is liable to be struck down as the field of legislation is already occupied by legislation of Parliament being the Reserve Bank of India Act, 1934, Banking Regulation Act, 1949, the Indian Companies Act, 1956 and the Criminal Law Amendment Ordinance, 1944 as made applicable by Criminal Law (Tamil Nadu Amendment) Act, 1977. It was also contended that the Tamil Nadu Act was arbitrary, unreasonable and violative of Articles 14, 19(1)(g) and 21 of the Constitution.

Relying on the Statement of Objects as well as the relevant provisions of the Tamil Nadu Act, it was held by the Supreme Court that its object was to ameliorate the situation of thousands of depositors from the clutches of financial establishments who had duped the investor public by offering high rates of interest on deposits and committed deliberate fraud in repayment of the principal and interest after maturity of such deposits. The Act provides for measures for attachment of the properties of the financial establishments as well as mala fide transferees and to bring these properties for sale for realisation of the dues payable to the depositors speedily.

It was observed by the Supreme Court that the Tamil Nadu Act was not focused on the transaction of banking or acceptance of deposits, but it is designed to protect the public from fraudulent financial establishments who defraud the public by offering lucrative returns on deposits and then disappear with the depositors' money or refuse to return the same with interest. In the opinion of the Supreme Court, the impugned Tamil Nadu Act is in pith and substance relatable to Entries 1, 30 and 32 of the State List (List II) of The Seventh Schedule. The entries 1, 30, and 32 are as follows:

1. Public order (but not including the use of any naval, military or air force or any other armed force of the Union or of any other force subject to the control of the Union or of any contingent or unit thereof in aid of the civil power).

30. Money-lending and money-lenders; relief of agricultural indebtedness.
32. Incorporation, regulation and winding up of corporations, other than those specified in List I, and universities; unincorporated trading, literary, scientific, religious and other societies and associations; co-operative societies".

21. From the above, it can be viewed that though in the common parlance the broad spectrum of money mobilisation activities are known as Chit Fund but actually they are all different kinds of money mobilization and regulated by different agencies. Many of such activities are outside the purview of SEBI (CIS) regulation and are regulated by the respective sectoral regulators. Such activities include, deposit accepted by NBFC,

Insurance, Pension, Chit Fund, deposit accepted by Nidhi and Cooperative Society, Deposit accepted by companies under Section 73 of Companies Act. A summary of some such activities which do not fall within the regulatory purview of SEBI is provided in the table below:

Sl. No.	Category of activity (whether Registered/ Unregistered)	Concerned Regulator / Authority
1.	Mobilization of Deposits by Non Banking Finance Companies	Reserve Bank of India
2.	Nidhi or mutual benefit society	Reserve Bank of India & Ministry of Corporate Affairs both
3.	Gold saving schemes launched by jewellers	MCA / Reserve Bank of India
4.	Deposits accepted by Companies under Section 73 of the Companies Act	Ministry of Corporate Affairs (MCA)
5.	Schemes offered by Cooperative Societies	State Governments
6.	Chit Fund Business	State Governments
7.	Multi Level Marketing /Pyramid Marketing schemes, Prize Chit and Money Circulation (Banning Act)	State Governments
8.	Contract of Insurance	Insurance Regulatory & Development Authority (IRDA)
9.	Unit Linked Insurance Plan	IRDA
10.	Pension Scheme or Insurance Scheme framed under EPF	IRDA or PFRDA
11.	New Pension Scheme	PFRDA
12.	Housing Finance Institutions	National Housing Bank

(v) <u>Registered Chit Funds under Chit Funds Act 1982</u>

22. Chit Funds are indigenous financial institutions in India that cater to the financial needs of the low-income households. Traditionally Chit Funds have served as a saving instrument which is unique when compared to other financial products; commercially, they act more like a financial intermediary bringing together borrowers and savers, aiming to channelise the liquidity from agents with surplus towards deficit spenders. In a chit fund scheme, a group of individuals come together for a pre-determined time period and contribute to a common pool at regular intervals. At specified periodical intervals, during the tenure of the scheme, the collected pool of money is lent internally through a bidding mechanism to the bidder that offers the largest discount for the money.

23. A chit fund is a traditional financial system which was prevalent even before the evolution of Banking. The system exists in other parts of the world by the name Rotating

Savings and Credit Association (ROSCA). The operations of chit funds are governed by a Central legislation in India. Chit funds are regulated entities, classified as Miscellaneous Non-Banking Financial Institutions, under the Reserve Bank of India Act, 1934 and are now governed by the Chit Fund Act, 1982, which is administered by the respective State governments.

24. The uniqueness of this industry over other financial intermediaries is the ability of the chit operators to evaluate the intrinsic strength of potential clients mainly on the faith of the subscribers' ability to repay, a succour to lower / middle income group, small businessmen etc. who are often wedged between the exorbitant cost of the money lenders and the stringent procedure of the banks. A chit is also seen not merely as an investment but a drop-by-drop plan to get lump sum finance for marriage, education, housing, business etc., at a future date. The chit funds are of a self-liquidating nature and take the character of Mutual Benefit.

25. Chits are defined under section 2(b) of the Chit Funds Act, 1982 (Central Act). On the other hand, Prize Chits are banned under the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 and the conventional chits are excluded from the definition of Prize Chits. It may be mentioned here that Chit Funds is an exempted activity under the SEBI Act, 1992. Under section 2-(b) of the Chit Funds Act, 1982 "chit" means a transaction 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 instalments 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.

26. The legal and operational details of Chit Funds are as under:

a. Chit Funds are also covered under Sec. 45-I(bb)(vii) Explanation I of the RBI Act, 1934. RBI Notification No.DNBC.39/DG(H)-77 dated June 20, 1977 categorises it as miscellaneous non-banking company (MNBC).

b. Since the subject is in the concurrent list (entry 7 of List III) of the Constitution, administration of the rules is with the respective State Governments. The company should be registered with the Registrar of chit fund of the State of their operation.

c. Chit fund company means a company managing, conducting or supervising, as foremen, agent or in any other capacity, chits as defined in Section 2 (b) of 'The Chit Funds Act, 1982'.

d. Any company carrying out the operation of 'Chit Fund' should have the words 'Chit', 'Chitty' or 'Kuri' as part of their company name.

e. Chit fund companies are not allowed to accept deposits from the public, trade in stock, equity or other cash management.

f. Act prohibits operation of Chit business unless sanctioned by the state Govt.

g. Chit funds, as of now, are not allowed to carry on other businesses without the permission of the Registrar/State Governments.

h. Penalty section 76-imprisonment upto two years or with fine which may extend Rs.5000/-

27. As per provision of section 45-I (bb) (vii) of the RBI Act, 1934, any amounts received by way of subscription in respect of a 'chit' are excluded from definition of "deposit" as defined in the RBI Act, 1934. Further, RBI has granted exemption to chit funds from the provisions of Sections 45-IA (mandatory registration), 45-IB (maintenance of liquid assets in approved securities), 45-IC (Reserve Fund) are not applicable to Chit Fund Companies. While RBI is empowered under the RBI Act, 1934 to issue directions to chit funds but to avoid any overlap, RBI does not issue directions to chit funds. However, since the banning of chit funds from accepting deposits does not come in conflict with the Chit Funds Act, 1982 or any regulations thereunder, RBI has prohibited chit funds from accepting deposits. While Chit funds may collect subscriptions, they are prohibited by RBI from accepting deposits with effect from August 28, 2009, except from shareholders.

28. The Chit Funds Act, 1982 has been notified in all States in India, except the State of Jammu and Kashmir. Based on the feedback gathered from Regional Offices of RBI, the status of existing framework and law in respect of chit funds in various states is as under:-

(a) Majority of the states / UTs have framed Rules in accordance with Chit Fund Act, 1982. There are some states where separate rules have not been framed yet.

(b) The Chit Fund Act, 1982 is not applicable in the State of Jammu and Kashmir. The companies undertaking chit fund business in the State are required to

register themselves with the Registrar of Companies (RoC), Ministry of Corporate Affairs (MoCA), Jammu/ Srinagar.

29. In this regard RBI in a post-evidence reply submitted as under:

"The chit fund business is included in the list of businesses under RBI Act. RBI has granted exemption to chit funds from the requirement of registration, maintenance of liquid assets and reserves. RBI is having the powers under RBI Act to issue directions to chit funds but to avoid any overlap RBI does not issue directions to chit funds. However, since the banning of chit funds from accepting deposits does not come in conflict with the Chit Funds Act, 1982 or any regulations there under, RBI has prohibited chit funds from accepting deposits. While Chit funds may collect subscriptions…, they are prohibited by RBI from accepting deposits with effect from August 2009. In effect, while the chit fund business is within the purview of State Governments, the public deposit acceptance activities come under the purview of the RBI.

…RBI is of the view that regulation of chits under the Chit Funds Act, 1982 may be continued without any change unless the State Governments want any modifications to make the provisions more effective. State Government machinery should be used to the fullest extent possible to nab the persons committing offences under the banning Act.

As regards addressing the issue of branches in rural areas, RBI has actively promoted Financial Inclusion as a national agenda and made significant progress. There has been an increase in the total number of villages having banking connectivity, either through brick and mortar branches or Business Correspondents/Facilitators. The number of banking outlets providing doorstep banking services in villages have increased from 67,694 as on March 31, 2010 to 2,70,610 as on March 31, 2013".

30. In this regard, the representatives of the All India Chit Funds Association submitted the following during the oral evidence as follows:-

"...The kind of Chit Fund Act that we have, the regulations that are in place are much more severe than what is available in depositing companies. The Act is obsolete; it is not in tune with the on-going economic reforms; application is zero; and there is no coordination between one State and another.

...We need to be governed so that there are no scams. If the chit fund act is banned, what happens is the registered chit funds will be sufferers. So, the chit funds have to be continued.

The Chit fund can be named as Fraternity Fund.....We have only 25,000 chit fund operators doing a business of Rs.30,000 crore per annum. But actually, the volume of a chit fund operation, if you take it in totality, it will be more than 50

lakh people in our country....How to bring them under regulation is to simplify the enactment.....The only solution is to make the legislation user friendly.

The main reason for failure of chit fund is lack of proper recovery in chit fund companies. If we can have separate fast track courts for chit fund companies in the cities and district, it will really help convert unregistered chit funds into registered chit funds..."

They made the following suggestions for the growth and proper regulation of the registered chit funds industry:

(i) The key Advisory Group on Chit Fund/Nidhi companies, constituted by the Ministry of finance has carried out the preliminaries, done-in-depth study of the sector, and the recommendations of the group, if implemented, shall pave way for a user friendly, yet effective legislation that is in tune with the current economic situation. The reason for the enormous growth in the unregistered sector is on account of the fact that the existing legislation is over-regulatory and acts as a disincentive.

(ii) The media categorizes almost every financial misdeed as 'A Chit Fund Scam' and there is no rebuttal or any clarification from the concerned departments. This type of misinformation should be reined, as it could create a run, thereby putting at risk the public money. Media, relevant authorities may be restrained from such misdemeanor.

(iii) Exemption from Service Tax is fully justified on both social and economic parameter. Parity on technical ground, with other NBFCs should be granted.

(iv) Since the concept of chit funds has blended into our socio-economic culture and cannot be wished away, it would be prudent to include this unique, traditional financial tool, to complement other financial inclusion initiatives. Necessary relaxations in this regard may be looked into.

(vi) <u>Mushrooming of Ponzi schemes and enforcement thereof.</u>

31. Asked to furnish the details such as the number of ponzi companies operating and their annual turnover; root-cause of mushrooming of these companies across India; and the remedial measures taken or proposed, the Department of Financial Services in a written reply stated, among other things, as under:-

"…There is no centralised database of the business of chit funds in India. However, a research study entitled "Chit Funds as an Innovative Access to Finance for Low income Households" by the Institute of Financial Management and Research (IFMR) gives a estimate of the Chit Fund Industry at Rs. 12,000 crores based on the survey conducted of Chits registered between the financial

year 2001and 2007 in the five States of Andhra Pradesh, Delhi, Karnataka, Kerala and Tamilnadu.

Since the money circulation schemes, also commonly called as "Ponzi Schemes", are legally prohibited, and not a permitted activity, no database of such schemes is maintained……

The root cause of mushrooming of Ponzi Schemes could be found in the failure of the formal financial institutions in catering to the felt needs of the people for a savings and thrift schemes by expanding their geographical coverage to all parts of India and a general lack of awareness amongst masses of the distinction between legal and permitted financial products and illegal and unsafe schemes…"

32. On being asked to furnish the reasons for inordinate delay in passing orders by SEBI against Saradha Realty India Ltd. (SRIL), and other cases, it was submitted in detail as below:-

"Quasi-judicial orders are passed by SEBI under Section 11 / 11 B of the SEBI Act, 1992. These orders are appealable before the Securities Appellate Tribunal(SAT) and, thereafter, before the Supreme Court. The High Court can also apply their writ jurisdiction wherever they feel the need to do so.

Orders passed by SEBI have to follow the principle of natural justice and also establish a violation of SEBI regulation (such as SEBI CIS Regulation in this case) based on materials on record, evidence gathered, findings in the investigation, etc.

In many cases SAT and High Courts have set aside or remanded the case back to SEBI if principles of natural justice have not been followed or enough opportunity has not been given to the offender.

In a similar case of Rose Valley order was passed by SEBI on January 3, 2011; but the Calcutta High Court granted *status quo* orders and the same is continuing till date. The company has also challenged *vires* of Section 11 AA of the Act whereby CIS was brought under SEBI jurisdiction. Repeated attempts made by SEBI to get this matter disposed off early was of no avail and SEBI had to approach the Supreme Court for an early disposal. The Supreme Court gave direction in July 2012 to dispose of the matter preferably within 2 weeks or at least to consider vacating the stay. But till date the matter is still pending in the High Court.

In another case of West Bengal, MPS Greenery the provisional registration as a CIS has lapsed. The company was continuing to raise money. Directions were issued under Section 11 / 11 B of the SEBI Act,1992 asking the company not to raise money, but the company continued to defy SEBI orders and its agents got injunction & orders from the District Courts. In spite of SEBI pointing out to the District Courts that they had no jurisdiction under the SEBI Act,1992 courts took time to get the injunction vacated. In one case, SEBI had to move the High Court for vacating the injunction.

Finally on December 19, 2012, the High Court vacated the injunction and also pulled up and awarded cost of Rs. 10 lakhs. The agents in collusion with company filed a total of 12 suits and obtained injunctions in 8 matters. SEBI has been able to get the stay vacated in all cases except two cases in one court. Even today the injunction is continuing in that case and the company is continuing to raise money. SEBI has been issuing press advertisements cautioning people against making investments in the schemes of Rose Valley or MPS Greenery, but instead of following the rule of law, these companies have come out with counter advertisements in the newspapers challenging SEBI's jurisdiction.

The vires of Section 11 AA of the SEBI Act,1992 regarding CIS were also under challenge in the case of PGFL before the Supreme Court of India. SEBI fought this case successfully and finally on March 12, 2013 order was passed by the Supreme Court holding the validity of Section 11 AA. In spite of these developments, as highlighted above, SEBI has been facing difficulties in taking effective action against companies falling under CIS, because of intervention by various Courts and also lack of any effective action or cooperation by the State Governments.

In this background, it is to be pointed out that observing *prima facie* that the company Saradha had launched a CIS as defined under Section 11 AA of the SEBI Act, 1992 without obtaining registration from SEBI, a Show Cause notice was issued in December 2011. The company *vide* its reply dated January 03, 2012 denied the allegation and requested for personal hearing…."

…Hence, in view of principles of natural justice, SEBI gave sufficient reasonable opportunities to the company.

….it was observed that the company avoided furnishing of documents and failed to attend the document verification exercise. Accordingly, vide its order dated April 23, 2013, SEBI has directed Saradha Realty India Ltd and its Managing Director to wind up its existing Collective Investment Schemes and refund the money due to the investors within a period of 3 months and submit the winding up and repayment report to SEBI in accordance with SEBI (Collective Investment Schemes) Regulations 1999. It was also stated in the said order that failure to do so would result in the following actions by SEBI:

> 1.Prosecution proceedings Under Section 24 of SEBI Act 1992 and Adjudication Proceedings under Chapter VI of SEBI Act 1992 against the company and its directors.
>
> 2.Reference to State Government / local Police to register Civil / Criminal case against company and its directors for offences under the Indian Penal Code.
>
> 3. Reference to Ministry of Corporate Affairs to initiate process of winding up of company".

33. Asked to clarify as to when the Supreme Court's recent judgment in Sahara Case validated Section 11AA of the SEBI Act, 1992, and also allowed SEBI to seize their accounts and refund money to the investors, how can a similar issue in the matter of Rose Valley be allowed to continue in the High Court, it was submitted as follows:-

> "An interim order was passed by SEBI on January 03, 2011 directing Rose Valley not to collect money from investors. This was challenged by the company in the Calcutta High Court by filing a writ petition on January 18, 2011 which was dismissed by a single Judge. However, fresh Writ Petition 725 of 2011 was filed on July 19, 2011 by the company challenging the constitutional validity of Section 11AA of the SEBI Act, 1992 and SEBI (CIS) Regulations. 1999. On August 3, 2011 Calcutta High Court passed an Interim order restraining SEBI from proceeding further with the pending of proceedings. SEBI filed its counter affidavit on November 21, 2011.
>
> In view of frequent prayers for extension of time to file affidavit in reply by the Company, SEBI mentioned the matter for listing for urgent hearing before the High Court Calcutta. However, the Hon'ble High Court made it clear on 13/02/2012 that no mentioning would be entertained for inclusion in the list for early hearing.
>
> SLP (c) No. 19520/2012 was filed by SEBI in the Supreme Court of India which directed High Court at Calcutta to take up WP 725 of 2011 preferably within two weeks from July 2, 2012 or at least consider vacating the interim relief, particularly, in view of the fact that the respondents continue to invite deposits which may ultimately create difficulties as the clock cannot be turned back in future.
>
> In view of the direction of Supreme Court, the Calcutta High Court regularly heard the matter and hearings are concluded. Judgment is reserved.
>
> The matter regarding Rose Valley was taken up in Supreme Court in June 2012 for issues mentioned above whereas the Supreme Court delivered the judgment in the matter of PGFL upholding the constitutional validity of Section 11AA of the SEBI Act, 1992 in the month of March 2013, which has been brought to the notice of Calcutta High Court……."

34. On this issue, the RBI in a written reply agreed to a suggestion made by the Committee that cases if prosecuted in different States should be clubbed together under one court. Further asked as to could RBI not have gauged the gravity of the deposit collection by Saradha Group and other such companies, RBI responded in a post-evidence reply as given below:-

> "The money collected by Saradha cannot be termed as deposit. Further, as the Saradha Group was collecting money under Collective Investment Schemes, reference received on September 2011 was forwarded to the Economic Offences

Wing of the State Police (EOW) on September 21, 2012 to take suitable action, as the company was not registered with the Bank. Further, no information about activities of Saradha Group of companies was passed on / shared with RBI by other regulatory agencies during the course of deliberation of SLCC meeting held by Calcutta Regional Office of RBI. In the absence of any feedback/cooperation from other regulatory agencies, it becomes rather difficult to gauge activities of entities which are not under the regulatory and supervisory domain of RBI".

35. The details of action taken by the Central Ministries and regulatory bodies against the entities which collected deposits/monies illegally, as furnished to the Committee are given below:-

" The Ministry of Corporate Affairs:-

A total of 139 so called 'Chit Fund' cases have been assigned to Serious Fraud Investigation Office (SFIO) till 13 July, 2015 for investigation as well as 6 more cases have been assigned to it since that date.

The Reserve Bank of India (RBI):

The Ministry of Corporate Affairs (MCA) had forwarded in Dec, 2012 to RBI a list of 34,754 companies which are registered under Companies Act, 1956 and classified / categorized under 'Financial Intermediation, except Insurance and Pension Funding' and 'Activities auxiliary to Financial intermediation'. MCA had advised that many of these companies may be carrying on non-banking financial activities without mandatory registration as required under Section 45IA of RBI Act, 1934, as only 12,375 companies were registered with the Reserve Bank as Non-Banking Financial Companies (as on February 2013). MCA had requested the Reserve Bank to initiate action against such companies.

The latest updated overall position, as on June 19, 2015, is tabulated as under on the basis of preliminary examination of the financials and the action taken by the Reserve Bank of India thereafter:

Sr. No.	Category	No. of companies
1	Companies Referred by MCA to RBI	**34,754**
2	Of the above, Companies registered with RBI as NBFCs	**4,585**
3	Companies in MCA Database, not registered with RBI	30,169
4	Of the above (3), Companies under Liquidation	4,302
5	Of the above (3), Companies whose B/S not available on MCA website	4,253
6	Companies, which required further investigation (3-4-5)	**21,614**
7	Of the above (6), Companies found not meeting PBC criteria, i.e. are not considered as NBFCs	16,309
8	Of the above (6), Companies prima-facie meeting PBC	5,305
9	**Letters of Explanation issued to all the companies in (8) above**	

10	Of the above (8), Companies suspected of holding public deposits	104
11	**Of the above (10), No. of companies found to be holding public deposits on detailed scrutiny/ analysis**	**NIL**
12	Cases taken up for detailed review (approx.)	2,300
13	Scrutiny conducted	(1326)
14	Cases closed (on account of companies not meeting PBC / registered with another regulator)	1555
15	Referred back to MCA (since the company was not found on its registered address)	297

The data presented by the MCA to RBI on 34,754 companies also revealed that a large number of companies had migrated out of financial business since their incorporation but had continued to hold the financial code given at the time of incorporation by MCA. The MCA code was hence static and not dynamic, thereby giving a wrong picture of the activities of the company. The same was true of companies which had migrated into financial activities but did not hold a financial code. This was the reason that out of the list of 34,754 presented by MCA only 4,102 were found to be registered with RBI.

The RBI has also been carrying out scrutiny/ visits of the companies to ascertain/ establish whether the companies are carrying on their activities in violation of the RBI Act. The Reserve Bank made its action plan giving priorities to certain categories of companies, e.g. the companies suspected of accepting deposits, Rejected/ Cancelled companies, large Non- deposit taking companies etc.

It may be noted that on detailed scrutiny of the companies suspected to be holding public deposits, none of the companies were found to be accepting/ holding any deposit in violation of Sec 45 IA of the RBI Act, 1934. For the other companies, including the NBFCs whose application for certificate of registration was rejected earlier by the Bank, a graded approach to deal with these cases, having regard to the nature of violations, is being adopted by the Reserve Bank. It may also be noted that most of the companies (>80%) are very small in size (viz. asset size below Rs 10 crore) and on scrutiny majority of them were found to be not doing any active business

SEBI:

During the past three years, SEBI has passed interim orders against 72 entities, inter alia, directing these entities not to collect further money and not to alienate the property for, prima facie, carrying CIS activities without obtaining registration from SEBI as a Collective Investment Management Company in accordance with SEBI (CIS) Regulation, 1999. These interim orders are issued to immediately stop continuation of raising funds by these entities pending issuance of final order, so that no new investors are trapped into the schemes of these entities. The financial year wise interim orders passed against number of entities for the last three financial years is provided as under:

Sl. No.	Year	No. of Orders
1	2013-14	13
2	2014-15	51
3	2015-16	8
	Total	72

Orders passed during 2006-2012---6.

State-wise break up is given below:

Sr. No	State	Financial Year 2013-14	Financial Year 2014-15	Financial Year 2015-16	Total
1	Madhya Pradesh	0	13	3	16
2	Maharashtra	6	9	1	16
3	Uttar Pradesh	2	7	0	9
4	New Delhi	2	5	0	7
5	Punjab	1	5	1	7
6	Karnataka	0	3	1	4
7	Rajasthan	0	2	1	3
8	Tamil Nadu	0	2	0	2
9	Telangana	0	2	0	2
10	Chattisgarh	0	1	1	2
11	Gujarat	0	1	0	1
12	West Bengal	2	1	0	3
	Total	13	51	5	72

During this period, SEBI has also passed final orders against 23 entities, inter alia, directing these entities to refund the monies collected from investor with returns promised for carrying CIS activities without obtaining registration from SEBI as a Collective Investment Management Company in accordance with SEBI (CIS) Regulation, 1999. . The year wise break up is given as under:

Sl. No.	Year	No. of Orders
1	2013-14	7
2	2014-15	14
3	2015-16	2
	Total	23

Unauthorised Fund raising through Deemed Public Issue

Another unlawful manner of raising funds has been through issue of securities under the so called 'Private Placement route'. SEBI has taken action against certain companies who have raised money by issuing securities such as Non Convertible Debentures (NCDs)/ Non Convertible Redeemable preference shares (NCRPS) from more than 49 investors in violation of Section 67(3) of Companies Act, 1956, SEBI (Issue and Listing of Debt Securities) Regulation, 2008, SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 and SEBI (Issue and Listing of Non-Convertible Redeemable preference Shares) Regulations, 2013. SEBI passed interim orders against these companies (for NCDs/NCRPS). The number of interim orders passed is as follows:

Sl. No	Financial Year	Total Number of Companies against whom SEBI has passed orders
1	2013-14	4
2	2014-15	103
3	2015-16	45
	Total	**152**

State-wise break up is given below:

Sr. No	State	Financial Year 2013-14	Financial Year 2014-15	Financial Year 2015-16	Total
1	West Bengal	1	70	20	91
2	Odisha	0	11	1	12
3	Madhya Pradesh	0	9	15	24
4	Uttar Pradesh	0	4	1	5
5	Assam	0	2	1	3
6	New Delhi	3	2	1	6
7	Bihar	0	1	1	2
8	Jharkhand	0	1	0	1
9	Karnataka	0	1	0	1
10	Punjab	0	1	1	2
11	Maharashtra	0	1	0	1
12	Tripura	0	0	1	1
13	Chattisgarh	0	0	0	2
14	Gujarat	0	0	1	1
	Total	4	103	45	152

Out of the above 152 cases, SEBI has passed final orders in 13 cases directing the entities to refund the money to investors along with returns due.

Central Board of Direct Taxes (CBDT):

"…ITD at Calcutta had taken action in certain so-called Chit-fund companies in F.Ys. 2010-11 and 2011-12. During the course of investigation, it was found that these were not actually Chit-fund companies under Chit-fund Act, 1982 and they were only popularly referred to as Chit-fund companies. However, they were running schemes in the nature of a Collective Investment Scheme (CIS) as defined in section 11AA of SEBI Act, 1992

During the above investigation carried out by ITD, it was found that the major violation of the provisions of the Income-tax Act, 1961….The books of account maintained by these entities do not reflect their actual financial position. Other than the aforesaid violations, no major concealment of income was detected in these cases.

It is relevant to submit that the actions taken by ITD in the above cases had revealed violations of other laws also which were suitably informed by ITD to SEBI; Ministry of Corporate Affairs; Secretary (Finance), Government of West

Bengal and Reserve Bank of India (RBI). Further, the matter was also shared in the Regional Economic Intelligence Council (REIC).

…..Investigation Reports were also provided to the Central Economic Intelligence Bureau (CEIB) for necessary action by other Department/ Agencies.

Investigations conducted in certain similar cases by ITD at Nagpur in 2009 revealed that deposits were mobilized from public promising unusually high returns. It was found that the funds were misappropriated and the promoter of such scheme had purchased lands in his own name and in the names of his concerns. Appropriate action was taken in these cases in accordance with provisions of the Income-tax Act, 1961.

During investigation by ITD at Ahmedabad in March, 2013 it was found that Appropriate action has been taken in these cases so far as violations of the Income-tax Act, 1961 are concerned. A letter has been sent to the Director General of Police, There are *prima facie* violations of CIS regulations, administered by SEBI; a reference has been made to SEBI and Serious fraud Investigation Office (SFIO)….

Central Board of Excise and Customs (CBEC):

….No case of Service Tax evasion by any chit fund operator has been booked/ detected by this Directorate General.

The Directorate of Enforcement:

The Madhya Pradesh High Court had ordered that investigation and appropriate action in accordance with law may be initiated by various Financial Sector Regulators, Registrar of Companies, Ministry of Finance and State Governments in case of select companies mentioned in the order. The Court also directed that the CBI report of the investigation may also be sent to all the Regulatory Authorities. All the authorities may inform about the date of receipt of the order and the action taken thereon.

On being asked as to what action has been taken by the Enforcement Directorate in case of investigation of companies which were involved in unauthorised deposit taking and also money laundering, the Department of Financial Services in a post-evidence reply stated as under:

"The copy of the judgement of Madhya Pradesh High Court in the case of Writ Petition No. 3332 of 2010 in the case of Dharmvir Singh and another versus Union of India and others dated 13th July, 2012 was sent to both SEBI and RBI for taking appropriate action.

The High Court decision on Ponzi Schemes was received by the RBI on 24.09.2014. RBI's comments based on the Hon'ble Court's order are as below:

None of the companies in question whom Madhya Pradesh High Court order cites are NBFCs registered with the RBI. The order cites the CBI enquiry that found that they were involved in collection of money towards sale of plots of land or even livestock. Those activities are clearly not in the nature of NBFI activities. Therefore, they cannot be categorized as NBFCs. Secondly, the collection of money according to the order clearly mentions were for the purposes cited and therefore are not covered by the definition of a 'deposit' (under section 45-I(bb)(v) of the RBI Act, 1934).

The inquiry by CBI concluded that the activities warrant prosecution under the Madhya Pradesh PID Act provisions of which have been violated. The alleged abuses/misconducts of the companies based on the CBI preliminary inquiry is not in the RBI's jurisdiction and therefore does not warrant any action by RBI.

It is appropriate that a permanent coordination mechanism of intelligence agencies, enforcement agencies and financial sector regulators may be set up at the Central and State level with a set of standard operating procedure and red-flag indicators. The permanent coordination mechanism may also focus on identifying the gaps and suggesting remedial measures to effectively control such unauthorised deposit taking schemes.

The Directorate of Enforcement has informed that they have registered 57 cases under Prevention of Money Laundering Act, 2002 (PMLA) for offences arising out of scheduled offences registered by LEAs relating to Collective Investment Schemes, Chit Funds etc. In these cases, assets worth Rs. 1133.25 crore have been provisionally attached and 03 Prosecution Complaints have been filed under PMLA in these cases.

With regards to Madhya Pradesh High Court order in WP 3332 of 2010 (PIL), it was observed that most of the Chit-Fund/Multilevel Marketing Companies/firms pertain to Gwalior, MP. Hence, copies of FIRs registered against said companies were called from the Police Authorities in Gwalior. However, copy of FIR has been received from the Police Authorities only in one case i.e. KBCL INDIA PVT Ltd. No other FIRs and documents have been received from the Police Authorities despite repeated reminders. The matter is being followed up with the Police Authorities."

36. Asked to explain the underlying causes behind of recent frauds in collective investment schemes, the Chairman, SEBI submitted before the Committee as below:-

"...a concern has been expressed that why only one company got registered as CIS and SEBI perhaps need to dilute its CIS Regulations. I would very humbly like to submit before this hon. Committee that having any such desire or move would be detrimental to protecting the interest of the investor. What has SEBI CIS regulation prescribed? It has prescribed, for example, that there has to be a

minimum capital requirement. It has prescribed certain corporate governance in the company. For example, at least 50 per cent directors should be independent directors. There should be a trust. The trustees and directors should be fit and proper. They have to be approved by SEBI Board. They cannot appoint on their own. The type of investments that they can make, that has been prescribed.

This is also in line with various other regulations which we have, for example, companies raising money in the private market or mutual funds, if somebody wants to raise a mutual fund.

..people are in the last three years or four years going towards informal systems of savings or financial instruments. For example, more money has gone into housing sector; more has gone into gold; and more money has into this informal sector.

The money going to primary market, mutual funds, banking deposits and insurance sector, that has shown a decline in the last three or four years.....pending any legislation, there is a strong need for coordination of various agencies..".

37. To a suggestion made by the Committee that a survey should be carried out to estimate the value of the fraudulently obtained amount from investors in all CISs cases, the Department of Financial Services responded in a post-evidence reply as follows:-

"The amount collected in respect of the 664 cases was provided by SEBI based on the information available with SEBI. It may be noted that these 664 cases relate to the period around the promulgation of SEBI (CIS) regulation, 1999. SEBI has already initiated prosecution proceeding in respect of those cases where they failed to repay the investors. SEBI is of the view that carrying out a survey at this point of time to ascertain the value of amounts mobilised in these cases may not be feasible due to the lapse of more than a decade.

In respect of the other 9 cases, the amount collected by the entities was provided based on the information submitted by the entities during the course of examination/ quasi judicial proceedings/ information available with credit rating agencies.

The details of amount collected (based on information available) by the entities against whom SEBI passed orders during the last three years is provided as under:

S. No.	Entity	Amount Raised
1	MPS Greenery Developers Ltd.	Rs.1450.95 Cr as on July 31, 2012
2.	Rose Valley Real Estate & Constructions Ltd. (RVRECL)	Rs.1271.98 cr as on March 31, 2010
3.	Sun-Plant Agro Limited	Rs.24.21 Cr (till March 31, 2009)

4.	Nicer Green Forests Ltd.	Not Available
5.	NGHI Developers India Ltd.	Not Available
6.	Maitreya Services Pvt. Ltd.	Rs. 804 cr approximately (till March 31, 2011)
7	Sumangal Industries Ltd.	Not Available
8	Osian's- Connoisseurs of Art Private Limited	Rs. 104 cr. approximately
9	Saradha Realty Limited	Rs.43.36 cr (till March 31, 2010)

38. Asked about the steps taken or proposed to prevent the Companies / Directors of those Companies who are already banned in other cases so that they could not crop up in new situations, the Department of Financial Services submitted as under:-

> "SEBI *vide* its letter dated January 12, 2012 made a reference to MCA regarding the names of CIS entities and their directors who have carried out CIS operations in violation of the SEBI (CIS) regulations, 1999 and also requested MCA to circulate the same as a caution list of entities and directors among all Registrar of Companies (RoCs) so as to prevent such entities and directors from being associated with any new company. SEBI has not granted registration under SEBI (CIS) regulation, 1999 to any entity where the directors in the 664 +9 cases were the directors. Further, SEBI has initiated the process of examining whether any of the directors were common in the 664 + 9 cases. This exercise would require examination of numerous / voluminous records which would be a time consuming process. SEBI would expeditiously complete this exercise".

39. Regarding availability of expertise to deal with CISs, the SEBI stated in a written reply as under:-

> "SEBI is examining the activities of several companies with respect to applicability of SEBI (CIS) regulations, 1999. SEBI has received references/ complaints against 292 companies for carrying on activities of CIS. So far activities of 46 companies with respect to applicability of SEBI (CIS) regulations have been examined and complaints/ references against 37 companies were closed as they were not CIS. Further, during the last three years it had passed orders against nine companies for violation of SEBI (CIS) regulations. In addition to the above SEBI is also dealing with prosecution proceedings initiated against 553 entities as on March 31, 2013. In view of the above, SEBI may require more man power in future to deal with the challenges ahead".
>
> Further, SEBI had written Hon'ble Finance Minister seeking power of attachment of bank accounts, sale of movable and immovable property on lines of Income Tax Act for enforcement of its orders.

40. With regard to judicial interventions SEBI Chairman deposed before the Committee as follows:

> "It is very clear in the SEBI Act that an order passed by us can be appealed to Securities Appellate Tribunal and against that an appeal can be filed on with the Supreme Court. The High Court has no jurisdiction on appellate side so far as SEBI Act is concerned. Nobody can contest their writ powers but under the appellate jurisdiction and under the SEBI Act, they have no powers. But we have dozens of examples where the High Courts are interfering...So obviously a District Court has no role. Here in case of MPS Greenery, five district courts of West Bengal Hooghly and Barasat-have given injunction orders. The SEBI had to go to the High Court. We did not get relief from the High Court. We went to the Supreme Court which directed the High Court to pass an order. But in the process, they went on collecting money...."

(vii) <u>Regulation of Online / Direct Selling Schemes</u>

41. Representations were received from the Direct Selling Schemes stakeholders as follows:

> <u>Indian Direct Selling Association:-</u>
>
> "..Direct selling is an alternate channel of distribution and means the marketing of consumer products/services directly to the consumers generally in their homes or the homes of others, at their workplace and other places away from permanent retail locations, usually through explanation or demonstration of the products by a direct seller.
>
> Many companies in various parts of the world like Singapore, Malaysia, China, Japan, Korea, US, UK etc. have been successfully operating with proper legislative framework in place since last many years. Most often, direct selling in India has been misunderstood to be a part of money circulation scheme and hence authorities regulate us under the Prize Chits and Money Circulation Scheme (Banning) Act, 1978. We would again like to state that Direct Selling Structure differs from Prize Chits Scheme both in form and function. It does not envisage promoting or conducting any scheme for the making of quick or easy money rather it takes a lot of time and effort to make sales which is the base of earning money.
>
> …On more than one occasion this issue has also drawn attention of Parliament and the Ministry of Consumer Affairs, Food & Public Distribution in December, 2002, Ministry of Commerce & Industry in August, 2005 and Ministry of Finance in August, 2009 have all clarified that the provisions of the Prize Chits and Money Circulation Scheme (Banning) Act, 1978 do not apply to Direct Selling Companies.

However, they have also recognized the fact that due to lack of definitional clarity on definition of Direct Selling many fly-by-night operators are misusing the concept and thus there is a need to have a definition to differentiate between direct selling companies and fraudulent financial pyramid schemes. Hence, it is extremely important to define a distinction between direct selling companies and fraudulent financial pyramid schemes which operate in the guise of multi level of marketing.

Federation of Indian Chambers of Commerce and Industry (FICCI):-

…With growing consumer income and need to spend on discretionary items, direct selling has a strong potential in India.

…FICCI is asking for a clear legislation for the direct selling industry since a year now. Despite contributing socially and economically, the sector's operational and functional aspects have been misinterpreted due to the existence of fly-by-night operators. This is simply because there is no formal law or guideline to regulate operations of direct sellers in the country...

Herbalife International India Pvt.Ltd:-

…..in the absence of a specific regulation for direct selling industry in India, regulation meant to check money circulation schemes is erroneously being applied to the industry. This has created great uncertainty for the ethical, legitimate and law-abiding direct selling companies. The regulatory ambiguity perhaps also emboldens unethical and fraud pyramid scheme operators to pose as direct selling companies and dupe consumers. The resolution, we believe, lies in:-

(a). A clear definition of direct selling through an Act or a set of Guidelines;

(b). Exclusion of direct selling companies,…..from the provisions of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978;

(c). Inclusion of a clear definition pyramid marketing schemes in the the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 and banning such schemes.

Amway Corporation:-

...direct selling offers opportunities for inclusive growth that can benefit both unemployed and under-employed members of society. The industry recognizes that the fraud committed by some who claim to be direct sellers is harmful. We, therefore, strongly support efforts by the Government to establish clear guidelines for direct selling both to crack down on fraud and to establish a legal framework for our business model".

42. During oral evidence of the Department of Consumer Affairs on16 July, 2015, the Department were asked what steps have been taken to regulate the function of Multi-

level marketing/ direct selling companies in India. The Department of Consumer Affairs in their written replies have stated as follows:

> "The issues with respect of Direct Selling/Multilevel marketing companies is being examined by an inter-ministerial Committee under Secretary, Consumer Affairs with representatives of six other departments (i.e. Finance, Industrial Policy & Promotion, Legal Affairs, Financial Services, Information Technology and Corporate Affairs) and three State Governments (i.e. Delhi, Andhra Pradesh and Kerala) as members. The Committee is to submit its recommendations by 18.11.2015 and subject to completion of consultations with all stakeholders concerned i.e. other departments, the Industry Associations, consumer organisations, State governments, general public etc."

43. In this regard, SEBI submitted as follows:-

> "So far SEBI has come across two cases involving schemes collecting money from investors through internet. In one case the entity was not offering any units or securities to the investors and was found to carry out MLM activities. Hence, it did not come under the purview of SEBI. The same was informed to the Ministry of Finance vide letter dated August 05, 2011. In the other case, it is seen that the entity claims to be a Mutual Aid Fund and it is a voluntary informal network of millions of people across the earth….Prima facie, the activities of the company do not fall within the purview of SEBI".

> Further, in their briefing on the subject, the DG, Indian Institute of Corporate Affairs made *inter-alia* the following submission:

> > The Prize Chits of Money Circulation Schemes (Banning) Act, 1978 focuses on schemes for the making of "quick and easy money" and defines these as "money circulation schemes". The broadness of the Act's language means that it may be misapplied to a variety of business models, including those that are legitimate "direct sellers". This adds to the confusion and clogs the law enforcement system as ponzi/pyramid schemes also get a window of opportunity to disguise themselves as 'direct selling'. In this regard, courts have considered the legality of 'direct selling'; they have generally laid down a simple test;
>
> > Whether or not the business depends solely on the recruitment of new members in order to generate income. We, therefore, have to establish whether the business revenue is coming from sales or is it from membership/joining fees alone;
>
> > In order to redress this regulatory uncertainty, two steps are needed. Firstly, there must be a mandatory registration process for direct selling, which should be facilitated through a central regulatory body. Secondly, a clear definition of 'direct selling' must be provided, enumerating its identifiable features and distinguishing it clearly from ponzi/pyramid schemes".

(viii) Regulation of Non-Banking Financial Companies (NBFCs)

44. The difference between Non-Banking Financial Institution (NBFI) and Non-Banking Financial Company (NBFC) as explained by the RBI in a written reply is given below:-

> "Under the RBI Act, Non-Banking Financial Institution (NBFI) means a company, corporation or a co-operative society. A non-banking institution which carries on any of the businesses of a financial institution listed in the RBI Act will be a non-banking finance institution. A Non-Banking Financial Company (NBFC) is a company incorporated under the Companies Act, which carries on any business of a financial institution or carries on the business of receiving deposits as its principal business. RBI may, with the approval of the Central Govt., notify any other non-banking institution or a class of such institutions as non-banking financial company".

45. The Governor, RBI during the oral evidence held on 24 May, 2013 enunciated the role of RBI in regulation of Non-Banking Financial Companies (NBFC) as given below:-

> "As per the Reserve Bank Act, the regulatory mandate of the Reserve Bank in the non-bank financial space is quite limited. We regulate only non-banking financial companies whose principal business is collecting deposits or companies whose principal business is finance. Significantly, the Reserve Bank Act does not define what is principal for this purpose. It became necessary therefore, to define the word 'principal'. After careful consideration by a Committee of its Central Board, the Reserve Bank determined that a company whose principal business is finance has to meet two criteria. First, its financial assets have to be more than fifty per cent of its total assets and second, the company's income from financial assets has to be more than fifty per cent of its total income. This determination was made in 1999, put out in the public domain and has been followed consistently ever since. This definition has stood the test of time. It has not been contested legally and has not been questioned by any authority including the Government of India. What follows from this is when a company does not fulfil this 50:50 criteria, it becomes a non-banking non-financial company and falls outside the purview of the Reserve Bank. Acceptance of deposits by such non-banking non-financial companies is administered by the Registrar of Companies. Furthermore, what makes the situation complex is that not all financial companies that meet the 50:50 criteria are within the Reserve Bank's regulatory purview. Companies with very specific business activities such as insurance, housing finance, stock broking, merchant banking, venture capital funds, Nidhis are all regulated by other regulators. Although mentioned in the Reserve Bank Act, chit funds too are exempted from registration with the Reserve Bank. The total number of NBFCs currently registered with the Reserve Bank is about 12,300.

.... Focus of RBI regulation of NBFCs:- The Reserve Bank regulation is driven by three objectives:- 1. Financial stability, 2. depositor safety, and 3. consumer protection. We secure financial stability by imposing protection norms such as minimum capital adequacy ratio, liquidity requirements, and sectoral exposures, with the norms being tighter for larger NBFCs. In respect of deposit taking NBFCs, depositor protection is safeguarded by prescribing additional prudential safeguards like mandatory credit rating, limiting the quantum of deposits that can be collected, SLR, etc. To protect consumers, we have asked NBFCs to institute a fair practices code which should be clear and transparent".

46. In a response to a query as to whether NBFCs that are not regulated by the RBI are illegal, RBI submitted a written reply as follows:-

"No. There are many types of NBFCs that are regulated by other financial sector regulators such as IRDA (Insurance companies), NHB (Housing Finance Companies), SEBI (Stock Broking Companies, Merchant Banking Companies, Venture Capital Companies, Mutual Funds), Ministry of Corporate Affairs (Nidhi Companies), and State Governments (Chit Fund Companies).

As and when RBI comes across instances of a company engaged in NBFI activities without obtaining Certificate of Registration (CoR) from RBI, appropriate action as prescribed in Section 58 of RBI Act, 1934 is initiated against the entity concerned. Various types of actions have been initiated against 71 companies for violations of the RBI regulations, including issuing prohibitory orders for collection of deposits, prohibitory orders for disposing off their assets, criminal action, prosecution, penal action and initiation of liquidation proceedings".

47. Asked about the limitations in regulation of the non-banking sector, RBI in their post-evidence reply stated as below:-

"The regulatory gaps in NBFC regulations *vis a vis* banks was dealt with in detail by the Usha Thorat Committee on Issues and Concerns in the NBFC sector. The gaps identified relate to differences in regulation between bank sponsored NBFCs and standalone NBFCs, need for higher risk weights for exposure to sensitive sectors, similarity in prudential asset classification and provisioning norms between NBFCs and banks, mandatory credit rating for NBFCs accepting deposits, need for similar regulations between NBFCs and banks in so far as lending to stock brokers and merchant banks, maintenance of liquidity in the balance sheet of NBFCs and bringing Government NBFCs under the RBI regulatory fold etc. The Committee also stated that the supervisory framework for NBFCs sector should be strengthened and made more comprehensive and forward looking. The Reserve Bank is actively considering these recommendations for implementation to address these limitations".

48. To a query raised by the Committee as to whether any ceiling on quantum of deposits that can be raised by Residuary Non-Banking Companies (RNBCs), the written reply as submitted by the RBI is given below:-

> "There is no upper ceiling on acceptance of deposits by RNBCs. However, as a matter of policy, RBI is not in favour of acceptance of deposits by non- banking institutions. Both the existing RNBCs i.e. M/s Sahara India Financial Corporation Ltd and M/s Peerless General Finance and Investment Ltd have been directed to stop their deposit taking activity and repay their deposit liability completely by the year 2015; since it was found that their business model was inherently unsustainable. These companies have also been directed to completely cover their deposit liability by way of investment in approved securities. The Bank is closely monitoring the repayment of deposits and ensures that adequate liquid assets are available for such repayments".

49. On the issue that NBFCs continue to promise high interest rates 30-40 per cent despite the maximum interest rate to be charged by them is fixed by RBI, a written reply as submitted by the RBI is given below:-

> "RBI has not issued any guidelines on interest rates to be charged on loans granted by companies registered with RBI as NBFCs, other than NBFC-Micro finance institutions, on the loans granted by them. The rate of interest to be charged by the company is governed by the terms and conditions of the loan agreement entered into between the borrower and the lending NBFC. However, in order to ensure transparency in such matters, RBI has advised the NBFCs vide circular No. DNBS(PD)CC.80/03.10.042/ 2005-06 dated September 28 2006 to adopt a Fair Practices Code (FPC), with the approval of their Boards.....It is mandatory for NBFCs that the rate of interest and the approach for gradations of risk and rationale for charging different rate of interest to different categories of borrowers is disclosed to the borrower or customer in the application form and communicated explicitly in the sanction letter".

50. On being asked as to whether the Reserve Bank have taken exemplary action against the fraudulent companies, RBI submitted a post-evidence reply as under:-

> "The Reserve Bank regulates companies that conduct financial activities as defined under Section 45I (c) of the RBI Act, as their principal business. If the Bank comes across such companies carrying on NBFI activities as their principal business and has not sought the registration, the Bank is authorized to take action as envisaged in the RBI Act. We are not regulating insurance, prize chits etc mentioned in 45I(c). The Bank has till date taken action against 71 companies, including taking criminal action under Section 58B and 58C, initiation of winding up proceedings against such companies, or both".

51. To a suggestion made by the Committee that since the capital base of new companies seeking incorporation is very low, an increase in the capital base will prevent small companies from coming into existence, RBI in a written submission stated as follows:-

> "We agree with the views of the Committee. However, the matter needs to be addressed by the Ministry of Corporate Affairs. The Reserve Bank has concerns also over Limited Liability Partnership Firms (LLPs) incorporated under LLP Act 2008 and being allowed by the MCA to conduct non-banking financial activities. As the regulatory framework is minimal for LLPs, including entry point capital, and prudential regulations are non-existent, this creates a huge gap and arbitrage opportunity, with NBFCs wanting to convert to LLPs. The matter has been taken up with Ministry of Corporate Affairs. As per the MCA21 website there are currently 9,395 LLP registered by the MCA".

52. Regarding grievance redressal mechanism, RBI in a written reply stated that:-

> "RBI does receive complaints on companies registered with it and facilitates resolution of the complaints of the customer by taking it up with the concerned company. Complaints on companies not registered with the Bank are taken as Market Intelligence inputs to further investigate whether the company requires registering with the Bank under the principal business criteria. Complaints on unincorporated bodies accepting deposits are immediately forwarded to the concerned Economic Offences Wing of the State Police to take appropriate action under the IPC or Protection of Interest of Depositors' Act, if passed by the State Government in the concerned State. Apart from the above, there is no Ombudsman for the NBFC sector, as in the case of the banking sector".

(ix) <u>Follow-up Action taken to strengthen the existing systems / Acts:</u>

53. On being asked during the oral evidence held on 17 May, 2013 about the possibility of preventing recurrence of such scams in a timely manner through early warning system; and intelligence mechanism, the Department of Financial Services and the Ministry of Corporate Affairs in a post-evidence reply submitted that:-

> <u>"The Ministry of Finance (Department of Financial Services):</u>
>
> …..The Government has also constituted an Inter-Ministerial Group (IMG) in the Department of Financial Services, Ministry of Finance to look at inter-regulatory issues and improving systems and procedures and strengthening legal framework in the Financial Sector. The IMG would look into the existing systems, procedures and framework of economic intelligence and sharing amongst various regulatory bodies with a view to improving them and to ensure that preventive and curative measures are taken to stop the recurrence of money collection by unauthorised entities.

The Ministry of Corporate Affairs:

"(i) As Ponzi schemes are covered under the Prize Chits & Money Circulation Schemes (Banning) Act, 1978, this Ministry does not come into the picture as far as this issue is concerned. However, as many a time, such fraudulent schemes are known to have been floated by companies registered under the Companies Act, the Ministry has issued instructions that wherever complaints are received from general public or from other Ministries / Departments of the Centre / State Governments, the filing of such companies should be closely scrutinised. Such scrutiny should cover examination of balance sheets and other documents filed, qualification of auditors and other relevant details. Such exercises should also be carried out when there are 'system generated alerts' in the MCA-21 portal. Based on the results of scrutinies, wherever *prima facie* irregularities and violation of law appears to have been committed, cases are entrusted to the SFIO for intensive investigation under the Companies Act.

(iii) Besides, SFIO has also initiated / contemplated the following action:-

(a) Orientation of State police officers in collaboration with the CBI Training Academy.

(b) Identification of nodal officers in the State Police to contact for investigating affairs of companies running fraudulent schemes.

(c) Development of a suitable 'Fraud Prediction Model' (under preparation)

(iv) It may not be out of place to mention that the Ministry has also initiated following preventive actions :

(a) Identification of Finance companies and sharing their details with RBI, to enable RBI to isolate companies carrying on business without registration as NBFC.

(b) Forwarding of Model Rules under Prize Chits and Money Circulation Schemes (Banning) Act, 1978 to bring so called 'Multi Level Marketing' within the purview of 'Money Circulation'.

(c) Letter sent by the Hon'ble Corporate Affairs Minister to State Chief Ministers to enlist the active involvement of State Police to proceed against companies indulging in money circulation".

54. The amendment proposal of the Department of Financial Services is silent on the Chit Funds Act, 1982, and the Depositories Act, 1996. On being asked as to whether any Expert Group during the last 30 years has been set up or any regulatory body suggested to the Ministry of Finance to review existing legal / regulatory / institutional

framework for chit fund / ponzi companies, the Department of Financial Services stated in a written reply as under:-

> "DFS has constituted a Key Advisory Group on Chit Fund / Nidhi Companies (KAG) to:
>
> i) Review of existing legal / regulatory / institutional framework for Chit Fund / Nidhi Companies and its efficacy;
>
> ii) Action plan including policy initiatives for orderly growth of the Sector;
>
> iii) To recommend the legal / institutional / regulatory initiatives related measures required for orderly growth of the Sector.
>
> The final version of the Report of the KAG has been submitted in February, 2013 and is under finalisation in consultation with the State Governments. The recommendations of the Group, inter-alia, include recommending certain legislative and non-legislative measures for providing operational flexibility to the recognized chit funds.
>
> The purpose of Depositories Act, 1996 is to provide a legal framework for establishment of Depositories in India. The amendments to Depositories Act, 1996 would be considered as part of the strengthening the regulatory and supervisory powers of SEBI, for which a separate exercise is being undertaken by the Department of Economic Affairs, Ministry of Finance".
>
> In the last 30 years, no Expert Group / Regulatory Body has reviewed or suggested to the Ministry of Finance to review the existing legal / regulatory / institutional framework for chit funds / Ponzi Companies. As mentioned above, the Report of KAG on Chit Funds is being finalised to recommend measures for orderly growth of the sector.
>
> However, there are specific proposals to introduce legal amendments to the SEBI Act, 1992 and the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 to strengthen the existing regulatory and supervisory framework and also to reduce the regulatory gaps in the financial sector. The legislative proposals in the matter are being discussed in the Ministry of Finance.."

55. The amendment proposal of the Department of Financial Services is also silent on the RBI Act, 1934. Asked as to whether the various Acts being administered by RBI, which were enacted more than 50 years ago, also need to be consolidated into a comprehensive legislation for better understanding and regulation, the RBI in a written reply stated as follows:-

> "From the definition of "financial institution", the business of insurance (regulated by IRDA); the business of chits (regulated under Chit Funds Act, 1982) and prize chits (banned by the Banning Act) may be deleted. This will strengthen the hands of respective regulators and enforcement agencies. Consolidation of all RBI

administered Acts into a comprehensive legislation for better understanding and regulation may be considered. It may be noted that FSLRC has since submitted its report to Government along with the draft Bill (Indian Financial Code) to consolidate and amend the law relating to Indian Financial Sector".

(x) Multi-State Cooperatives

It has been brought to the notice of the Committee that some bogus compnaies running ponzi schemes etc. have transferred their funds and assets to Multi-State Cooperatives. Some of them are as follows:

Sl. No.	Entity against SEBI order passed w.r.t CIS activities	Operating under Cooperative Societies
1	Samruddha Jeevan Foods Ltd.	Samruddha Jeevan Multi State Multi Purpose Cooperative Societies Ltd.
2	Sai Prasad Foods Ltd. Sai Prasad Properties Ltd. Sai Prasad Corporation Ltd.	Sai Prasad Global Multi Purpose Cooperative Societies Ltd.
3	Utkarsh Plotters & Multi Agro Solutions India Ltd.	Utkarsh Atro Multi State Cooperative Pvt. Ltd.
4	PGF Ltd PACL	Lotus Agricultural and Marketing Cooperative Society Ltd. & Kisan Agrotech Cooperative Society Ltd.
5	Agri Gold Farm Estates India Private Limited.	Agrigold Pariwar Mutually Aided Cooperative Society Limited
6	Saradha Chit Fund	Ma Sarada Agro Multi State Cooperative Credit Society

56. During the Oral Evidence of the Department of Agriculture & Cooperation held on 16th July, 2015, the Ministry was asked as to why an abnormal increase in multi-State cooperatives has taken place in the last two years.

The Ministry replied as under:

1. "Multi-State cooperative societies registered under provisions of the MSCS Act, 2002 are functioning as autonomous cooperative organisations accountable to their members. The duties and responsibilities of the members, Board of Directors, General Body and the Central Registrar of Cooperative Societies have been defined
in the Act. As per provision of section 49 of the MSCS Act, 2002, the Board is empowered to undertake all business activities including accepting of deposits and giving loan to members. The Central Registrar can invoke certain provisions of the said Act such as power of Central Government to direct special audit in certain cases (u/s 77), conduct of inquiry (u/s 78), inspection (u/s 79), to give directions in public interest (u/s 122) and supersede the Board of multi-State cooperative society (u/s 123) if the conditions mentioned therein have been fulfilled. In addition, CRCS can order inspection of books of accounts etc. of a multi-State cooperative society u/s 108 of the MSCS Act, 2002. The concerned

RCSs of States/UTs have been authorized to conduct inspection u/s 108 of the said Act.

2. To conduct special audit u/s 77, the Central Government or the State Government either by itself or both, shall hold not less than 51% of the paid-up capital in the multi-State cooperative society. To conduct inquiry u/s 78 and inspection u/s 79, the Central Registrar may on a request from a federal cooperative to which a multi-State cooperative society is affiliated or a creditor or not less than one-third of the members of the board or not less than one-fifth of the total number of members of a multi-State cooperative society, shall hold an inquiry or direct some person authorized by him by order in writing in this behalf to hold an inquiry into the constitution, working and financial condition of a multi-State cooperative society. To give direction in public interest u/s 122 and supersede the board of the multi-State cooperative society u/s 123, the Central Government shall hold not less than 51% of the share capital in the multi-State cooperative society.

3. Regarding registration of societies, it is stated that as per the provision of section 6 of the MSCS Act, 2002, the application for registration has to be submitted by the Chief Promoter duly signed by individuals at least 50 persons from the States concerned where the society extends its area of operation. After submission of the proposal by the Chief Promoter, the same is being examined as per provisions of the MSCS Act, 2002 and if the proposal meets the requirement of the provisions of the Act, the same being registered as a multi-State cooperative society.

4. As stated above, to conduct inquiry u/s 78, Central Registrar may on a request from a federal cooperative to which a multi-State cooperative society is affiliated or a creditor or not less than one-third of the members of the board or not less than one-fifth of the total number of members of a multi-State cooperative society, shall hold an inquiry or direct some person authorized by him by order in writing in this behalf to hold an inquiry into the constitution, working and financial condition of a multi-State cooperative society. But no such conditions have been fulfilled from the complaints received so far in this Department from SEBI/RBI/CBI on this matter. However, on receipt of complaints, respective RCSs of States/UTs have been requested to conduct inspection u/s 108 of the MSCS Act, 2002.

5. This Ministry has also observed that there is abnormal increase in registration of multi-State cooperative credit and multipurpose societies in the years 2010, 2011 & 2012 and the following action has been taken to restrict registration of new societies :-

a) For registration of any new multi-State cooperative credit society, the following documents have been made compulsory for its registration under the provisions of the MSCS Act, 2002 vide this Department's Order dated 29.05.2013:

(i) No Objection Certificate from the Registrar of Cooperative Societies of the States/UTs concerned where the proposed area of operation of the society extends.

(ii) Verification certificate of the background and other credentials of the Chief Promoter/Promoters duly certified by the Registrar of Cooperative Societies of the State where Registered Office of the society is proposed to be located.

b) To ensure effective monitoring of multi-State cooperative societies located in various States/UTs, the government has decided to authorize the RCSs of all States/UTs by delegating powers to them to conduct inspection u/s 108 of the MSCS Act, 2002 vide circular dated 29.05.2013**.**

c) It has also been decided that primary multi-State cooperative societies shall be registered initially with only two contiguous States/UTs as area of operation vide order dated 26.03.2014.

d) Since RBI is of the view that acceptance of deposits from nominal members by multi-State credit societies may have to be construed as accepting deposits from public and carrying out banking activities, therefore, RCS of all States/UTs have been directed vide this Department's order dated 26.03.2014 that multi-State cooperative credit societies shall henceforth, discontinue accepting deposits from nominal members.

e) Based on the inspection conducted u/s 108 of the MSCS Act, 2002, by RCS, Government of Odisha, winding up orders have been passed for eleven societies for which registered office situated in the State of Odisha.

f) Based on the judgement of the Hon'ble High Court of Rajasthan at Jodhpur dated 19.11.2014 in DB Civil Petition No. 26/2013, all the multi-State cooperative societies have been directed vide this Department's letter dated 18.02.2015 that not to carry on any banking business namely, to take deposits, opening of branches for its banking activities, installation and running of ATMs and distributing loans to depositors with immediate effect unless they have a valid license from RBI under the Banking Regulation Act, 1949.

g) As & when RBI/SEBI has informed to this Department that particular society is involving in the collection of deposits from the public/nominal members, the concerned RCS of the States have been requested to conduct inspection u/s 108 of the MSCS Act, 2002 and also the societies have been directed to refund the amount collected from the nominal members."

(xi) Way Forward:

Single Regulator or Single Law: What is required?

57. According to the Ministry of Finance (Department of Financial Services), the classification of regulatory and supervisory functions of different regulator is to: a) ensure healthy growth of the companies including financial companies; b) Ensure that

these companies function as a part of the financial system within the policy framework, in such a manner that their existence and functioning do not lead to systemic aberrations; and that c) the quality of surveillance and supervision exercised by the different regulators is sustained by keeping pace with the developments that take place in this sector of the financial system.

58. On being asked as to whether we can have a centralised regulation and enforcement of unauthorised deposit collection activity by established regulators duly empowered, like SEBI or we should leave the regulation and enforcement of these unauthorised schemes particularly to the State authorities, the Department of Financial Services in a post-evidence reply stated as under:

> "Under the recently amended the Securities and Exchange Board of India (SEBI) Act, 1992, all schemes not registered with SEBI or other regulated schemes involving pooling of funds of One Hundred Crore Rupees or more would be deemed to be Collective Investment Scheme (CIS) requiring mandatory registration and regulation under the SEBI Act, 1992. Further, any scheme conforming to the conditions of SEBI regulations would also be covered under the definition of CIS. Therefore, SEBI has been empowered to regulate all major schemes which are unauthorised / unregistered. SEBI has powers of investigation and prosecution under the SEBI Act, 1992. The recently enacted The Securities Laws (Amendment) Act, 2014, which amended the SEBI Act, 1992, empowers SEBI to seek information from any person.
>
> There are several institutional mechanisms at the Central Level and at the level of State Governments. The Financial Stability and Development Council (FSDC) and the Sub-Committee of FSDC perform the role of acting as permanent institutional mechanisms to deal with the issues of inter-regulatory gaps and overlaps at the Central level. The FSDC is chaired by the Finance Minister and all the financial sector regulators are Members of this. The Sub-Committee of FSDC is chaired by the Governor, RBI and all the financial sector regulators are Members. The State Level Coordination Committee (SLCC) is a permanent Institutional Mechanism for coordination among the regulators and the enforcement agencies to deal with the issues of unauthorised/ unregistered deposit taking or money collection schemes. The SLCC has, as its members, apart from the RBI, the Regional Directorate of the MCA, local unit of SEBI, IRDA, NHB, ICAI, the Economic Intelligence Units of the State Police, the Law and the Home Ministries of the State Government and the Registrar of Chits.
>
> To strengthen the SLCC framework, the SLCCs were reconstituted in May, 2014 at the behest of Financial Stability Development Council – Sub-Committee (FSDC-SC). The SLCC is now being chaired by the Chief Secretary/Administrators of the States/UTs and the frequency of the meetings have been increased to quarterly as opposed to half yearly earlier. As all the

relevant financial sector regulators and enforcement agencies participate in the SLCC, it should be possible to quickly share the information and agree on an effective course of action to be taken against entities indulging in unauthorized and suspect businesses involving funds mobilization from public.

Going ahead, a dedicated website for SLCC is being designed which will contain information on registered entities of the SLCC participants, activities of various SLCCs, besides other information. The participants would be able to share information among each other on real time basis, as also have facility to start and contribute to discussion threads (blogs). A module for public in the SLCC portal to post information on suspected unauthorised financial activities, as also for registering their complaints against any regulated/unregulated entity directly or assisted through the Administrator is envisaged. This should help in taking action against such entities in an expeditious manner through information sharing among the Regulators and Enforcement agencies.

The State laws on Protection of Interest of Depositors in Financial Establishments need to be strengthened, as these laws, inter-alia, provide for repayment of money to depositors. The States, where such laws are not formulated, these should be immediately enacted. The Government has already written in June, 2015 to the States and Union Territories (UTs) which do not have such Depositor Protection Acts to quickly enact one, so that the regulatory vacuum in this area could be removed. In this connection, a Model Draft Act prepared by RBI has been shared with the States and UTs. Since the State police and law enforcement agencies have a presence at the ground level, these agencies must be assigned a definite responsibility to control the incidence of unauthorised deposit collection activities.

The Companies Act, 2013 and the Companies (Acceptance of Deposits) Rules, 2014, inter-alia, provide for deposit insurance in case an entity decides to raise deposits from public."

59. In this regard, RBI submitted a written reply as follows:-

"…While a single law to regulate collection of money by various financial entities may not be suitable, a single grievance redress agency to which an investor may complain would be useful. RBI could extend the necessary cooperation with such agencies particularly with respect to the entities coming under the regulatory jurisdiction of RBI".

60. The Governor, RBI during the sitting of the Committee held on 24 May, 2013 highlighted some important areas for way forward as under:-

"At present there are several regulators regulating acceptance of money from the public. Also there are transactions which look like deposits but technically are not. Similarly deposits are collected disguised as some other products. The FSLRC, as you had mentioned, has made certain recommendations with regard to regulation of deposit-taking bodies.

The second issue on the way forward is surveillance and enforcement. Effective regulation needs to be complemented by effective surveillance and empowerment of existing laws with punishment being harsh and quick to act as a deterrent. The third is coordination mechanism. There should be a coordination mechanism at the State level involving regulatory surveillance and enforcement agencies.

The effectiveness of the State-level Coordination Committee established by the Reserve Bank varies from State to State. This was in fact one of the main issues we discussed at the Reserve Bank's annual meeting with the State Finance Secretaries earlier this week, just two days ago. Some of you may have seen reports of that in the newspapers. I have requested all the State Finance Secretaries to consult their Chief Ministers, their Finance Ministers and all related agencies at the State level, and give us their considered views on how to make coordination effective. We will chalk out an action plan after receipt of those suggestions within the next one month.

The fourth issue is public awareness. Greater public awareness is by far the most effective safeguard against transgression of law. The Reserve Bank has taken a number of initiatives towards financial literacy and we will examine how we can extend and expand our outreach and coverage. As part of this endeavour and after the recent financial sector happenings, early next week we will put out on our website FAQs on the non-bank financial sector as a public awareness campaign. We will also ensure that adequate publicity is given to that in the print and electronic media in English, Hindi and vernacular languages.

Finally, Sir, the most effective way of protecting people from unlawful schemes and fraudulent operators is to provide them access to the formal financial sector which is more effectively regulated. Both the Government of India and the Reserve Bank of India have been endeavouring to deepen financial inclusion. One lesson we have learnt is that getting every household to have a bank account is necessary but not sufficient. You have to ensure that the account is used to save money, to remit funds, and also to get credit and micro-insurance. The Reserve Bank remains committed to achieving such meaningful financial inclusion".

61. On being asked to comment on the view expressed by the Committee that much in the financial sector appears to have remained unregulated and unregistered, the Secretary, Department of Financial Services while deposing before the Committee stated that:-

"we have a whole host of regulating and people who are treading on this largely grey area and operating till now fairly independently, although systems have been put in place – not really effectively, I may add – to coordinate the activities of all these agencies at the State level and at the Government of India level. One of the main tasks before us which we have taken up now is to make sure that our coordination mechanism become a little more effective and each one of us do not

reinvent the wheel which appears, in all fairness I may state, that sometimes what one organ is doing is not always known to the other organs of the State.

although it is a Central Act – Prize Chits Act is a Central Act –the implementation of the rules is not only with the States, but the rules are also to be notified by the States.

...I must admit that now we have started acting more vigorously and I would not mind in saying that we were earlier not as active as we should be.

We have now set in motion that thing in process whereby the companies will be identified immediately if they do not make filing by the regular date, to inform the regulators concerned".

62. On being asked as to what pre-emptive schemes could be put in place and how could the depositors be repaid their money in full which is deposited with the unauthorised money collection schemes, the Department of Financial Services in a post-evidence reply stated as follows:

"The State laws on Protection of Interest of Depositors in Financial Establishments need to be strengthened, as these laws, inter-alia, provide for repayment of money to depositors. The States, where such laws are not formulated, these should be immediately enacted. The Government has already written in June, 2015 to the States and Union Territories (UTs) which do not have such Depositor Protection Acts to quickly enact one, so that the regulatory vacuum in this area could be removed. In this connection, a Model Draft Act prepared by RBI has been shared with the States and UTs. Since the State police and law enforcement agencies have a presence at the ground level, these agencies must be assigned a definite responsibility to control the incidence of unauthorised deposit collection activities.

The SLCCs were reconstituted in May, 2014, and are now being chaired by the Chief Secretary/Administrators of the States/UTs. The frequency of the meetings has been increased to quarterly as opposed to half yearly earlier. As all the relevant financial sector regulators and enforcement agencies participate in the SLCC, it should be possible to quickly share the information and agree on an effective course of action to be taken against entities indulging in unauthorized and suspect businesses involving funds mobilisation from public.

As regards the creation of awareness amongst consumers about the authorised and unauthorised deposit taking, it requires continuous efforts and is work-in progress. From a public policy perspective, proactive measures have been taken by the RBI, both within the provisions of the RBI Act and beyond, with a view to safeguard the interest of the depositors. As part of financial literacy efforts, RBI has been conducting various outreach programmes to sensitise the public against placing deposits with unauthorized entities / entities that promise unsustainable returns. RBI would be shortly commencing a mass Public Awareness Campaign by using multiple media channels."

63. On being asked as to how the collection of monies by unauthorized companies could be prevented in future, the SEBI in a written submission stated that:-

> "SEBI has been raising concerns regarding pooling of money from public by unscrupulous operators across the country in the absence of a clear regulatory framework. Companies carry out activities involving mobilization of money from the general public without obtaining permission from any regulator. Companies are expanding into areas that are currently unregulated, e.g., timeshare, emu farming etc.
>
> SEBI has proposed creation of a new entity outside of the existing regulators to act as a Principal Regulator, which would be authorized by law for monitoring all money collection schemes. The jurisdiction of the Principal Regulator has to be defined in such a way that if no controlling or regulatory authority is responsible for a money collection scheme, it will by default come under the purview of the Principal Regulator".

64. When asked to clarify as to whether the proposal for single Regulator will become super regulator and there will be more confusion, the SEBI in a post-evidence reply stated that:-

> "…SEBI has proposed creation of a new entity outside of the existing regulators to act as a Principal Regulator, which would be authorized by law for the monitoring all money collection schemes. Further, the principal regulator is proposed to have the following characteristics:
>
> - The regulator would be independent
> - The regulator would be authorized by law for monitoring all such money collection schemes. A new law may be created for this purpose.
> - The regulator will have legal authority to take action even in those cases where the State Government is authorized to act. The principal Regulator may act as a coordinator in such cases with the State Government, but with over-arching powers over activities which State Governments also regulate.
> - The regulator would also have its own staff and resources.
> - The jurisdiction of the Principal Regulator has to be defined in such a way that if no controlling or regulatory authority is responsible for a money collection scheme, it will by default come under the purview of the Principal Regulator.
>
> Once the Principal Regulator is formed, all Collective Investment Schemes will also come under the purview of the Principal Regulator. The guiding principle would be where there is an activity involving mobilization of funds from public and where there is no other central regulator present, then the activity would be regulated by the proposed Principal Regulator".

65. Asked as to why no efforts are being made to educate the people about these schemes which defraud people with the promises of high returns and then defalcate the

money collected from public, the Department of Financial Services clarified in a written reply as under:-

> "The Department of Financial Services has asked RBI to educate people about such schemes and unregistered entities. It is agreed that these educational and awareness campaigns may be undertaken on sustained and regular basis".

66. While the RBI agreed to a suggestion made by the Committee that since websites are inaccessible to the overwhelming majority, a one week awareness campaign including through electronic media in the hinterland against fraudulent activities should be conducted by the Reserve Bank of India, it is stated in a post-evidence reply as under:-

> "RBI is currently working on a public awareness campaign to increase awareness specifically about non-banking finance companies. RBI would keep the suggestions of esteemed members of the Standing Committee in mind while designing this campaign".

67. In this regard, the Chairman, SEBI in his deposition before the Committee stated as under:-

> "We have launched a massive campaign in 14 different languages. We have got both electronics and newspaper print advertisements. We have also been issuing notices through newspapers alerting people against a particular company. Again, the difficulty is because the same set of companies were getting support from various courts, it has become very demoralising for us that we issue a notice saying that such and such company is not registered with us, please do not invest there. The next day the company comes out with a counter newspaper advertisement saying, 'No, SEBI is wrong'. In fact, in one case they have said that what SEBI has placed is amounting to a contempt of court. So, they have placed us on notice that what we are doing is a contempt of court.
>
> We have now decided that we will be opening offices in various States. We had only four offices earlier. In all the major States we have been opening offices. We have decided to open offices. Our people are there. One of the purposes is to have investor education. Secondly, whenever we get any reference, our attempt is that our officers will now go and do field verification, including the advertisements done through Internet and all. We will have more manpower doing it".

68. SEBI in a post-evidence reply further added as follows:-

SEBI through various measures spread awareness among investors about unregistered CIS / Ponzi Schemes. Given below is the summary of such efforts made in last few years:

> Primary message spread**:** caution investors not to invest in unregistered CIS / Ponzi schemes, and do proper due diligence before investing in any investment scheme.

Activities undertaken to spread awareness: Specific advertisement cautioning investors against unregistered CIS / ponzi scheme were carried in mass media, and this topic is also covered in various other awareness programs conducted by SEBI. Details given below:

Media Campaign: Advertisement cautioning investors, carried in print and electronic media (TV, Radio, mobile) at pan India in Hindi, English and 11 major regional languages. Details given below:

Advertisement carried in mass media (approx. numbers)				
	Insertions in various print editions	Radio Spots	TVC spots	SMSs
2013-14	-	25,683	19,772	-
2014-15	2,530	89,252	16,448	2,50,00,000

Investor Awareness / Education programs: Various programs are conducted through Investor Associations, Resource Persons, trade bodies viz, SE, Depositories etc. Details given below:

Investor education / awareness programs				
	Resource Person's program	**Regional Seminars**	**Investor Association 's + Joint Programs**	**Visit to SEBI programs**
2007-08	-	-	15	-
2008-09	-	-	26	-
2009-10	-	-	40	-
2010-11	176		153	8
2011-12	3,089	47	175	30
2012-13	5,934	44	206	41
2013-14	9,493	77	224	90
2014-15	7,702	51	223	167
2015-16*	1,119	4	37	19

*****_Provisional details up to June 30, 2015_

SEBI stalls at various fairs and exhibitions: SEBI participated in various fairs / exhibitions including Book fair at New Delhi, 34th India International trade Fair at New Delhi, Lucknow Mahotsav, Kreta Suraksha Mela in Kolkata, Book fair at

Chandigarh etc. SEBI is also planning to put a stall in the forthcoming Kumbh Mela at Nasik.

Expenditure on Education / Awareness activities:

- Investor Education / awareness activities are conducted under the aegis of SEBI Investor Protection and Education Fund (IPEF), and so far over Rs. 70 Crore have been spent on various education / awareness activities including media campaign.
- Over Rs. 35 Crore alone has been so far spent on media campaigns on unregistered CIS / ponzi schemes.

OBSERVATIONS / RECOMMENDATIONS

1. For the past few years, there have been several cases of unauthorised collection of money and deposits fraudulently inducing public to invest in dubious schemes promising unusually high returns or offering gifts in kind. The menace of such illegal financial and marketing schemes has grown big in recent years. The exclusion of large segment of the population from access to formal financial channels makes them vulnerable to the machinations of unscrupulous operators and nefarious schemes. Further, the inability/inaction of the financial sector regulatory mechanism/investigative agencies including States to identify and clamp down on the promoters of such schemes and the regulatory gaps and overlap have created grey areas where dubious firms could flourish. Besides, the fact that financial literacy in our country is still poor and people being unable to discern genuine financial instruments from bogus ones has compounded matters. In the absence of financial literacy and knowledge, people are inevitably driven by greed alone. The Committee would therefore like the Government to promote financial literacy and awareness on a big scale by launching country-wide campaign through different media. There is also a need to encourage and incentivise institutionalised small savings and safe avenues of investment and make them more attractive to the common public, weaning them away from dubious schemes.

2. The Committee note that entities which raise money from public fall under the jurisdiction of different regulatory bodies. For instance, the Non-Banking Financial Companies (NBFCs) are under the regulatory and supervisory jurisdiction of the RBI, Chit Funds and Money Circulation including multilevel marketing schemes are under the domain of State Government; Collective Investment Schemes come under the purview of SEBI; schemes offered by Cooperative Societies are under State Government; Multi State Cooperative Societies come under Central Registrar, Ministry of Agriculture and deposits taken by non-NBFCs are regulated by the Ministry of Corporate Affairs under the Companies Act. Inspite of such diverse and dispersed regulation, there are

several entities/schemes which are not regulated by any of the financial sector watchdogs. These entities, therefore, take advantage of this regulatory vacuum/lacuna to raise large amounts of money from gullible people. In most such cases, public is defrauded and the promoters of these schemes disappear with the money collected. The Committee would, therefore, urge the Government to plug forthwith the regulatory loopholes and vacuum prevailing in the vast, expanding financial services industry, presently existing on the fringes of regulation or in the grey regulatory zones or in the midst of non-regulation and regulatory failures. For this purpose, the Committee desire that appropriate legislative provisions, coupled with effective administrative and enforcement measures should be brought in without further delay so that the hard-earned savings and investment made by millions of people are duly protected, and the fraudulent operators are also brought to book fast besides bringing about deterrent effect for such mushrooming operators.

3. Fund-raising has assumed different forms adopting different business models, ranging from installment schemes to buy agricultural land to unauthorised money collection schemes to dupe the unsuspecting public. The Committee believe that considering the devious and complex nature of these schemes, far greater degree of vigilance, activism and intelligence gathering /sharing is called for by the existing regulators such as RBI, SEBI, Registrars of Cooperative Societies, Registrars of Companies, SFIO and the state enforcement agencies. There is a need to quickly identify the underlying nature of the scam so that it can be handed over to the appropriate investigative agency. The Committee feel that time factor is of great significance here, both to prevent a fraudulent scheme from snow-balling to epic proportions and to ensure that the deposited money is not siphoned off. Therefore, to restore investor confidence in the financial system, regulators and enforcement agencies must act proactively to nip the fraud in the bud rather than take action after complaints pile up and situation gets out of hand. The State Government machinery should be utilised to gather market intelligence about incipient scams and promptly disseminate the same to the investors/prospective investors. Dedicated desks require to be set

up for citizens to lodge their complaints, as on-line forums for complaints-redressal are not adequate. This warrants coordinated action by the concerned regulators and agencies at a decentralised level.

4. As the Secretary, Department of Financial Services submitted during his deposition before the Committee, there is a great deal of confusion and uncertainty about deposit-taking by different entities. On the one hand, 'deposits' are covered under the Companies Act and the rules made thereunder, which, however, covers only the non-bank non-financial companies. The deposits collected by Banking Companies and Non-Banking Financial Companies (NBFCS) are currently regulated and supervised by RBI. However, the Committee find that there may be entities which are engaged in both financial as well as non-financial activities. Therefore, in such a situation, it may become difficult to identify the actual regulator. The Committee, would, therefore recommend unification and harmonisation of regulation of all entities engaged in acceptance of deposits from public, whether it is a NBFC or a non-NBFC. The present mechanism in respect of vanishing companies should also be tightened.

5. The Committee were informed by RBI that as a matter of public policy, Reserve Bank has decided that only banks should be allowed to accept public deposits and as such, since 1997, they have not issued any certificate of registration for NBFCs authorising acceptance of public deposits. However, it is common knowledge that several scams have come to light in the NBFC sector from time to time. Lakhs of low income households have been lured into these 'deposit schemes' promising unviable and exorbitant rates of interest. Several of these households have lost their entire life's savings, as these companies /firms went bust. The Committee note in this regard that there are two categories involved here-unauthorised acceptance of deposits by incorporated entities and, the other by unincorporated bodies. As far as the first category is concerned, the RBI Act vests the responsibility for pursuing such violations exclusively with the Reserve Bank. The obligation to pursue the second category of acceptance of deposits, that is by the unincorporated entities (which is absolutely prohibited by

the RBI Act) rests concurrently with the Reserve Bank and the State Governments concerned. The Committee find that although most of the scams relate to such entities, the RBI has been routinely and rather helplessly requesting the State Governments to pursue such cases and have also suggested to the States to enact the Protection of Interest of Depositors Act, which would enable them to attach the money and properties of the defaulter / promoter / partners/ directors etc. As the larger public is at the receiving end of such legal complexities and is obviously bewildered by the utter lack of control or regulation, the Committee desire that the Central Government should take up the matter with both RBI and the States to incorporate adequate legal provisions so that the legal prohibition on deposit-taking by unincorporated bodies is strictly enforced. All State Governments require to be specially sensitised for this purpose and asked to enact the Protection of Interest of Depositors Act without delay. In this regard, the Committee would recommend that a Central Legislation may be enacted incorporating the best features of the State Acts wherever enacted. The respective State Acts may then be accordingly amended in line with the Central law.

In this context, the Committee would like to point out with concern that although several States have enacted State level Protection of Interest of Depositors Act, there appears to be hardly any case/instance where the purpose of returning the small investors/depositors money could be achieved. This Act mandated the State level investigating agencies including EoW/District Magistrates/District Collectors to take preventive action and authorized the State agencies to investigate the process where abnormal returns are promised and extraordinary commission of the agents are given. It is not evident as to whether any State/investigating agency has taken any preventive action as provided in the Act. The Committee, therefore, are of the view that in the light of such a dismal situation, there is an urgent need to galvanise and strengthen the enforcement and vigilance mechanism at the State level so that scamsters are severely punished and small investors are duly protected. An effective whistle blower mechanism should also be developed for this purpose.

6. In order to plug the loopholes in regulation and the propensity of operators to design "deposit products" that do not strictly fall within the statutory definition of deposits or conduct activities not strictly falling under any regulator, the Committee note that the mechanism of State Level Coordination Committee (SLCC) constituted under the auspices of RBI, provides a forum for information sharing and coordination among different regulators as well as the State government agencies in the absence of a unified central regulator. The Committee desire that this State-level mechanism should be institutionalised, strengthened, and duly empowered in view of the decentralised and dispersed nature of this money collection phenomenon. The Chief Secretary of the State should invariably chair the meetings of this body. Central agencies like Registrars of Companies, Income Tax, Enforcement Directorate etc. should also be made part of this forum. Recent trends of money collection from ponzi schemes etc. flowing to multi-state cooperatives should be taken cognisance of and neighbouring States in the Region should also be involved through the mechanism of SLCC. The Economic Offences Wing of the State Police should report to the SLCC in regard to investigation and prosecution of cases relating to unauthorised deposits, money collection schemes and other such activities banned under the Prize Chits and Money Circulation Schemes (Banning) Act. The Economic Offences Wing should have a specially trained dedicated team at the district-level, so that acts of illegal money mobilisation can be detected at the micro-level at the initial stage itself. A pro-active vigilance system should be integrated into the SLCC for this purpose. The Committee would also suggest that in order to complement strict enforcement action, economic offences courts may be set up or designated in every State for trial of such economic offences including those under SEBI Act, RBI Act, State Depositors Protection Act, Prize Chits and Money Circulation Schemes (Banning) Act etc. The special courts provided for in the recently enacted Securities Laws (Amendment) Act, 2014 may be extended in its scope for this purpose. Such a designated court will not only lead to speedy and timely trial but also eliminate unnecessary / overlapping litigation besides containing the volume and size of fraud by such operators.

This will also prompt compliance to orders passed by regulators such as SEBI, who have been facing serious difficulties in this regard.

The Committee feel that all the concerned authorities should have taken note of observations passed in the Madhya Pradesh High Court orders of July 2012 on the ponzy companies. CBI findings quoted by the Court, required more attention. The 12 major ponzy companies indulging in thousands of crores of scam, as mentioned in the Madhya Pradesh High Court order, should have been dealt with strongly by the concerned Regulators/agencies. The Committee recommend that the Department of Economic Affairs, Ministry of Finance should monitor the follow-up action on these ponzy companies by Regulators/investigating agencies on regular basis and make necessary administrative arrangements for ensuring better enforcement.

7. One of the major factors for unauthorised money mobilisation could be attributable to the high rates of commission paid to the agents, who in turn go all out to lure gullible public, particularly in non-metro areas. Thus, with a view to discouraging this trend and dis-incentivising the same, the Committee would recommend that payment of commission to agents may be legally capped at a nominal rate of say 2%. With regard to presentation of audited accounts by various entities, it should also be made mandatory to separately reflect deposits / borrowings, if any, whenever it exceeds a certain multiplier of say, 50 times the paid-up share capital. The Committee would also recommend Deposit-linked Insurance for all the collective investment schemes. There should also be a provision for a minimum capital reserve to be maintained with the regulator as a safety valve against default. Banks should be instructed to inform related departments like Income Tax or concerned regulators like SEBI/RBI whenever cash deposits by such persons/entities exceed a certain limit. Pre-emptive provisions such as these would doubtlessly help curb the growing menace of illegal money circulation / collection schemes and also enable adequate protection to depositors/investors.

8. The Committee note that there are two central legislations, namely Prize Chits and Money Circulation Schemes (Banning) Act, 1978 and the Chit Funds Act, 1982, both of which fall under the legislative jurisdiction of the Ministry of Finance (Department of Financial Services). Both these Acts are, however, administered by the State Governments. While 'chit funds' are permissible activity and legitimate business under the Chit Funds Act, 1982, it has been conceded by Secretary, Department of Financial Services in his deposition before the Committee that in "most of the recent instances, it was a flagrant violation of the Prize Chits and Money Circulation (Banning) Act, 1978". The Committee note that most of the Schemes, where complaints are received thus fall in this category, which also includes the multi-level marketing schemes. In case of 'ponzi' schemes, the act of collection of money also constitutes an independent offence of 'money circulation' under the afore-mentioned Banning Act. The Committee, therefore, cannot but conclude that the Ministry of Finance (Department of Financial Services) have only remained a reticent by-stander, as they singularly failed to address the issue of non-enforcement and rampant violation of the Prize Chits and Money Circulation Schemes (Banning) Act, which falls squarely under their legislative competence, even though the enforcement remains the primary responsibility of the State Government. Neither did the Department initiate any legislative measures to plug the loopholes, nor were administrative steps taken as the nodal Department, to pursue prompt enforcement action by State governments. As this subject falls in the Concurrent List of the Constitution, it was the bounden duty of the Department of Financial Services to review and tighten up the Act in the light of ground-level experiences and initiate necessary legislative changes, in consultation with State governments, particularly when scam after scam were erupting depriving millions of their life time savings. The Committee are constrained to seek an explanation from the Department on their inaction in this crucial matter and future proposals if any, to contain such menace.

9. 'Chits' are defined under the Chit Funds Act, 1982. Chit Funds are indigenous financial institutions in the country, especially in the southern parts,

that particularly cater to the financial needs of low-income households, bringing together borrowers and savers. In a chit fund scheme, a group of individuals come together for a pre-determined time period and contribute to a common pool at regular intervals. They operate under the regulatory ambit of the Registrar, Chit Funds of the State of their operation. Chit Funds are, however, prohibited from accepting deposits by RBI regulations. It has been submitted to the Committee that there are about 25,000 chit fund operators involving more than 50 lakh subscribers. In view of the operational difficulties being faced by this sector, the Department of Financial Services has constituted a Key Advisory Group on Chit Funds / Nidhi Companies to review the existing legal / regulatory framework for orderly growth of the registered chit funds sector. The report of this Key Advisory Group is stated to have been submitted to the Department way back in February, 2013. The Committee are surprised that the Department of Financial Services has still not taken any follow-up action on this report, although more than two years have elapsed. They, therefore, strongly recommend the Department to finalise their legislative and administrative proposals on the strengthening and streamlining of the registered Chit Funds Sector within a period of three months from the presentation of this Report.

10. It has been brought to the notice of the Committee that huge amount of money has been transferred out of ponzi schemes to Multi-State Cooperatives, which has a weak regulatory regime at present. It seems that the present Regulator for Multi State Cooperatives i.e. Central Registrar falls under Ministry of Agriculture, which do not have any financial regulatory infrastructure. As number and amount of Multi State Cooperatives have increased hundred times since 2010, the Committee would suggest that the enforcement aspect with regard to financial schemes operating through Multi State Cooperatives be shifted to Department of Economic Affairs under Ministry of Finance, since the Multi-State Cooperatives have now become some kind of a shelter for illegitimate funds, which seemed to have surprisingly escaped the notice of the concerned Authorities, particularly the Central Registrar under Ministry of Agriculture. The Committee would also recommend that the Government should institute special

audit with regard to these Multi-State Cooperatives so that this scam can be unearthed and corrective action taken immediately. In this regard, the Committee would also suggest that the regulatory regime in respect of Multi-State Cooperatives should be streamlined and tightened so that they do not become an instrument of diverting and shielding illegal funds from ponzi companies etc.

11. The Committee note that there are several cases relating to unauthorised financial schemes pending at different levels for investigation / prosecution / adjudication / compliance. They desire that a nodal Department of the Central Government, say Department of Economic Affairs under Ministry of Finance should compile and consolidate updates on these cases and facilitate coordinated action with concerned agencies like SEBI, RBI, Ministry of Corporate Affairs, Department of Financial Services, Department of Agriculture & Cooperation and Ministry of Consumer Affairs through digital backbone. The Central investigative agencies like the CBI, Enforcement Directorate, Investigation Wing of Income Tax as also the enforcement agencies from the concerned States may also be involved in this exercise. The Committee desire that follow-up action initiated on this count along with a status note be submitted within three months of the presentation of this Report.

The Committee also express their concern about SEBI's action or lack of it on ponzy companies since 2010. The Committee note that in the last one year, SEBI has initiated action against 200 ponzy/fraudulent/bogus/deemed public issues u/s 67 of the Companies Act, 1956. The Committee also observe that after receiving complaints, SEBI initiated enquiry, but the interim order took 2 to 3 years, whereas the final order took more than 5 years and during this interim period the ponzy company's promoters one way or the other collected thousands of crores of additional amounts from the small investors. The Committee would now expect SEBI to become more transparent, vigilant and accountable in their regulatory action, showing the same level of alacrity as in the case of M/s Sahara.

12. As Ponzi/pyramid schemes become more and more complex and sophisticated, taking the appearance of legitimate businesses, it is all the more

important to be able to easily distinguish between fraudulent schemes and legitimate businesses such as Direct Selling, Collective Investment Schemes, etc.

In their deposition before the Committee, the Indian Institute of Corporate Affairs (IICA), Ministry of Corporate Affairs, presented a "Whitepaper on Regulation of Direct Selling in India". They also presented an exposure draft of a legislation that distinguishes between Ponzi/pyramid schemes and legitimate direct selling companies and proposed a mandatory regulatory and registration process for the direct selling industry in India. Given that there is considerable ambiguity in identifying Ponzi/pyramid schemes and distinguishing them from legitimate Direct Selling businesses, there is merit in considering the findings of the "Whitepaper on Regulation of Direct Selling in India" by IICA. Most importantly, the exposure draft in the IICA Whitepaper proposes a statutory provision under Section 5 of the draft that defines a Pyramid Scheme. This definition seems to provide, as evidenced from their legal research on Indian and international jurisprudence, an objective 'smell test' for law enforcement agencies to apply at the time of investigation. It is hoped that this will lead to more timely detection and efficacious investigations. The Committee would recommend that the Ministry of Finance, Ministry of Corporate Affairs and Ministry of Consumer Affairs consider the IICA Whitepaper and more specifically, the exposure draft and establish a regulatory framework and compulsory registration process for all Direct Selling businesses in order to provide an oversight mechanism as to whether they are legitimate direct selling businesses or Ponzi/pyramid schemes.

13. In the view of the Committee, the way forward with regard to regulation of various money collection / investment schemes operating in different form and names across the country would be to have a model central law that would be comprehensive and all-encompassing including in its ambit collective investment schemes, chit funds, Direct Selling Schemes and such other activities which are presently permissible but are defined and regulated in a dispersed manner. This law should also contain a separate Section / Chapter on non-permissible schemes as well, clearly spelling out the nature of such prohibited activities

[including the provisions of the Prize Chits and Money Circulation (Banning) Act] with its penal consequences. Clear-cut definitions are required to be provided so that prohibited schemes do not operate by camouflaging as legitimate schemes like 'direct selling. The chief reason for failure of the Prize Chits and Money Circulation (Banning) Act has been found to be its broad and open-ended definition of 'money circulation', which has left scope for large-scale circumventing by unscrupulous operators. The Committee would therefore recommend that the proposed model law should define the nature and scope of various schemes in unambiguous and specific terms. Such a law should also have provisions such as attachment of property, recovery and distribution of proceeds in a stipulated time-frame, deterrent penalties with imprisonment, time-bound repayments/compensation and provision for class action suits/litigation. These offences should be treated as "offences committed against the State" analogous to the Indian Penal Code and accordingly made non-bailable and cognisable. The proposed law should also invoke the concurrent administrative jurisdiction of both the Central and State Governments in the implementation of the law in the light of recent enforcement experiences with the money circulation/collection schemes. The present arrangement of sharing of responsibility of regulation of these schemes between central agencies such as SEBI/RBI and the State Governments may continue in the interim, till a considered decision is taken on the constitution of a separate/principal regulator to be provided for in the proposed law.

NEW DELHI
21 September, 2015
30 Bhadrapada, 1937 (Saka)

DR. M. VEERAPPA MOILY,
Chairperson,
Standing Committee on Finance

Minutes of the Second sitting of the Standing Committee on Finance

The Committee sat on Thursday, the 18th September, 2014 at 1130 hrs. to 1400 hrs. in Committee Room 'D', Ground Floor, Parliament House Annexe, New Delhi.

PRESENT

Dr. M. Veerappa Moily - Chairperson

LOK SABHA

2. Shri Sudip Bandyopadhya
3. Shri Nishikant Dubey
4. P.C. Gaddigoudar
5. Shri Shyama Charan Gupta
6. Shri Prataprao Jadhav
7. Shri Rattan Lal Kataria
8. Shri Bhartruhari Mahtab
9. Shri Prem Das Rai
10. Shri Rayapati Sambasiva Rao
11. Prof. Saugata Roy
12. Shri Jyotiraditya M. Scindia
13. Shri Gajendra Singh Sekhawat
14. Shri Gopal Shetty
15. Dr. Kiritbhai Solanki
16. Dr. Kirit Somaiya

RAJYA SABHA

17. Shri Naresh Agrawal
18. Shri Naresh Gujral
19. Dr. Mahendra Prasad
20. Shri P. Rajeeve
21. Shri Digvijay Singh
22. Dr. Manmohan Singh

SECRETARIAT

1.	Shri R. K. Jain	-	Joint Secretary
2.	Shri P.C. Koul	-	Director
3.	Shri Ramkumar Suryanarayanan	-	Additional Director
4.	Shri M.L. K.	-	Deputy Secretary

WITNESSES

Ministry of Finance (Department of Financial Services)

1. Smt. Snehlata Shrivastava, Additional Secretary
2. Dr. Shashank Saksena, Economic Advisor

Ministry of Corporate Affairs

1. Shri Naved Masood, Secretary
2. Shri M.J. Joseph, Additional Secretary
3. Shri Nilimesh Baruah, Director, Serious Fraud Investigation Office

Reserve Bank of India

1. Shri R. Gandhi, Deputy Governor
2. Shri G.S Hegde, Legal Consultant

Securities and Exchange Board of India

1. Shri U.K. Sinha, Chairman
2. Shri S. Raman, Whole Time Member
3. Shri J. Ranganayaklu, Executive Director
4. Shri Ananta Barua, Executive Director

2. At the outset, the Chairperson welcomed the Members and the representatives of the Ministry of Finance (Department of Financial Services), Ministry of Corporate Affairs, Reserve Bank of India (RBI) and Securities and Exchange Board of India (SEBI) After the customary introduction, the representatives of the Department of Financial Services made an audio-visual presentation on the Subject 'Efficacy of Regulation of Collective Investment Schemes, Chit Funds, etc.'

3. After the briefing was over the members sought several clarifications on wide ranging issue, including magnitude of Collective Investment Schemes; Multi-level Marketing Schemes; Chit Funds; Direct Selling; Gold Schemes; Federal arrangements between the Union and State Governments in regulation and the administration of

Schemes like Collective Investment Schemes; action taken by the RBI in regard to the Companies whose details have been shared with them by the Ministry of Corporate Affairs; status of cases including Saradha Group Companies being dealt with by the SEBI and Serious Fraud Investigation Office; status of enactment of special laws by the Ministries/Departments on the Recommendations made by the Inter-Ministerial-Group (IMG) constituted for proper enforcement of regulatory/legal framework for Multi-Level Marketing Companies, Non-Banking Financial Companies and Collective Investment Schemes; Effectiveness of the enactment of the Securities Laws (Amendment) Act, 2014; Regulatory gaps 'lacunae in the extant system which allow multi-farious schemes and financial activities of entities / companies in an unrestricted manner; suggestions to improve the effectiveness of the extant system with a view to curb these activities; mechanism to ensure that the interest of the stakeholders is protected as in the case of 'Satyam' case; need for evolving of Umbrella regulatory authority to deal with the ills besetting the financial sector in the Country; measures taken to spread the awareness / alertness amongst the gullible public about the dubious and unregulated schemes / promising attractive return etc. The witnesses responsible to some of the queries of the members.

4. The Chairperson directed the representatives of the Ministries, RBI and SEBI to furnish detailed written replies on the points raised by the Members at the earliest.

(The witnesses then withdrew)

5. One of the members then drew the attention of the Chairman to UIDAI and related matters and stated that although the Committee had presented its Forty-second Report on the National Identification Authority of India Bill, 2010 in the Fifteenth Lok Sabha but the said legislative proposal was yet to be enacted. He, therefore, suggested the Committee ought to revisit the Subject at the earliest. Before the Sitting concluded the Committee decided to sit again on 25 September, 2014.

A verbatim record of the proceedings has been kept.

The Committee then adjourned.

Minutes of the Thirtieth Sitting of the Committee on Finance

The Committee sat on Thursday, the 25th June, 2015 at 1100 hrs. to 1245 hrs. in Committee Room 'C', Ground Floor, Parliament House Annexe, New Delhi.

PRESENT

Dr. M. Veerappa Moily - Chairperson

LOK SABHA

2. Shri Shyama Charan Gupta
3. Shri Prataprao Jadhav
4. Shri Rattan Lal Kataria
5. Shri Prem Das Rai
6. Shri Gajendra Singh Sekhawat
7. Shri Gopal Shetty
8. Shri Anil Shirole
9. Shri Shivkumar Udasi
10. Dr. Kirit Somaiya

RAJYA SABHA

11. Shri C.M. Ramesh
12. Dr. Manmohan Singh

SECRETARIAT

1.	Smt. Abha Singh Yaduvanshi	-	Joint Secretary
2.	Shri P.C. Tripathy	-	Director
3.	Shri Ramkumar Suryanarayanan	-	Additional Director
4.	Shri Kulmohan Singh Arora	-	Deputy Secretary

WITNESSES

1. Shri T.S. Sivaramakrishnan, General Secretary, All India Association of Chit Funds (Regd.)
2. Shri Mudit Kapoor, Asst. Professor, ISB, Hyderabad

2. The Committee heard the views of the All India Association of Chit Funds (Regd.) on the subject ‘Efficacy of Regulation of Collective Investment Schemes, Chit Funds, etc.' Major issues discussed were the existing regulatory framework governing the chit funds and the collective investment schemes, the regulatory gaps present in such framework, ways to make such framework more effective and responsive to present times, need to have a unified regulator for the chit funds industry, role of registered chit fund companies in providing micro finance to poor people, lack of support from Government institution to the registered chit fund industry, implementing the recommendations of Key Advisory Group, need to de-link and rebrand the registered the chit fund industry, etc.

A verbatim record of the proceedings has been kept.

The Committee then adjourned.

Minutes of the Thirty-first Sitting of the Committee on Finance

The Committee sat on Thursday, the 16th July, 2015 at 1500 hrs. to 1815 hrs. in Committee Room 'D', Ground Floor, Parliament House Annexe, New Delhi.

PRESENT

Dr. M. Veerappa Moily - Chairperson

LOK SABHA

2. Shri S.S. Ahluwalia
3. Shri P.C. Gaddigoudar
4. Shri Shyama Charan Gupta
5. Shri Prataprao Jadhav
6. Shri Rattan Lal Kataria
7. Shri Bhartruhari Mahtab
8. Shri Rayapati Sambasiva Rao
9. Prof. Saugata Roy
10. Shri Gajendra Singh Sekhawat
11. Shri Gopal Shetty
12. Shri Anil Shirole
13. Dr. Kiritbhai Solanki
14. Dr. Kirit Somaiya

RAJYA SABHA

15. Shri Satish Chandra Misra
16. Shri K.N. Balagopal
17. Dr. Manmohan Singh

SECRETARIAT

1.	Smt. Abha Singh Yaduvanshi	-	Joint Secretary
2.	Shri P.C. Tripathy	-	Director
3.	Shri Ramkumar Suryanarayanan	-	Additional Director
4.	Shri Kulmohan Singh Arora	-	Deputy Secretary

PART I

(1500 hrs. to 1630 hrs.)

WITNESSES

Reserve Bank of India

1. Shri H.R. Khan, Deputy Governor
2. Smt. Meena Hemchandra, Executive Director
3. Shri G.S. Hegde, Legal Consultant
4. Shri Sathyan David, Chief General Manager
5. Shri C.D. Srinivasan, Chief General Manager

Securities and Exchange Board of India

1. Shri U.K. Sinha, Chairman
2. Shri S. Raman, Whole Time Member
3. Shri Prashant Saran, Whole Time Member
4. Shri Ananta Barua, Executive Director
5. Shri J. Ranganayakulu, Executive Director

2. The Committee welcomed the representatives of RBI and SEBI and heard them in the first session on the subject 'Efficacy of Regulation of Collective Investment Schemes, Chit Funds, etc.' Major issues discussed were the steps taken by both the regulators in the recent past to regulate chit funds, numerous collective investment schemes, etc. floating in the country, speedy implementation of the Depository (Protection of Interest of Depositors) Act, strengthening of the State Level Coordination Committee (SLCC) mechanism, plugging the loopholes in Multi-State Cooperative Societies Act, providing budgetary support to SEBI for spreading investor awareness in the Country, amending some provisions of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978, revisiting the definition of deposits, empowering the State Governments to take up investigation and prosecution of ponzi schemes, setting up of specialised police stations in each district to handle such fraudulent cases, jurisdictional overlap of the regulators in regulating such schemes, need to have a Centralised Information Intelligence Providing System, suggestions to reduce unwanted judicial intervention by District Courts and High Courts, etc.

PART II
(1630 hrs. to 1815 hrs.)

WITNESSES

Ministry of Finance (Department of Financial Services)

1. Dr. Hasmukh Adhia, Secretary
2. Smt. Snehlata Shrivastava, Additional Secretary
3. Dr. Shashank Saksena, Economic Advisor

Ministry of Finance (Department of Economic Affairs)

Shri Manoj Joshi, Joint Secretary (Financial Market)

Ministry of Corporate Affairs

1. Shri Pritam Singh, Additional Secretary
2. Shri Amardeep Singh Bhatia, Joint Secretary
3. Shri Navrang Saini, Director (Inspection and Investigation)
4. Shri Nilimesh Baruah, Director, SFIO

Ministry of Agriculture (Department of Agriculture and Cooperation)

1. Shri Avinash K. Srivastava, Additional Secretary
2. Dr. Ashish Kumar Bhutani, Joint Secretary (Cooperation & Credit)

Ministry of Consumer Affairs, Food and Public Distribution (Department of Consumer Affairs)

1. Shri C. Viswanath, Secretary
2. Smt. Chandralekha Malviya, Principal Adviser
3. Shri G. Gurucharan, Addtional Secretary

Investigative/Enforcement Agencies

1. Shri Rajiv Singh, Joint Director, CBI
2. Shri Madhup Tiwari, DIG, CBI
3. Shri Yogesh Gupta, Special Director, Enforcement Directorate
4. Shri Himanshu Kumar Lal, Joint Director, Enforcement Directorate

3. The Committee welcomed and heard the representatives of Ministry of Finance, Ministry of Agriculture, Ministry of Corporate Affairs, Ministry of Consumer Affairs in the 2nd Session on the same subject. Major issues discussed included steps taken by the Agriculture Ministry in preventing the proliferation of dubious Multi-State Cooperatives

floated by ponzi companies, nexus between the ponzi schemes and money laundering activities, possibility of merging the Prize Chits and Money Circulation Scheme (Banning) Act, 1978 with the Chit Fund Act, 1982, role of Ministry of Corporate Affairs/Serious Fraud Investigation Office (SFIO) in preventing & detecting frauds of ponzi companies, setting up a mechanism to give back the money of defrauded investors in full, need to redefine the economic offences and have a unfiled model law at the central level, training the States police so as have a proper investigation of the economic offences, need to have more banks at the local level, insurance coverage to deposits, etc.

(The witnesses then withdrew)

A verbatim record of the proceedings has been kept.

4. Thereafter, the Committee took up the following draft Reports for consideration and adoption:

(i) Draft Report on Action Taken by the Government on the recommendations contained in the 2nd Report of the Committee on Finance on DFGs (2014-15) of the Ministry of Finance (Department of Economic Affairs, Expenditure, Financial Services and Disinvestment);

(ii) Draft Report on Action Taken by the Government on the recommendations contained in the 3rd Report of the Committee on Finance on DFG (2014-15) of the Ministry of Finance (Department of revenue);

(iii) Draft Report on Action Taken by the Government on the recommendations contained in the 5th Report of the Committee on Finance on DFGs (2014-15) of the Ministry of Corporate Affairs: and

(iv) Draft Report on Action Taken by the Government on the recommendations contained in the 6th Report of the Committee on Finance on DFGs (2014-15) of the Ministry of Statistics and Programme Implementation.

5. After some deliberations, the Committee adopted the above draft Reports without any modification and authorised the Chairperson to finalise them and present these Reports to Parliament.

The Committee then adjourned.

Minutes of the Thirty-second Sitting of the Committee on Finance

The Committee sat on Wednesday, the 19th August, 2015 from 1100 hrs. to 1315 hrs. in Committee Room 'D', Ground Floor, Parliament House Annexe, New Delhi.

PRESENT

Dr. M. Veerappa Moily - Chairperson

LOK SABHA

2. Shri S.S. Ahluwalia
3. Shri Venkatesh Babu T.G.
4. Shri Nishikant Dubey
5. Shri P.C. Gaddigoudar
6. Shri Shyama Charan Gupta
7. Shri Prataprao Jadhav
8. Shri Rattan Lal Kataria
9 Shri Bhartruhari Mahtab
10. Shri Gajendra Singh Sekhawat
11. Shri Gopal Shetty
12. Shri Shivkumar Udasi
13. Dr. Kirit Somaiya

RAJYA SABHA

14. Shri Naresh Gujral
15. Shri C. M. Ramesh
16. Shri Ajay Sancheti
17. Shri Digvijay Singh
18. Dr. Manmohan Singh

SECRETARIAT

1.	Smt. Abha Singh Yaduvanshi	-	Joint Secretary
2.	Shri P.C. Tripathy	-	Director
3.	Shri Ramkumar Suryanarayanan	-	Additional Director
4.	Shri Kulmohan Singh Arora	-	Deputy Secretary

WITNESSES

Indian Institute of Corporate Affairs (IICA)

1. Dr. Bhaskar Chatterjee, DG & CEO, IICA.
2. Dr. Vijay Kumar Singh, Associate Professor, IICA

2. At the outset, the Chairperson welcomed the Members to the Sitting of the Committee. Thereafter, the Committee expressed their condolences on the sad demise of Smt. Suvra Mukherjee, wife of His Excellency, President of India, Shri Pranab Mukherjee.

3. After the customary welcome of the representatives of Indian Institute of Corporate Affairs (IICA), the representatives of IICA briefed the Committee on the subject "Efficacy of Regulation of Collective Investment Schemes, Chit Funds etc". The major issues discussed were empirical study undertaken by the Indian Institute of Corporate Affairs on the working of various models of Direct Selling in the country, need for standalone legislation on Direct Selling in the country, need for demarcation of legitimate Direct Selling business from pyramid schemes and Ponzi schemes etc., having a transparent and consumer friendly business model, consumer protection from direct selling - camouflaged ponzi and pyramid schemes, changes in the regulatory environment with the aid of policy papers and consultation of institutes like IICA etc. The Committee observed that a pattern of high frequency trading has been noticed in secondary markets of India. In this regard, it was decided by the Committee that SEBI may be called for further examination of the subject in detail subsequently. The Chairperson then directed the representatives of IICA to furnish written replies on the point raised by the Members within three days to the Committee Secretariat.

(The witnesses then withdrew)

A verbatim record of the proceedings has been kept.

4. Thereafter, the Committee took up the following draft Reports for consideration and adoption :

(i) Draft Report on Action Taken by the Government on the recommendations contained in the Fourth Report of the Committee on Finance on Demands for Grants (2014-15) of the Ministry of Planning.

(ii) Draft Report on the Subject - 'Planning Process - A Review'.

5. After some deliberations, some of the Members suggested certain modifications in the draft reports. Some Members requested the Chairperson to give them more time to study the draft Reports. The Committee then decided to consider the above draft Reports at a later date.

The Committee then adjourned.

Minutes of the First Sitting of the Standing Committee on Finance

The Committee sat on Thursday, the 10 September, 2015 from 1100 hrs. to 1245 hrs. in Committee Room 'D', Ground Floor, Parliament House Annexe, New Delhi.

PRESENT

Dr. M. Veerappa Moily - Chairperson

LOK SABHA

2. Shri S.S. Ahluwalia
3. Shri Sudip Bandyoypadhyay
4. Shri Nishikant Dubey
5. Shri Shyama Charan Gupta
6. Shri Rattan Lal Kataria
7. Shri Bhartruhari Mahtab
8. Prof. Saugata Roy
9. Shri Jyotiraditya M. Scindia
10. Shri Gajendra Singh Sekhawat
11. Shri Gopal Shetty
12. Shri Anil Shirole
13. Shri Kiritbhai Solanki
14. Dr. Kirit Somaiya
15. Shri Shivkumar Udasi

RAJYA SABHA

16. Shri Naresh Agrawal
17. Shri K.N. Balagopal
18. Shri Naresh Gujral
19. Shri Satish Chandra Misra
20. Dr. Mahendra Prasad
21. Shri C. M. Ramesh
22. Shri Ajay Sancheti
23. Dr. Manmohan Singh

SECRETARIAT

1.	Smt. Abha Singh	-	Joint Secretary
2.	Shri P.C. Tripathy	-	Director
3.	Shri Ramkumar Suryanarayanan	-	Additional Director

2. At the outset, the Chairperson welcomed the Members to the Sitting of the Committee. The Committee then took up the following draft Reports for consideration and adoption :

(i) Draft Report on Action Taken by the Government on the recommendations contained in the Fourth Report of the Committee on Finance on Demands for Grants (2014-15) of the Ministry of Planning.

(ii) Draft Report on the Subject - 'Planning Process - A Review'.

(iii) Draft Report on the Subject - 'Efficacy of Regulation of Collective Investment Schemes, Chit Funds, etc.

3. After some deliberations, the Committee adopted the reports with minor modifications and authorised the Chairperson to finalise and present the same to the Hon'ble Speaker, Lok Sabha / Parliament.

4. XX XX XX XX XX

The Committee then adjourned.