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THE BANNING OF UNREGULATED DEPOSIT SCHEMES ACT, 2019

# Taming of the unscrupulous

The rules under the Act may hold the key to its implementation, say experts



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After being unanimously passed by Parliament, the Banning of Unregulated Deposit Schemes Act, 2019 (the Act), got the president's assent on July 31. Given the extent of unregulated deposits and lending that have been part of the country's informal economy, this law has been brought to protect the interests of depositors and holding deposit-takers accountable. The government had passed an Ordinance in February to deal with this issue.

The Act aims to curb unregulated and fraudulent deposit-taking schemes, providing succour to depositors.

"While the objective is to control deceitful practices carried out through unregulated schemes and chit funds, the implementation depends on a lot of information collection, reporting, sharing of information between income tax authorities, regulators and investigating agencies, in order to unearth, probe and take appropriate action," said Upasana Rao, partner at law firm Trilegal. On the practical side, this is difficult to achieve and increases the administrative burden on these agencies, she said.

Besides major challenges of making people aware, appointing competent authorities, speed-

## CHECKING FRAUD: SALIENT FEATURES OF THE NEW LAW

- A ban on all deposit-taking schemes, except those regulated by the nine regulators mentioned in the Act
- Powers to the competent authority for provisionally attaching the property of unregulated deposit-takers, including all deposits received
- Constitution of designated courts in specific areas to speedily decide cases filed under the Act
- Creation of an online central database for collecting information on deposit-takers and their businesses
- Provides punishment for offences of running unregulated deposit schemes, fraudulently defaulting on regulated deposit schemes and wrongful inducement of depositors
- Exemption for deposits taken in the ordinary course of business

ily deciding cases and creating the infrastructure to implement this law in its letter and spirit, other issues might arise when it is operationalised.

### Defining the ordinary course of business

For one, there is a crucial difference between the February Ordinance and the Act. The Act introduces Section 41, which says that the provisions of this law shall not apply to deposits taken in the ordinary course of business. "When the

Ordinance was passed, businesses felt that it was going to impact any fund they raise in the ordinary course of their business. An improvement in the Act is the clarity brought in by excluding such deposits from the scope of unregulated deposits," noted Rupali Singhania, partner and founding member at Areete Consultants.

However, experts said that what is meant by "deposits taken in the ordinary course of business" is left vague. According to Vinod Kothari,

director, Vinod Kothari Consultants, "An interpretation is deposits taken to finance a real business activity. While this interpretation seems to be the intent of Section 41, it should be remembered that all the chit fund companies of West Bengal took deposits under the pretext of some ostensible business transaction."

Kothari said if unincorporated businesses are allowed to take deposits for the purpose of business, it will create the scope for a regulatory arbitrage. "The Ordinance was extremely stringent and non-permissive. Section 41, on the other hand, grants a major escape route and it might end up defeating the objective of the law."

### Serving depositors' claim

The Act is being appreciated for giving priority to depositor claims over all other debts. However, there is a catch. Though this provision is giving an upper hand to those who suffered from the fraud of unregulated deposits against the government dues and debts, this will only be possible in cases where there is no case pending under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 or the Insolvency and Bankruptcy Code, 2016. "In those cases, depositors will be below secured financial creditors and may become parallel operational creditors/unsecured financial creditors," said Daizy Chawla, senior partner at law firm Singh & Associates.

According to Parag Srivastava, leader, private equity and M&A at Nishith Desai Associates, translating this provision into reality appears challenging. "The moment there will be a provisional attachment order, or as a matter of fact any order issued against the deposit taker, all the other creditors (whether financial or non-financial), government agencies, etc may get involved and try to seek injunctions or initiate other proceedings against the deposit taker," he said.

### Punishment for misleading ads

The Act seeks to punish wrongful inducement concerning unregulated deposit schemes. MoS for Finance, Anurag Thakur claimed in the Rajya Sabha that this will also cover celebrities endorsing such schemes. However, according to experts, this may not entirely play out as intended. This is because the relevant provision in the Act uses the term "knowingly" which means that celebrities can still get away scot-free by showing that they did not know about the fact that the scheme was unregulated or fraudulent.

Experts said that how the Act will play out on the ground depends a lot on the rules that shall be framed under it. They hope the rules will impart more clarity on these issues.