All you wanted to know about NBFCs

A. Definitions

1. What is a Non-Banking Financial Company?

A Non-Banking Financial Company (NBFC) is a company a) registered under the Companies Act, 1956, b) its principal business is lending, investments in various types of shares/stocks/bonds/debentures/securities, leasing, hire-purchase, insurance business, chit business, and c) its principal business is receiving deposits under any scheme or arrangement in one lump sum or in installments. However, a Non-Banking Financial Company does not include any institution whose principal business is agricultural activity, industrial activity, trading activity or sale/purchase/construction of immovable property. (Section 45 I (c) of the RBI Act, 1934) . One key aspect to be kept in view is that the financial activity of loans/advances as stated in 45 I (c) , should be for activity other than its own. In the absence of this provision, all companies would have been NBFCs.

2. What are systemically important NBFCs?

NBFCs whose asset size is of Rs.100 cr or more as per last audited balance sheet are considered as systemically important NBFCs. The rationale for such classification is that the activities of such NBFCs will have a bearing on the financial stability in our country.

B. Entities Regulated by RBI

3. Does the Reserve Bank regulate all financial companies?

No. Some financial businesses have specific regulators established by law to regulate and supervise them, such as, IRDA for insurance companies, Securities Exchange Board of India (SEBI) for Merchant Banking Companies, Venture Capital Companies, Stock Broking companies and mutual funds, National Housing Bank (NHB) for housing finance companies, Department of Companies Affairs (DCA) for Nidhi companies and State Governments for Chit Fund Companies. Companies which do financial business but are regulated by other regulators, are given specific exemption by the Reserve Bank from its regulatory requirements, such as, registration, maintenance of liquid assets, statutory reserves, etc. The Chart below gives the nature of activities and the concerned regulators.

4. What kind of specific financial companies are regulated by RBI?

The Reserve Bank of India regulates and supervises Non-Banking Financial Companies which are into the business of (i) lending (ii) acquisition of shares, stocks, bonds, etc., or (iii) financial leasing or hire purchase. The Reserve Bank also regulates companies whose principal business is to accept deposits. (Section 45I (c) of the RBI Act, 1934)

5. What are the powers of the Reserve Bank with regard to 'Non-Bank Financial Companies', that is, companies that meet the 50-50 Principal Business Criteria?

The Reserve Bank has been given the powers under the RBI Act 1934 to register, lay down policy, issue directions, inspect, regulate, supervise and exercise surveillance over NBFCs that meet the 50-50 criteria of principal business. The Reserve Bank can penalize NBFCs for violating the provisions of the RBI Act or the directions or orders issued by RBI under RBI Act. The penal action can also result in RBI cancelling the Certificate of Registration issued to the NBFC, or prohibiting them from accepting deposits and alienating their assets or filing a winding up petition.

C. Entities NOT regulated by RBI

6. Why are insurance companies, stock broking and merchant banking companies, Nidhis, housing finance companies and Chit Fund Companies not regulated by the Reserve Bank of India?

These companies have been exempted from registration and other regulations of RBI in order to avoid dual regulation on them as they are regulated by other financial sector regulators.

7. Does the Reserve Bank have any statutory power vis a vis these exempted NBFCs?

It depends on the extent of exemption granted. Housing Finance Companies, for instance, are exempt from RBI regulations. Other entities like Chit Funds, Nidhi companies, Mutual Benefit companies, Insurance companies, Merchant Banking companies, Stock Broking companies, etc., are granted exemption from the requirements of registration, maintenance of liquid assets and statutory reserves. RBI though does not issue directions that could conflict with the directions issued by other financial regulators, viz., Housing Finance Companies are regulated by the National Housing Bank, Insurance Companies by IRDA, Stock broking, Merchant Banking Companies, Venture Capital Companies and companies that run Collective Investment Schemes and Mutual Funds are regulated by SEBI, Nidhi Companies are regulated by the Ministry of Corporate Affairs and Chit Fund Companies are under the regulatory ambit of the respective State Governments.

8. Does RBI regulate companies that carry on the financial activities as part of their business?

The Reserve Bank regulates and supervises companies which are engaged in financial activities as their *principal business*. Hence if there are companies engaged in agricultural operations, industrial activity, purchase and sale of goods, providing services or purchase, sale or construction of immovable property as their principal business and are doing some financial business in a small way, they will not be regulated by the Reserve Bank.

9. In respect of companies which do not fulfill the 50-50 criteria but are accepting deposits – do they come under RBI purview?

A company which does not have financial assets which is more than 50% of its total assets and does not derive at least 50% of its gross income from such assets is not an NBFC. Its principal business would be non-financial activity like agricultural operations, industrial activity, purchase or sale of goods or purchase/construction of immoveable property, and will be a non-banking non-financial company. Acceptance of deposits by a Non-Banking Non-Financial Company is governed by the Companies Acceptance of Deposits Rules, 1975. The Registrar of Companies in the State Governments administer the schemes.

D. Principal Business Criteria (PBC)

10. What does conducting financial activity as “principal business” mean?

Financial activity as principal business is when a company’s financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 percent of the gross income. A company which fulfils both these criteria will be registered as NBFC by RBI. The term 'principal business' is not defined by the Reserve Bank of India Act. The Reserve Bank has defined it so as to ensure that only companies predominantly engaged in financial activity get registered with it and are regulated and supervised by it and other trading, manufacturing or industrial companies are not brought under its regulatory jurisdiction. Interestingly, this test is popularly known as 50-50 test and is applied to determine whether or not a company is into financial business.

E. Residuary Non-Banking Companies (RNBCs)

11. What is a Residuary Non-Banking Company (RNBC)? In what way is it different from other NBFCs?

Residuary Non-Banking Company is a class of NBFCs whose 'principal business' is to receive deposits, under any scheme or arrangement or in any other manner. These companies are not into investment, asset financing or lending. Functioning of these companies is different from that of NBFCs in terms of method of mobilization of deposits and requirement of deployment of depositors' funds. These companies, however, have now been directed by the Reserve Bank not to accept any deposits and to wind up their businesses as RNBCs.

12. We understand that there is no ceiling on raising of deposits by RNBCs, then how safe is deposit with them?

It is true that there is no ceiling on raising of deposits by RNBCs. However, every RNBC has to ensure that the amounts deposited with it are fully invested in approved investments. In other words, in order to secure the interests of depositor, such companies are required to invest 100 per cent of their deposit liability into highly liquid and secure instruments, namely, Central/State Government securities, fixed deposits with scheduled commercial banks (SCB), Certificate of deposits of SCB/FIs, units of Mutual Funds, etc.

13. Can RNBC forfeit deposit if deposit instalments are not paid regularly or discontinued?

No. Residuary Non-Banking Company cannot forfeit any amount deposited by the depositor, or any interest, premium, bonus or other advantage accrued thereon.

14. What is the rate of interest that an RNBC must pay on deposits and what should be maturity period of deposits taken by them?

The minimum interest an RNBC should pay on deposits should be 5% (to be compounded annually) on the amount deposited in lump sum or at monthly or longer intervals; and 3.5% (to be compounded annually) on the amount deposited under daily deposit scheme. Interest here includes premium, bonus or any other advantage, that an RNBC promises to the depositor by way of return. An RNBC can accept deposits for a minimum period of 12 months and maximum period of 84 months from the date of receipt of such deposit. They cannot accept deposits repayable on demand. However, at present, the two RNBCs in existence (Peerless and Sahara India Financial Corporation Ltd) have been directed by the Reserve Bank to stop collecting deposits, repay the deposits to the depositor and wind up their RNBC business as their business model is inherently unviable.

F. Definition of deposits, Eligible / Ineligible Institutions to accept deposits and Related Matters

15. What are deposits?

Deposits mean monies collected in any manner, *other than* that collected by way of share capital, contribution of capital by the partners of a partnership firm, security deposit, earnest money deposit, advance consideration for purchase of goods, services or construction, loans taken from banks, financial institutions and money lenders and subscription to chit funds. Monies collected in any manner other than these would be termed as deposits

16. Which entities can legally accept deposits from public?

Banks, including co-operative banks, can accept deposits. Non-bank finance companies, which have been issued Certificate of Registration by RBI with a specific licence to accept deposits, are entitled to accept public deposit. In other words, not all NBFCs registered with the Reserve Bank are entitled to accept deposits but only those that hold a deposit accepting Certificate of Registration can accept deposits. They can, however, accept deposits, only to the extent permissible. Housing Finance Companies, which are again specifically authorized to collect deposits and companies authorized by Ministry of Corporate Affairs under the Companies Acceptance of Deposits Rules framed by Central Government under the Companies Act can also accept deposits also upto a certain limit. Cooperative Credit Societies can accept deposits from their members but not from the general public. The Reserve Bank regulates the deposit acceptance only of banks, cooperative banks and NBFCs.

It is not legally permissible for other entities to accept public deposits. Unincorporated bodies like individuals, partnership firms, and other association of individuals are prohibited from carrying on the business of acceptance of deposits as their principal business. Such unincorporated bodies are prohibited from even accepting deposits if they are carrying on financial business.

17. Can all NBFCs registered by RBI accept deposits ? Does getting Certificate of Registration from RBI mean the company can also raise deposits?

No. As stated above, registration with RBI does not automatically allow an NBFC to accept deposits. The Reserve Bank specifically authorizes an NBFC to accept deposits. This permission is given after verifying a registered NBFC's performance for three years. That an NBFC is permitted to raise deposits from public is specifically mentioned in its certificate of registration. In fact as a matter of public policy, Reserve Bank has decided that only banks should be allowed to accept public deposits and as such has since 1997 not issued any Certificate of Registration (CoR) for new NBFCs for acceptance of public deposits.,

18. Why is the RBI so restrictive in allowing NBFCs to raise public deposits?

The Reserve Bank's overarching concern while supervising any financial entity is protection of depositors' interest. Depositors place deposit with any entity on trust unlike an investor who invests in the shares of a company with the intention of sharing the risk as well as return with the promoters. Protection of depositors' interest thus is supreme in financial regulation. Banks are the most regulated financial entities. The Deposit Insurance and Credit Guarantee Corporation pays insurance on deposits up to Rs.one lakh in case a bank failed.

19. Which are the NBFCs specifically authorized by RBI to accept deposits?

The Reserve Bank publishes the list of NBFCs that hold a valid Certificate of Registration for accepting deposits on its website : www.rbi.org.in → Sitemap → NBFC List → List of NBFCs Permitted to Accept Deposits. At times, some companies are temporarily prohibited from accepting public deposits. The Reserve Bank publishes the list of NBFCs temporarily prohibited also on its website. The Reserve Bank keeps both these lists updated. Members of the public are advised to check both these lists before placing deposits with NBFCs.

20. Can a Co-operative Credit Society accept deposits from the public?

No. Co-operative Credit Societies cannot accept deposits from general public. They can accept deposits only from their members within the limit specified in their bye laws.

21. Can a Salary Earners' Society accept deposits from the public?

No. These societies are formed for salaried employees and hence they can accept deposit only from their own members and not from general public.

22. How does the Reserve Bank come to know about unauthorized acceptance of deposits by companies not registered with it or of NBFCs engaged in lending or investment activities without obtaining the Certificate of Registration from it?

The Reserve Bank gets to know of NBFCs unauthorizedly accepting deposits or engaged in lending and investment without its authorization, mainly through complaints and grievances received from the public, from industry sources and from Exception Reports received from Statutory Auditors of these companies. The Reserve Bank also gets to know about this through market intelligence gathered from newspapers or from information gathered by its own Regional Offices or any other such sources.

Further, RBI has put in place an institutional mechanism at all its Regional Offices to coordinate between the financial sector regulators in the form of State Level Coordination Committee (SLCC). The members of SLCC include, State Government officials from the Home and Law Departments, Registrar of Companies, Regional Directorate of Ministry of Corporate Affairs, National Housing Bank, SEBI, Registrar of Chits, and ICAI. The SLCC meets every half year to exchange information on such unauthorized activities of financial entities.

23. Can Proprietorship/Partnership Concerns associated/not associated with registered NBFCs accept public deposits ?

No. Proprietorship and partnership concerns are un-incorporated bodies. Hence they are prohibited under the RBI Act 1934 from accepting public deposits.

24. There are many jewellery shops taking money from the public in instalments. Is this amounting to acceptance of deposits?

It depends on whether the money is received as advance for delivering jewellery at a future date or whether the money is received with a promise to return the same with interest. The money accepted by Jewellery shops in instalments for the purpose of delivering jewellery at the end of the period of contract is not deposit. It will amount to acceptance of deposits if in return for the money received, the jewellery shop promises to return the principal amount along with interest.

25. What action can be taken if such unincorporated entities accept public deposits? What if NBFCs which have not been authorized to accept public deposits use proprietorship/partnership firms floated by their promoters to collect deposits?

Such unincorporated entities, if found accepting public deposits, are liable for criminal action. Further NBFCs are prohibited by RBI from associating with any unincorporated bodies. If NBFCs associate themselves with proprietorship/partnership firms accepting deposits in contravention of RBI Act, they are also liable to be prosecuted under criminal law or under the Protection of Interest of Depositors (in Financial Establishments) Act, if passed by the State Governments.

26. What action is taken if financial companies which are lending or making investments as their principal business do not obtain a Certificate of Registration from the Reserve Bank ?

If companies that are required to be registered with the Reserve Bank as NBFCs, are found to be conducting non-banking financial activity, such as, lending, investment or deposit acceptance as their principal business, without seeking registration, the Reserve Bank can impose penalty or fine on them or can even prosecute them in a court of law. If members of public come across any entity which does non-banking financial activity but does not figure in the list of authorized NBFC on RBI website, they should inform the nearest Regional Office of the Reserve Bank, for appropriate action to be taken for contravention of the provisions of the RBI Act, 1934.

27. NBFCs are charging high interest rates from their borrowers. Is there any ceiling on interest rate charged by the NBFCs to their borrowers?

Reserve Bank of India has deregulated interest rates to be charged to borrowers by financial institutions (other than NBFC- Micro Finance Institution). 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 NBFCs. However, the NBFCs have to be transparent and the rate of interest and manner of arriving at the rate of interest to different categories of borrowers should be disclosed to the borrower or customer in the application form and communicated explicitly in the sanction letter etc.

28. What action can be taken against persons/financial companies making false claim of being regulated by the Reserve Bank ?

It is illegal for any financial entity or unincorporated body to make a false claim of being regulated by the Reserve Bank to mislead the public to collect deposits and is liable for penal action under the Indian Penal Code. Information in this regard may be forwarded to the nearest office of the Reserve Bank and the Police.

29. What is the difference between acceptance of money by Chit Funds and acceptance of deposits?

Deposits are defined under the RBI Act 1934 as acceptance of money other than that raised by way of share capital, money received from banks and other financial institutions, money received as security deposit, earnest money and advance against goods or services and subscriptions to chits. All other amounts, received as loan or in any form are treated as deposits. Chit Funds activity involves contributions by members in instalments by way of subscription to the Chit and by rotation each member of the Chit receives the chit amount. The subscriptions are specifically excluded from the definition of deposits and cannot be termed as deposits. While Chit funds may collect subscriptions as above, they are prohibited by RBI from accepting deposits with effect from August 2009.

30. Where can one find the list of registered Non-deposit taking NBFCs which are engaged in lending and investment activities?

The list of non-deposit taking NBFCs that hold a valid Certificate of Registration and allowed to lend and make investments is available on the RBI website : www.rbi.org.in → Sitemap → NBFC List → List of NBFCs not accepting public deposits.

G. Depositor Protection Issues

31. What precautions should a depositor take before placing deposit with an NBFC?

A depositor wanting to place deposit with an NBFC must ensure the following before placing deposits :

i. That the NBFC is registered with RBI and specifically authorized by the RBI to accept deposits. A list of deposit taking NBFCs entitled to accept deposits is available at www.rbi.org.in → Sitemap → NBFC List. The depositor should check the list of NBFCs permitted to accept public deposits and also check that it is not appearing in the list of companies prohibited from accepting deposits, which is available at www.rbi.org.in → Sitemap → NBFC List → NBFCs who have been issued prohibitory orders, winding up petitions filed and legal cases under Chapter IIIB, IIIC and others.

ii. NBFCs have to prominently display the Certificate of Registration (CoR) issued by the Reserve Bank on its site. This certificate should also reflect that the NBFC has been specifically authorized by RBI to accept deposits. Depositors must scrutinize the certificate to ensure that the NBFC is authorized to accept deposits.

iii. The maximum interest rate that an NBFC can pay to a depositor should not exceed 12.5%. The Reserve Bank keeps altering the interest rates depending on the macro-economic environment. The Reserve Bank publishes the change in the interest rates on www.rbi.org.in → Sitemap → NBFC List → FAQs.

iv. The depositor must insist on a proper receipt for every amount of deposit placed with the company. The receipt should be duly signed by an officer authorized by the company and should state the date of the deposit, the name of the depositor, the amount in words and figures, rate of interest payable, maturity date and amount.

32. What precautions have to be taken by the public to forewarn themselves about the likelihood of losing money in schemes that offer high rates of interest?

Before investing in schemes that promise high rates of return investors must ensure that the entity offering such returns is registered with one of the financial sector regulators and is authorized to accept funds, whether in the form of deposits or otherwise. Investors must generally be circumspect if the interest rates or rates of return on investments offered are high. Unless the entity accepting funds is able to earn more than what it promises, the entity will not be able to repay the investor as promised. For earning higher returns, the entity will have to take higher risks on the investments it makes. Higher the risk, the more speculative are its investments on which there can be no assured return. As such, the public should forewarn themselves that the likelihood of losing money in schemes that offer high rates of interest are more.

33. Does RBI guarantee the repayment of the deposits collected by NBFCs ?

No. The Reserve Bank does not guarantee repayment of deposits by NBFCs even though they may be authorized to collect deposits. As such, investors and depositors should take informed decisions while placing deposit with an NBFC.

34. What action can a depositor take if any NBFC fails to return principal, interest thereof on deposits?

If an NBFC registered with the RBI fails to return depositor's money, the depositor can complain against the NBFC to the nearest Regional Office of the Reserve Bank. Depositors can also approach the Company Law Board constituted under the Companies Act 1956 or a civil court or Consumer Disputes Redressal Forums for recovery of their money. Affected persons can complain to the State Police authorities/Economic Offences Wing of the State Police as well. Some States have passed the Protection of Interest of Depositors (in Financial Establishments) Act, which empowers the States to attach the assets of such entities and distribute the proceeds thereof to the depositors.

35. Can the exempted category of NBFCs accept/hold deposits?

No. NBFCs which are exempted from the provisions of the RBI Act or its directions cannot hold/accept deposits from the public as not holding or accepting deposits is one of the conditions for granting them such exemption. HFCs can however accept deposits to the extent allowed by NHB.

36. What does RBI do to protect the interest of NBFC depositors?

RBI has issued detailed regulations on deposit acceptance, including the quantum of deposits that can be collected, mandatory credit rating, mandatory maintenance of liquid assets for repayment to depositors, manner of maintenance of its deposit books, prudential regulations including maintenance of adequate capital, limitations on exposures, and inspection of the NBFCs, besides others, to ensure that the NBFCs function on sound lines. If the Bank observes through its inspection or audit of any NBFC or through complaints or through market intelligence, that a certain NBFC is not complying with RBI directions, it may prohibit the NBFC from accepting further deposits and prohibit it from selling its assets. In addition, if the depositor has complained to the Company Law Board (CLB) which has ordered repayment and the NBFC has not complied with the CLB order, RBI can initiate prosecution of the NBFC, including criminal action and winding up of the company.

More importantly, RBI initiates prompt action, including imposing penalties and taking legal action against companies which are found to be violating RBI's instructions/norms on basis of Market Intelligence reports, complaints, exception reports from statutory auditors of the companies, information received through SLCC meetings, etc. The Reserve Bank immediately shares such information with all the financial sector regulators and enforcement agencies in the State Level Coordination Committee Meetings.

As a premier public policy institution, as part of its public policy measure, the Reserve Bank of India has been in the forefront in taking several initiatives to create awareness among the general public on the need to be careful while investing their hard earned money. The initiatives include issue of cautionary notices in print media and distribution of informative and educative brochures/pamphlets and close interaction with the public during awareness/outreach programs, Townhall events, participation in State Government sponsored trade fairs and exhibitions. At times, it even requests newspapers with large circulation (English and vernacular) to desist from accepting advertisements from unincorporated entities seeking deposits.

37. What is the purpose of enacting Protection of Interest of Depositors in Financial Establishments by the State Governments?

The purpose of enacting this law is to protect the interests of the depositors. The provisions of RBI Act are directed towards enabling RBI to issue prudential regulations that make the financial entities function on sound lines. RBI is a civil body and the RBI act is a civil Act. Both do not have specific provisions to effect recovery by attachment and sale of assets of the defaulting companies, entities or their officials. It is the State government machinery which can effectively do this. The Protection of Interest of Depositors in Financial Establishments Acts, confers adequate powers on the State Governments to attach and sell assets of the defaulting companies, entities and their officials.

38. Will the passage of the Protection of Interest of Depositors in Financial Establishments by the State Governments help in nailing unincorporated entities and companies from unauthorisedly accepting deposits?

Yes, to a large extent. The Act makes offences, such as, unauthorized acceptance of deposits by any entity, firm or company a cognizable offence, that is entities that are indulging in unauthorized deposit acceptance or unlawful financial activities can be immediately imprisoned and prosecuted. Under the Act, the State Governments have been given vast powers to attach the property of such entities, dispose them off under the orders of special courts and distribute the proceeds to the depositors. The widespread State Government / State Police machinery is best positioned to take quick action against the culprits. The Reserve Bank has, therefore, been urging all the State Governments to pass the legislation on Protection of Interest of Depositors in Financial Establishment Act. Sixteen States and 1 Union Territory have this legislation in place as on date. These States are Andhra Pradesh, Assam, Bihar, Goa, Gujarat, Himachal Pradesh, Karnataka, Madhya Pradesh, Maharashtra, Mizoram, New Delhi, Tamil Nadu, Tripura, Uttaranchal, Sikkim, Meghalaya, J&K and Chandigarh Administration. Some State Governments have used this Act effectively to safeguard the interests of the depositors.

39. Does RBI have any grievance redressal mechanism in place?

If complaints or grievances against the NBFCs are submitted to the nearest office of the Reserve Bank of India, the same are taken up with the NBFC concerned to facilitate resolution of the grievance/complaint.

40. Still there are cases of unscrupulous financial entities cheating public time and again. How does RBI plan to strengthen its surveillance on unauthorized acceptance of deposits/unauthorized conduct of NBFI business by companies?

The Reserve Bank is strengthening its market intelligence function in various Regional Offices and is constantly examining the financials of companies, references for which have been received through market intelligence or complaints to the Reserve Bank. In this, context, members of public can contribute a great deal by being vigilant and lodging a complaint immediately if they come across any financial entity that contravenes the RBI Act. For example, if they are accepting deposits unauthorisedly and/conducting NBFC activities without obtaining due permission from the RBI. More importantly, these entities will not be able to function if members of public start investing wisely. Members of the public must know that high returns on investments will also have high risks. And there can be no assured return for speculative activities. Before investing the public must ensure that the entity they are investing in is a regulated entity with one of the financial sector regulators.

H. Collective Investment Schemes (CIS) and Chit Funds

41. Are Collective Investment Schemes (CIS) regulated by the Reserve Bank of India?

No. CIS are schemes where money is exchanged for units, be it time share in resorts, profit from sale of wood or profits from the developed commercial plots and buildings and so on. Collective Investment Schemes (CIS) do not fall under the regulatory purview of the Reserve Bank.

42. Which is the authority that regulates Collective Investment Schemes (CIS)?

SEBI is the regulator of CIS. Information on such schemes and grievances against the promoters may be immediately forwarded to SEBI as well as to the EOW/Police Department of the State Government.

43. Is the conducting of Chit Fund business permissible under law?

The chit funds are governed by Chit Funds Act, 1982 which is a Central Act administered by state governments. Those chit funds which are registered under this Act can legally carry on chit fund business.

44. If Chit Fund companies are financial entities, why are they not regulated by RBI?

Chit Fund companies are regulated under the Chit Fund Act, 1982, which is a Central Act, and is implemented by the State Governments. RBI has prohibited chit fund companies from accepting deposits from the public in 2009. In case any Chit Fund is accepting public deposits, RBI can prosecute such chit funds.

I. Money Circulation/Multi-Level Marketing (MLM)/ Ponzi Schemes/ Unincorporated Bodies (UIBs)

45. What are money circulation/Ponzi/multi-level marketing schemes?

Money circulation, multi level marketing / Chain Marketing or Ponzi schemes are schemes promising easy or quick money upon enrollment of members. Income under Multi level marketing or pyramid structured schemes do not come from the sale of products they offer as much as from enrolling more and more members from whom hefty subscription fees are taken. It is incumbent upon all members to enroll more members, as a portion of the subscription amounts so collected are distributed among the members at the top of the pyramid. Any break in the chain leads to the collapse of the pyramid, and the members lower in the pyramid are the ones that are affected the most. Ponzi schemes are those schemes that collect money from the public on promises of high returns. As there is no asset creation, money collected from one depositor is paid as returns to the other. Since there is no other activity generating returns, the scheme becomes unviable and impossible for the people running the scheme to meet the promised return or even return the principal amounts collected. The scheme inevitably fails and the perpetrators disappear with the money.

46. Is acceptance of money under Money Circulation/Multi-level Marketing/Pyramid structured schemes allowed?

No. Acceptance of money under Money Circulation/Multi-level Marketing/Pyramid structured schemes and Ponzi schemes is not allowed as acceptance of money under those schemes is a cognizable offence under the Prize Chit and Money Circulation (Banning) Act 1978.

47. Does RBI regulate Money Circulation/Multi-level Marketing/Pyramid structured scheme?

No. Prize Chits and Money Circulation Schemes are banned under the Prize Chits and Money Circulation Schemes (Banning) Act of 1978. The Reserve Bank has no role in implementation of this Act, except advising and assisting the Central Government in framing the Rules under this Act.

48. Then who regulates entities that run such schemes?

Money Circulation/Multi-level Marketing /Pyramid structured schemes are an offence under the Prize Chits and Money Circulation Schemes (Banning) Act, 1978. The Act prohibits any person or individual to promote or conduct any prize chit or money circulation scheme or enrol as member to its schemes or anyone to participate in it by either receiving or remitting any money in pursuance of such chit or scheme. Contravention of the provisions of this Act, is monitored and dealt with by the State Governments.

49. What if someone operates such a scheme?

Any information/grievance relating to such schemes should be given to the police / Economic Offence Wing (EOW) of the concerned State Government or the Ministry of Corporate Affairs. If brought to RBI notice – we will inform the same to the concerned State Government authorities.

50. Who can the Depositor/Investor turn to in case of grievances?

The two Charts given at Annex I and II depict the activities and the regulators overseeing the same. Complaints may hence be addressed to the concerned regulator. If the activity is a banned activity, the aggrieved person can approach the State Police/Economic Offences Wing of the State Police and lodge a suitable complaint.

51. Who has the power to take action against Unincorporated Bodies (UIBs) accepting deposits?

As per Section 45T of RBI Act, both the RBI and State Governments have been given concurrent powers. Nonetheless, in order to take immediate action against the offender, the information should immediately be passed on to the State Police or the Economic Offences Wing of the concerned State who can take prompt and appropriate action. Since the State Government machinery is widespread and the State Government is also empowered to take action under the provisions of RBI Act, 1934, any information on such entities accepting deposits may be provided immediately to the respective State Government's Police Department/EOW.

Many of the State Governments have enacted the State Protection of Interests of Depositors Act in Financial Establishments, which empowers the State Government to take appropriate and timely action.

Section 45S of the RBI Act 1934 specifically prohibits unincorporated bodies like individuals, firms and unincorporated association of individuals from accepting deposits from the public if they are carrying on financial activity or are accepting deposits as their principal business. The Act makes acceptance of deposits by such UIBs punishable with imprisonment or fine or both.

The RBI Act, 1934, gives concurrent powers to the Reserve Bank and the State Government to obtain a search warrant from the Court to investigate the acceptance of deposits by such UIBs.

An Authorized Officer of the Reserve Bank or the State Government can file a complaint in a court of law against the unincorporated bodies and the individuals concerned for the offence.

ANNEX-I

CHART - I

Overview of Regulators of Non-Banking Companies

Companies
(Registered under Section 3 of the Companies Act 1956)

NBFCs registered with RBI *

Regulation, Supervision, Surveillance & Enforcement under RBI

NBFCs Regulated by Other Regulators

Type of Financial Institutions	**Authority for Regulation, Supervision, Surveillance & Enforcement**
Housing Finance Institutions	National Housing Bank
Merchant Banking Company, Venture Capital Fund Companies, Stock Broking, Collective Investment Schemes(CIS)	SEBI
Nidhi Companies, Mutual Benefit Companies	MCA
Chit Fund Companies	State Government
Insurance Companies	IRDA

Non Banking Non Financial Companies

Regulation, Supervision and Surveillance under the Companies Act 1956.

Regulator : Ministry of Corporate Affairs (MCA)

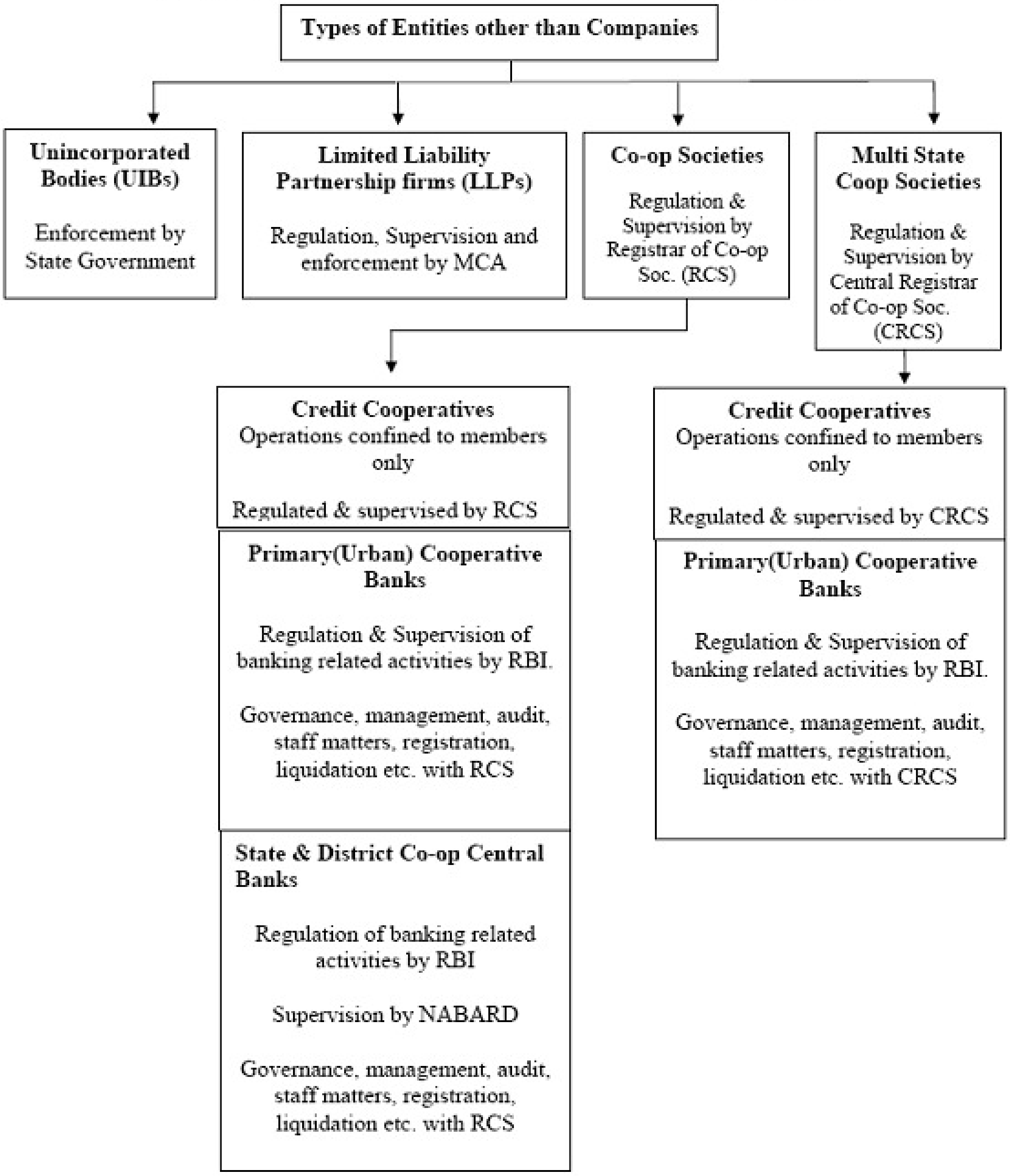
Enforcement Agency : State Governments

* NBFC is a financial Institution that is into Lending or Investment or collecting monies under any scheme or arrangement but does not include any institutions which carry on its principal business as agriculture activity, industrial activity, trading and purchase or sale of immovable properties. A company that carries on the business of accepting deposits as its principal business is also a NBFC.

ANNEX-II

CHART II

Overview of Regulators of Entities other than Companies



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