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**STANDING COMMITTEE ON FINANCE  
(2015-16)**

**SIXTEENTH LOK SABHA**

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

*[Action taken by the Government on the recommendations contained in Twenty First Report of the  
Standing Committee on Finance on 'Efficacy of regulation of Collective Investment  
Schemes (cis), Chit Funds, etc.' ]*

**THIRTY-FIFTH REPORT**



**LOK SABHA SECRETARIAT  
NEW DELHI**

**August, 2016 Sravana, 1938 (Saka)**

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STANDING COMMITTEE ON FINANCE  
(2015-2016)

(SIXTEENTH LOK SABHA)

**MINISTRIES OF FINANCE (DEPARTMENTS OF ECONOMIC AFFAIRS,  
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*[Action taken by the Government on the recommendations contained in Twenty First Report of the  
Standing Committee on Finance on 'Efficacy of regulation of Collective Investment  
Schemes (cis), Chit Funds, etc.']*

Presented to Lok Sabha on 10 August, 2016

Laid in Rajya Sabha on 10 August, 2016



LOK SABHA SECRETARIAT  
NEW DELHI

August, 2016 Sravana, 1938 (Saka)

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Schemes (cis), Chit Funds, etc.*

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\* Not appended in the cyclostyled copy

## **COMPOSITION OF STANDING COMMITTEE ON FINANCE – 2015-16**

**Dr. Veerappa Moily - Chairperson**

### **MEMBERS**

#### **LOK SABHA**

2. Vacant \*\*
3. Shri Venkatesh Babu T.G.
4. Shri Sudip Bandyopadhyay
5. Shri Nishikant Dubey
6. Shri P.C. Gaddigoudar
7. Dr. Gopalakrishnan C.
8. Shri Shyama Charan Gupta
9. Shri Chandrakant B. Khaire
10. Shri Rattan Lal Kataria
11. Shri Bhartruhari Mahtab
12. Shri Prem Das Rai
13. Shri Rayapati Sambasiva Rao
14. Prof. Saugata Roy
15. Shri Jyotiraditya M. Scindia
16. Shri Gajendra Singh Sekhawat
17. Shri Gopal Shetty
18. Shri Anil Shirole
19. Shri Shivkumar Udasi
20. Dr. Kiritbhai Solanki
21. Dr. Kirit Somaiya

#### **RAJYA SABHA**

22. Shri Naresh Agrawal
23. Shri Naresh Gujral
24. Vacant \*
25. Shri Satish Chandra Misra\*\*\*
26. Dr. Mahendra Prasad
27. Shri T.K. Rangarajan
28. Shri C.M. Ramesh
29. Shri Ajay Sancheti
30. Shri Digvijaya Singh
31. 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 Kulvinder Singh         | - | Executive Officer   |

\* Vacancy caused due to retirement of Shri A. Navaneethakrishnan, MP from Rajya Sabha w.e.f. 29.06.2016

\*\* Consequent upon his appointment to the Council of Ministers, Shri S.S. Ahluwalia, MP ceased to be the member of the Committee w.e.f. 05.07.2016

\*\*\* Shri Satish Chandra Misra, MP, Rajya Sabha Nominated w.e.f. 08.07.2016

## INTRODUCTION

I, the Chairperson of the Standing Committee on Finance, having been authorized by the Committee, present this Thirty-Fifth Report on action taken by Government on the Observations / Recommendations contained in the Twenty-First Report of the Standing Committee on Finance on 'Efficacy of Regulation of Collective Investment Schemes (CIS), Chit Funds, etc.

2. The Twenty-First Report was presented to Lok Sabha / laid on the Table of Rajya Sabha on 03rd December, 2015. The Action Taken Notes on the Recommendations were received from the Government *vide* their communication dated 29 February, 2016.

3. The Committee considered and adopted this Report at their sitting held on 04 August, 2016.

4. An analysis of the action taken by the Government on the recommendations contained in the Twenty-First Report of the Committee is given in the Appendix.

5. For facility of reference, the observations / recommendations of the Committee have been printed in bold in the body of the Report.

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**NEW DELHI**  
**04 August, 2016**  
**13 Sravana, 1938 (Saka)**

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

## REPORT

### CHAPTER – I

This Report of the Standing Committee on Finance deals with action taken by Government on the recommendations/observations contained in their 21st Report (Sixteenth Lok Sabha) on the subject "Efficacy of Regulation of Collective Investment Schemes, Chit Funds etc." which was presented to the Hon'ble Speaker on 07 October 2015 and presented to Lok Sabha / Laid in Rajya Sabha on 03 December 2015.

2. The Action Taken Notes have been received from the Government in respect of all the 13 recommendations contained in the Report. These have been analyzed and categorized as follows:

- (i) Recommendations/Observations that have been accepted by the Government:

Recommendation Nos.1,2,3, 4,6,7,8,11,12 and 13

(Total 10)  
(Chapter- II)

- (ii) Recommendations/Observations which the Committee do not desire to pursue in view of the Government's replies:

Recommendation Nos. Nil

(Total Nil)  
(Chapter- III)

- (iii) Recommendations/Observations in respect of which replies of Government have not been accepted by the Committee:

Recommendation Nos. 5, 9 and 10

(Total 03)  
(Chapter -IV)

- (iv) Recommendations/Observations in respect of which final replies by the Government are still awaited:

NIL

(Total - NIL)  
(Chapter- V)

3. The Committee desire that the replies to the observations/recommendations contained in Chapter-I may be furnished to them expeditiously.

4. The Committee will now deal with the action taken by the Government on some of their recommendations.

### **Unauthorised collection of money and deposits**

#### **Recommendation (Para No. 1)**

5. 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 countrywide 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.

6. In their action taken reply the Ministry of Corporate Affairs have submitted as follows:-

"The Government has undertaken a massive exercise of Financial Inclusion through the Pradhan Mantri Jan-Dhan Yojana, wherein, about 21 crore bank account have been opened with a view to provide regulated financial services. Further, through the three Jan-Suraksha Schemes, namely, Pradhan Mantri Jeevan Jyoti Bima Yojana, Pradhan Mantri Suraksha Bima Yojana and Atal Pension Yojana, over 12.53 crore citizens have been covered under the social security schemes of life or accidental insurance or old age pension. The objective of the Government is to maximise the access and use of regulated financial products throughout the country in a cost effective manner. Further, the Reserve Bank of India (RBI) has decided to grant "in-principle" approval on 19<sup>th</sup> August, 2015 to the 11 applicants to set up Payments Banks. Further, RBI decided to grant "in-principle" approval on 16<sup>th</sup> September, 2015 to the 10 applicants to set up Small Finance

Banks. With the setting up of these new types of banks, the access of the people to regulated financial services would increase.

It is agreed that an informed investor is the best form of defense against the lure of a dubious money collection schemes promising unreasonable rate of returns. SEBI, RBI, Department of Consumer Affairs (DCA) and Ministry of Corporate Affairs (MCA) conduct their own campaigns. A coordinated strategy is being formulated to launch a massive Nation-wide consumer / depositor education and awareness campaign by using the Depositor Education and Awareness Fund (DEAF) of RBI, Investor Education and Protection Fund (IEPF) of MCA, the Investor Protection and Awareness Fund (IPEF) of SEBI. RBI has informed that it is agreeable to allow a part of the DEAF to be used for promoting depositor education and awareness through mass media campaign, advertisements and other means. Further, SEBI has informed that an amount of Rs. 200 crores is allocated to SEBI under IPEF for creating awareness and cautioning investors against the ponzi schemes, etc."

**7. The Committee note with satisfaction that the Government have taken some measures for promoting small savings, creating public awareness and financial literacy while cautioning investors against fraudulent schemes. These include (i) opening of about 21 crore bank accounts, (ii) introduction of three Jan-Suraksha schemes namely Pradhan Mantri Jeevan Jyoti Bima Yojana, Pradhan Mantri Suraksha Bima Yojana and Atal Pension Yojana under which over 12.53 crore citizens have been covered, and (iii) formulation of a coordinated strategy to launch a massive nation-wide campaign by using the Depositor Education and Awareness Fund (DEAF) of RBI, Investor Education and Protection Fund (IEPF) of the Ministry of Corporate Affairs and Investor Protection and Awareness Fund of the Securities Exchange Board of India. The Committee hope that the co-ordinated strategy being formulated will soon be implemented. They also hope that these measures will help promote enhanced financial literacy and awareness in the country, weaning away the public from fraudulent schemes promising attractive returns.**

## **Different Regulatory Bodies**

### **Recommendation (Para No. 2)**

8. 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. In spite 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.

9. In their action taken reply the Ministry of Corporate Affairs have submitted as follows:-

"The Central Economic Intelligence Bureau in the Department of Revenue, Ministry of Finance and its Regional Economic Intelligence Councils, along with the State Level Coordination Committees, provide an existing administrative structure for capturing information regarding ponzi schemes early. It would be appropriate to attune, with strengthening if necessary, the existing structure to directly address the problem of unauthorised deposit taking. As the unauthorised money mobilisation is majorly done in the hinterland, the primary responsibility for preventing and dealing with unauthorised deposit taking activities rests with the State Government not only due to its local presence and criminal enforcement power, but also due to the provisions of the Chit Funds Act, 1982, and the Prize Chits and Money Circulation

Schemes (Banning) Act, 1978 (PCMCSB Act), wherein the authority to implement the provisions of these Acts is with the State /Union Territory Governments.

As regards proposing appropriate legislative measures, a comprehensive Central Law on unauthorised deposit taking schemes is being formulated to deal with the menace of such schemes. "

**10. The Committee have been informed that the Central Economic Intelligence Bureau in the Department of Revenue, Ministry of Finance and its regional Economic Intelligence Councils along with the State level coordination committees, provide the necessary administrative structure for capturing information regarding ponzi schemes early and it would be better to attune, with strengthening if necessary, the already existing structure to address the problem of unauthorised deposit taking. As even now several cases of unauthorised collection of money and deposits are being reported, the Committee would like the concerned agencies including the State level agencies to work with greater cohesion, coordination and effectiveness for concrete results at the ground level. As regards appropriate legislative measures, the Committee have been informed that a comprehensive central law on unauthorised deposit taking schemes is being formulated to deal with the menace. The Committee would like the central law on unauthorised deposits and related matters be expedited so that a comprehensive Bill can be introduced in Parliament at least during the Winter Session later this year. The Committee would expect this proposed legislation to plug once and for all the regulatory loopholes, gaps and vacuum prevailing in the vast and expanding financial services industry.**

#### **Different forms of fund raising**

##### **Recommendation (Para No. 3)**

11. 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.

12. In their action taken reply the Ministry of Corporate Affairs have submitted as follows:-

"The existing mechanisms of intelligence gathering and information sharing of the Central Economic Intelligence Bureau, its Regional Economic Intelligence Councils and State Level Coordination Committees are to be strengthened by suitably strengthening and technologically leveraging these to facilitate real-time information gathering and dissemination amongst all stakeholders. The State Government enforcement agencies are invariably part of the existing mechanisms. A module for public in the State Level Coordination Committee portal (under development) 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".

**13. The Committee are happy to note that a module for public in the State level Coordination Committee portal is being developed to post information on suspected unauthorised financial activities and also for registering their complaints against any regulated/unregulated entity. The Committee would**

**recommend that the said module relating to the SLCC portal becomes functional soon. The Committee be kept abreast of the same.**

**Unauthorised acceptance of deposits**

**Recommendation (Para No. 5)**

14. 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 are required 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.

15. 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 authorised 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.

16. In their action taken reply the Ministry of Corporate Affairs have submitted as follows:-

"The Protection of Interest of Depositors (in Financial establishments) Act (PID Act), wherever enacted, normally has provisions enabling the State Authorities to attach the moneys and properties of not only the defaulting financial establishment, its directors, officials, etc., but also the moneys and properties believed to have been acquired by the financial establishment, either in its own name or in the name of any other person from out of the deposit collected by the company. Offences under the Act are cognizable. Designated courts are set up to try offences under the Act and to pass orders confirming attachments made by the State Government, to distribute the sale proceeds, etc. Most of the State Acts have also provisions by which orders of the State Authorities / Designated Court of one State can be enforced by the authorities or Designated Court of other State.

It is pertinent to note that the first State PID Act was enacted in 1997 by Tamil Nadu. In 18 years, that is, upto 2015, 24 States and 2 UTs have enacted PID Acts and 2 States have finalised their PID Acts and are awaiting Presidential Assent. 3 States and 5 UTs are yet to finalise their PID Acts and send for Presidential assent. Government and RBI have written to the States/ UTs, which have not enacted such law, to enact one, to avoid any regulatory vacuum in the area of control of deposit taking activity.

Further, it is a well established fact that the State Police Authorities are the first to take cognizance of a fraudulent, unauthorised money collection scheme, when the investors start complaining of non-receipt of the promised returns and when FIR is

lodged. It is essential to build capacities of district level officers, as well as police officials regarding the characteristics and modus operandi of ponzi schemes so that suspicious activities are recognised early. As mentioned in reply to recommendation No. 2 and 3, the existing mechanisms of intelligence gathering and information sharing of the Central Economic Intelligence Bureau, its Regional Economic Intelligence Councils and State Level Coordination Committees is proposed to be strengthened by suitably amending, strengthening and technologically leveraging these to facilitate real-time information gathering and dissemination amongst all stakeholders. The State Government enforcement agencies are invariably part of the existing mechanisms.

Further, a comprehensive Central Law on unauthorised deposit taking schemes is being formulated to deal with the menace of such schemes."

**17. The Committee note that the Protection of Interest of Depositors Act (PID Act) has been enacted by twenty four States and two Union Territories and two States have finalised their PID Acts and are awaiting Presidential assent. However, three States and five Union Territories are yet to finalise their PID Acts despite a request being made by the Government and RBI in this regard. The Committee therefore reiterate that the matter of enacting the PID Act be pursued vigorously with these States/UTs and they be apprised of the outcome in the matter. The Committee also recommend that the Comprehensive Central Law on unauthorised deposit taking schemes being formulated to deal with the menace of such scheme be finalised and enacted expeditiously.**

#### **Report of Key Advisory Group**

##### **Recommendations (Para No. 9)**

18. '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.

19. In their action taken reply the Ministry of Finance (Department of Financial Services) have submitted as follows:-

"A Key Advisory Group was constituted on Chit Funds (KAG) in September, 2011 to review the existing legal, regulatory and institutional framework for Chit Funds and its efficacy and suggest legal and regulatory initiatives required for orderly growth of the sector. KAG had submitted its report in September, 2013 and had given a number of recommendations relating to improvements in the institutional and legal structure to further develop the Chit Funds industry.

The Report of KAG was circulated among RBI, Insurance Regulatory and Development Authority (IRDA), Indian Banks' Association, All India Association of Chit Funds (AIACF) and the States / UTs of Andhra Pradesh, Kerala, Karnataka, Tamil Nadu, Maharashtra, Puducherry and Delhi in October, 2013. RBI, IRDAI, IBA and AIACF shared their comments on the KAG report with DFS, however, no comments were received from the States / UTs. The recommendations of KAG and suggestions of stakeholders were being processed in March, 2014 to propose amendments to the Chit Funds Act, 1982, however, the decision was deferred in view of the then pending General Elections. Department of Financial Services is examining the recommendations of the KAG on Chit Funds for taking a final view on administrative and legislative measures including amendments to the Chit Funds Act, 1982 and would inform the Committee shortly about the decision taken to implement specific recommendations of KAG, both non-legislative and legislative."

**20. The Committee note that a Key Advisory Group (KAG) was constituted on Chit Funds way back in September, 2011 to review the existing legal, regulatory and institutional framework for Chit Funds and its efficacy and also to suggest the legal/regulatory initiatives required for the purpose. The KAG accordingly presented its report in September, 2013 and had given a number of recommendations relating to improvements in the institutional and legal structure to further develop the Chit Funds Industry. In the Action taken reply,**

the Department of Financial Services have informed the Committee that the report of KAG was circulated among RBI, Insurance Regulatory Development Authority (IRDA), All India Association of Chit Funds (AIACF), Indian Banks' Association (IBA), States/UTs etc. Comments have since been received from RBI, IRDA, AIACF and IBA, however no comments have been received from the States/UTs. The Ministry have assured to inform the Committee shortly about the decision taken to implement specific recommendations of KAG, both non-legislative and legislative. The Committee in their original report on the subject had strongly recommended that the Department of Financial Services should finalise their legislative and administrative proposals on the registered Chit Funds sector within a period of three months from the presentation of the Report. The Committee are unhappy to note that the compliance period of three months has not been adhered to by the Department of Financial Services. They have taken unusually long time in finalising their position in the matter. The Committee would now expect the Department of Financial Services to firm up their proposals for the chit funds sector without further loss of time and bring the legislative and administrative proposal before the Committee forthwith. Furthermore, necessary legislation in the Chit Fund Sector be brought before Parliament during the Winter Session without fail.

#### **Transfer of money out of ponzi schemes**

##### **Recommendations (Para No. 10)**

21. 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.

22. In their action taken reply the Ministry of Corporate Affairs have submitted as follows:-

"The subject of multi-state cooperative societies is with the Department of Agriculture, Cooperation and Farmers' Welfare, Ministry of Agriculture and Farmers' Welfare. It has been informed by the Department of Agriculture, Cooperation and Farmers' Welfare that so far, no such irregularity has been proved that huge amount of money has been transferred out of ponzi schemes to Multi-State Cooperative Societies (MSCSs). However, certain complaints have been received in the Department of Agriculture, Cooperation and Farmers' Welfare, Ministry of Agriculture and Farmers' Welfare alleging that the following companies against whom strictures have been passed by SEBI for financial bungling in Collective Investment Schemes (CIS), have transferred their funds by forming the Multi-State Cooperative Societies and vice-versa and the same has been referred to the Ministry of Corporate Affairs vide the Department of Agriculture, Cooperation and Farmers Welfare letter dated 04.11.2015 for investigation through Serious Fraud Investigation Office (SFIO):

SI No.	Name of the entity	Registered Office / State
1	Samruddha Jeevan Foods Ltd.	Samruddha Jeevan Multi- State Multipurpose Cooperative Society Ltd., Pune, Maharashtra
2	Saiprasad Foods Ltd. Sai Prasad Properties Ltd. Sai Prasad Corporation Ltd.	Sai Prasad Global Multi-Purpose Cooperative Society Ltd., Pune, Maharashtra
3	Utkarsh Plotters & Multi Agro Solutions India Ltd.	Utkarsh Agro Multi State Cooperative Ltd., Jalgaon, Maharashtra.
4	PGF Ltd.	Lotus Agricultural and Marketing Cooperative Society Ltd., Pitampura, Delhi.
5	PACL Ltd.	Kisan Agrotech Cooperative Society Ltd; Pitampura, Delhi.

The Department of Agriculture, Cooperation and Farmers' Welfare depends on Registrars, Cooperative Societies of State Governments to do inspection, inquiry etc. into the affairs of MSCSs in case of complaints. The Department of Agriculture, Cooperation and Farmers' Welfare is also in the process of establishing a panel of chartered Accountants / Auditors etc. to look into the affairs of MSCSs in case of complaints etc. Further, it is mentioned that as on 31.12.2010, 545 MSCSs had been registered under the MSCS Act, 2002 and as on 31.12.2015, a total number of 1250 societies have been registered. From this, it is observed that registration has not increased 100 times as stated in the report since 2010. To conduct special audit on the affairs of the Multi-State Cooperative Credit Societies as stated in the Report, it requires not less than 51% of the paid up share capital holding of the Government of India / State Government in the total paid up share capital of the society as per the provision of section 77 of the MSCS Act, 2002 and therefore, conduct of special audit of these societies is not feasible as per the provisions of the MSCS Act, 2002.

The Department of Agriculture, Cooperation and Farmers' Welfare has stated that it is in agreement with the suggestion of the Committee that the regulatory regime in respect of MSCSs should be streamlined to protect the interest of the small investors / members of these societies."

**23. The Committee note with concern that the Department of Agriculture, Cooperation and Farmers Welfare, Ministry of Agriculture Farmer's Welfare have shed their responsibility by confirming that no irregularity has been proved about transfer of huge amount from Ponzi Schemes to Multi State Co-operative Societies (MSCSs). At the same time the Committee have been informed that some complaints have been received in the Department of Agriculture, Cooperation and Farmers Welfare, Ministry of Agriculture Farmer's Welfare alleging that some companies have transferred their funds by forming Multi-State Cooperative Societies and the same have been referred to Ministry of Corporate Affairs for investigation through Serious Fraud Investigation Office (SFIO). The Committee, therefore, desire that the SFIO should expeditiously investigate those complaints and finalise the same in a time-bound manner. Further, the Committee note that the Department of Agriculture, Cooperation and Farmers Welfare are in agreement with the observations of the Standing Committee that the regulatory regime in respect of MSCSs should be**

streamlined to protect the interest of the small investors/members of these societies. The Committee, therefore, reiterate their earlier recommendation that the regulatory regime in respect of MSCSs should be streamlined and tightened, so that they do not become an instrument of diverting and shielding illegal funds from ponzi companies etc. The Committee emphasize that necessary steps in this direction should be taken up urgently. The Committee would also reiterate that strong, time-bound action be taken against all such MSCSs, against whom (promoters, stakeholders group), SEBI has taken action or against whom complaints have been received. The Committee should be apprised of the action taken in this regard on urgent basis.

## **CHAPTER II**

### **RECOMMENDATIONS / OBSERVATIONS THAT HAVE BEEN ACCEPTED BY THE GOVERNMENT:**

#### **Recommendation (Serial No. 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 countrywide 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.

#### **Reply of the Government**

The Government has undertaken a massive exercise of Financial Inclusion through the Pradhan Mantri Jan-Dhan Yojana, wherein, about 21 crore bank account have been opened with a view to provide regulated financial services. Further, through the three Jan-Suraksha Schemes, namely, Pradhan Mantri Jeevan Jyoti Bima Yojana, Pradhan Mantri Suraksha Bima Yojana and Atal Pension Yojana, over 12.53 crore citizens have been covered under the social security schemes of life or accidental insurance or old age pension. The objective of the Government is to maximise the access and use of regulated financial products throughout the country in a cost effective manner. Further, the Reserve Bank of India (RBI) has decided to grant “in-principle” approval on 19<sup>th</sup> August, 2015 to the 11 applicants to set up Payments Banks. Further, RBI decided to grant “in-principle” approval on 16<sup>th</sup> September, 2015 to the 10 applicants to set up Small Finance Banks. With the setting up of these new types of banks, the access of the people to regulated financial services would increase.

It is agreed that an informed investor is the best form of defense against the lure of a dubious money collection schemes promising unreasonable rate of returns. SEBI, RBI, Department of Consumer Affairs (DCA) and Ministry of Corporate Affairs (MCA)

conduct their own campaigns. A coordinated strategy is being formulated to launch a massive Nation-wide consumer / depositor education and awareness campaign by using the Depositor Education and Awareness Fund (DEAF) of RBI, Investor Education and Protection Fund (IEPF) of MCA, the Investor Protection and Awareness Fund (IPEF) of SEBI. RBI has informed that it is agreeable to allow a part of the DEAF to be used for promoting depositor education and awareness through mass media campaign, advertisements and other means. Further, SEBI has informed that an amount of Rs. 200 crores is allocated to SEBI IPEF for creating awareness and cautioning investors against the ponzi schemes, etc.

**Ministry of Finance (Dept. of Financial Services) O.M. No 09/02/2014-BO.II dated 29.02.2016.**

### **Comments of the Committee**

(Please see Para No. 7 of Chapter I)

### **Recommendations (Serial No 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. In spite 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.

### **Reply of the Government**

The Central Economic Intelligence Bureau in the Department of Revenue, Ministry of

Finance and its Regional Economic Intelligence Councils, along with the State Level Coordination Committees, provide an existing administrative structure for capturing information regarding ponzi schemes early. It would be appropriate to attune, with strengthening if necessary, the existing structure to directly address the problem of unauthorised deposit taking. As the unauthorised money mobilisation is majorly done in the hinterland, the primary responsibility for preventing and dealing with unauthorised deposit taking activities rests with the State Government not only due to its local presence and criminal enforcement power, but also due to the provisions of the Chit Funds Act, 1982, and the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 (PCMCSB Act), wherein the authority to implement the provisions of these Acts is with the State /Union Territory Governments.

As regards proposing appropriate legislative measures, a comprehensive Central Law on unauthorised deposit taking schemes is being formulated to deal with the menace of such schemes.

**Ministry of Finance (Dept. of Financial Services) O.M. No 09/02/2014-BO.II dated 29.02.2016.**

#### **Comments of the Committee**

(Please see Para No. 10 of Chapter I)

#### **Recommendations (Serial No 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.

## **Reply of the Government**

The existing mechanisms of intelligence gathering and information sharing of the Central Economic Intelligence Bureau, its Regional Economic Intelligence Councils and State Level Coordination Committees are to be strengthened by suitably strengthening and technologically leveraging these to facilitate real-time information gathering and dissemination amongst all stakeholders. The State Government enforcement agencies are invariably part of the existing mechanisms. A module for public in the State Level Coordination Committee portal (under development) 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.

**Ministry of Finance (Dept. of Financial Services) O.M. No 09/02/2014-BO.II dated 29.02.2016.**

## **Comments of the Committee**

(Please see Para No. 13 of Chapter I)

## **Recommendations (Serial No. 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.

## **Reply of the Government**

A comprehensive Central Law on unauthorised deposit taking schemes is being formulated to deal the menace of such schemes. The recommendation of the Committee on uniformity in regulation of all entities engaged in acceptance of deposits from public would be kept in view while finalising the Law. A comprehensive Central Law on unauthorised deposit taking schemes is being considered to deal with such cases.

As regards strengthening the existing mechanism to check vanishing companies, the Ministry of Corporate Affairs has informed that a Central Monitoring Committee (CMC)

was constituted in the year 1999. The purpose of constitution of CMC is to devise a common strategy for taking stringent action against unscrupulous promoters who raise money from investors and mis-utilise them.

A total of 238 companies were initially identified as vanishing companies, out of which, 160 companies have since been deleted from the list as the criteria for treating a company as vanishing is no longer applicable to them. As such, only 78 companies remain as vanished. FIRs have been lodged against all 78 companies and their Directors to trace their whereabouts and also to take action under Indian Penal Code (IPC). Prosecutions have also been filed against these companies and their Promoters/ Directors under sections 162 and 220 of the Companies Act, 1956 for non-filing of Statutory Returns and under sections 62 / 63, 68 and 628 of the Companies Act, 1956 for mis-statement in prospectus/ fraudulently inducing persons to invest money/ false statements made in the offer documents, etc.

Instructions have been issued to the Registrars of Companies for physical verification of the registered offices of the vanishing as well as the listed companies which have defaulted in filing their Balance Sheets and Annual Returns.

The Ministry of Corporate Affairs has also taken further steps to check the incidents of vanishing companies:

- i) In 2006, the Ministry has amended the Companies Act, 1956 by inserting Sections 266A to 266G which makes it mandatory for every existing or prospective director to obtain a 'Director Identification Number'. This process requires detailed verification of particulars of a person along with a photograph, identity proof, residence proof, etc. so that traceability of the directors is ensured. This has been confirmed in Companies Act, 2013.
- ii) In case of incorporation of a new company or change of address of an existing company, Ministry has made it mandatory for the professionals verifying its details to personally visit the premises and certify that the premises are indeed at the disposal of the company. Further, in such cases, proof of registered address has also been made mandatory to be furnished at the time of incorporation or change of registered office address;
- iii) Instructions have also been issued to the Registrars of Companies to scrutinise the Balance Sheets and other records of the companies which raise money through public issue so as to monitor the utilisation of such funds;
- iv) Details of vanishing companies and their promoters / directors have been published in the Newspapers as well as placed on the website of the Ministry ([www.mca.gov.in](http://www.mca.gov.in)) to facilitate the investors to come forward and lodge their complaints against the vanishing companies.
- v) The term 'Fraud' has been defined in the new Companies Act, 2013 along with its punishment in section 447. The term 'fraud' and its punishment has also been linked to more serious offences in the new Act, viz., criminal liability for mis-statement in prospectus (section 34); fraudulently inducing persons

to invest money (section 36); frauds in connection with duplicate shares (section 46); fraudulent conduct of business (sections 206(4) and 213); fraud during investigation of affairs of a company (section 229) and for making false statements/filings under the new legislation (section 448).

The above steps are likely to have a deterrent effect against unscrupulous conduct of affairs by companies and their managements under the Company Law itself.

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### **Recommendations (Serial No. 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 ponzi companies. CBI findings quoted by the Court, required more attention. The 12 major ponzi 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.

### **Reply of the Government**

The existing structure of State Level Coordination Committees (SLCCs) may also be used for the purposes of information sharing and for receiving complaints from the aggrieved depositors and sending these to the appropriate regulatory authority. Sub-Committees have been formed in many states which are generally represented by operating level officials and meet at more frequent intervals to share the information among the regulators. RBI has informed that it is in the final stages of preparing a web-enabled portal to be used by all SLCCs, 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 amongst 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. RBI has also indicated that the website of SLCC is expected to go live shortly. RBI has set up market intelligence units / cells across all regional offices, which gather inputs from various sources and send the information on unauthorised financial activity to the supervisory department in RBI. The contents of the report are also shared with the relevant agencies at SLCC.

In all cases of illicit deposit taking, which are brought to the notice of the Department of Economic Affairs (DEA), the Department takes prompt action by referring these cases to the concerned law enforcement and regulatory agencies of both the Central and State Governments.

In cases that do not fall within the regulatory purview of SEBI, the matter is pursued with the relevant Central Agency / Regulator as well as the State Government to take action under the relevant Acts and the IPC and under the respective State Protection of Interest of Depositors (in Financial Establishment) Acts, respectively.

With regard to cases of unregistered Collective Investment Schemes (CIS) that fall within the purview of SEBI, the DEA has written to SEBI to review and streamline the procedure for handling these cases so that the proceedings against the

perpetrators can be completed in a time bound manner. SEBI has also been requested to initiate penal action - levying penalty and filing prosecution in all cases of unregistered CIS.

It is seen from examination of complaints / references against more than 1200 entities that these activities are essentially mobilisation of deposit under the garb of various schemes or Money Circulation Schemes / Multi Level Marketing. Such unauthorised money mobilisation can be effectively handled through the local enforcement agencies. SEBI has referred complaint against these entities bilaterally to the concerned regulator and also placed before various SLCCs.

With respect to Hon'ble Madhya Pradesh High Court Order (dated July 13th, 2012 regarding Writ Petition No 3332 of 2010), it may be mentioned that the Hon'ble Court in the said order has held that 33 named companies entered into contract with the investors and prima facie, committed offences under Section 3(1), 3(2) & 3(4) of Madhya Pradesh Nikshepakon Ke Hiton Ka Sanrakshan Adhiniyam 2000, Section 58B (5 and 5A) and Section 58 C of RBI Act, 1934, Sections 4, 5 and 6 of Prize Chits and Money Circulation Scheme (Banning) Act, 1978 and Section 420 of Indian Penal Code. SEBI has already taken appropriate action in the matter, and passed orders in 11 cases which were found to be, prima facie, unregistered CIS / Deemed public issue and referred 22 cases to other authorities concerned.

**Ministry of Finance (Dept. of Financial Services) O.M. No 09/02/2014-BO.II dated 29.02.2016.**

### **Recommendations (Serial No. 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.

### **Reply of the Government**

As far as illegal unregulated deposit taking activities are concerned, the activities / schemes are themselves illegal and therefore there is no case for capping payment of commission to the agents.

As for the regulated deposit taking schemes, the same are regulated under different statutes and the rules / regulations framed therein. The concerned regulators would examine these suggestions.

RBI has prescribed guidelines for NBFCs wherein deposits for an NBFC have been limited to 1.5 times of its net owned funds and these are required to submit periodical returns regarding the same. Further, deposit taking / holding NBFCs are required to maintain not less than 15% of the aggregate amount of the liabilities to the depositors invested in Government securities / Government guaranteed bonds.

SEBI (CIS) Regulations, 1999 provides detailed norms with respect to investment and expense ceiling. As units of securities are marketable instrument, no assured return is permitted. As per the SEBI CIS regulation, such assured return is prohibited. Any investment in securities market is subject to market risk.

It is agreed that banks should be instructed to inform related departments like Income Tax or the agencies concerned, whenever cash deposits by such persons / entities exceed a certain limit. In fact, banks do report the cash transaction reports and suspicious transactions reports to Financial Intelligence Unit, India.

**Ministry of Finance (Dept. of Financial Services) O.M. No 09/02/2014-BO.II dated 29.02.2016.**

### **Recommendations (Serial No. 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.

### **Reply of the Government**

As regards proposing appropriate legislative measures, a comprehensive Central Law on unauthorised deposit taking schemes is being formulated to deal with the menace of such schemes. On the need for amending the PCMCSB Act, this would depend whether a separate law on Direct Selling, is required or not which is being examined by Department of Consumer Affairs (DCA). On the need for amendments to the Chit Funds Act, 1982, the Key Advisory Group (KAG) on Chit Funds has suggested some legislative and non-legislative measures, which are being examined by the Government and suitable legislative and administrative action would be taken as soon as possible.

Further, DFS has been constantly pursuing all States / UTs for enactment of State PID Acts, which have not so far enacted such laws, to strengthen the regulatory and enforcement regime throughout the country. Even RBI has impressed upon the States / UTs in its annual conference with the State Government officials to enact a PID Law in States / UTs.

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### **Recommendations (Serial No. 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 ponzi companies since 2010. The Committee note that in the last one year, SEBI has initiated action against 200 ponzi / 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 ponzi 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.

### **Reply of the Government**

The Central Economic Intelligence Bureau and its Regional Economic Intelligence Councils, along with the State Level Coordination Committees, would develop a database of violations in deposit collection schemes to effectively address the problem of unauthorised deposit taking. Further, a comprehensive Central Law on unauthorised deposit taking schemes is being formulated to deal with the menace of such schemes.

With regard to cases of unregistered Collective Investment Schemes (CIS) that fall within the purview of SEBI, the Department of Economic Affairs has asked SEBI to review and streamline the procedure for handling these cases so that the proceedings against the perpetrators can be completed in a time bound manner. SEBI has also been requested to initiate penal action - levying penalty and filing prosecution in all cases of unregistered CIS.

**Ministry of Finance (Dept. of Financial Services) O.M. No 09/02/2014-BO.II dated 29.02.2016.**

### **Recommendations (Serial No. 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.

### **Reply of the Government**

The white paper, inter-alia, has suggested a regulatory framework and compulsory registration process for all Direct Selling businesses in order to provide an oversight mechanism to determine as to whether these are legitimate direct selling businesses or Ponzi / Pyramid Schemes.

The Department of Consumer Affairs has informed that the matter is being examined by Inter-Ministerial Committee (IMC) set up under the Chairmanship of Secretary (Consumer Affairs) for finalising guidelines on Direct Selling and also considering whether a separate Law on Direct Selling is required. The term of the Committee has been extended up to 18/05/2016.

**Ministry of Finance (Dept. of Financial Services) O.M. No 09/02/2014-BO.II dated 29.02.2016**

### **Recommendations (Serial No. 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.

### **Reply of the Government**

A comprehensive Central Law on unauthorised deposit taking schemes is being formulated to deal with the menace of such schemes. The recommendations of the Committee to provide for clear identification of unauthorised deposit collection scheme, attachment, recovery and distribution of proceeds in a stipulated time-frame, deterrent penalties with imprisonment for violations, and making the offence cognizable and non-bailable would be kept in view while finalising the law.

**Ministry of Finance (Dept. of Financial Services) O.M. No 09/02/2014-BO.II dated 29.02.2016**

### **CHAPTER - III**

**RECOMMENDATIONS/OBSERVATIONS WHICH THE COMMITTEE DO NOT  
DESIRE TO PURSUE IN VIEW OF THE GOVERNMENT'S REPLIES**

**NIL**

## **CHAPTER - IV**

### **RECOMMENDATIONS/OBSERVATIONS IN RESPECT OF WHICH REPLIES OF GOVERNMENT HAVE NOT BEEN ACCEPTED BY THE COMMITTEE**

#### **Recommendations (Serial No. 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 are required 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 authorised 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.

### **Reply of the Government**

The Protection of Interest of Depositors (in Financial establishments) Act (PID Act), wherever enacted, normally has provisions enabling the State Authorities to attach the moneys and properties of not only the defaulting financial establishment, its directors, officials, etc., but also the moneys and properties believed to have been acquired by the financial establishment, either in its own name or in the name of any other person from out of the deposit collected by the company. Offences under the Act are cognizable. Designated courts are set up to try offences under the Act and to pass orders confirming attachments made by the State Government, to distribute the sale proceeds, etc. Most of the State Acts have also provisions by which orders of the State Authorities / Designated Court of one State can be enforced by the authorities or Designated Court of other State.

It is pertinent to note that the first State PID Act was enacted in 1997 by Tamil Nadu. In 18 years, that is, upto 2015, 24 States and 2 UTs have enacted PID Acts and 2 States have finalised their PID Acts and are awaiting Presidential Assent. 3 States and 5 UTs are yet to finalise their PID Acts and send for Presidential assent. Government and RBI have written to the States/ UTs, which have not enacted such law, to enact one, to avoid any regulatory vacuum in the area of control of deposit taking activity.

Further, it is a well established fact that the State Police Authorities are the first to take cognizance of a fraudulent, unauthorised money collection scheme, when the investors start complaining of non-receipt of the promised returns and when FIR is lodged. It is essential to build capacities of district level officers, as well as police officials regarding the characteristics and modus operandi of ponzi schemes so that suspicious activities are recognised early. As mentioned in reply to recommendation No. 2 and 3, the existing mechanisms of intelligence gathering and information sharing of the Central Economic Intelligence Bureau, its Regional Economic Intelligence Councils and State Level Coordination Committees is proposed to be strengthened by suitably amending, strengthening and technologically leveraging these to facilitate real-time information gathering and dissemination amongst all stakeholders. The State Government enforcement agencies are invariably part of the existing mechanisms.

Further, a comprehensive Central Law on unauthorised deposit taking schemes is being formulated to deal with the menace of such schemes.

**Ministry of Finance (Dept. of Financial Services) O.M. No 09/02/2014-BO.II dated 29.02.2016.**

**Comments of the Committee**  
(Please see Para No. 17 of Chapter I)

**Recommendations (Serial No. 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.

**Reply of the Government**

A Key Advisory Group was constituted on Chit Funds (KAG) in September, 2011 to review the existing legal, regulatory and institutional framework for Chit Funds and its efficacy and suggest legal and regulatory initiatives required for orderly growth of the sector. KAG had submitted its report in September, 2013 and had given a number of recommendations relating to improvements in the institutional and legal structure to further develop the Chit Funds industry.

The Report of KAG was circulated among RBI, Insurance Regulatory and Development Authority (IRDA), Indian Banks' Association, All India Association of Chit Funds (AIACF) and the States / UTs of Andhra Pradesh, Kerala, Karnataka, Tamil Nadu, Maharashtra, Puducherry and Delhi in October, 2013. RBI, IRDAI, IBA and AIACF shared their comments on the KAG report with DFS, however, no comments were received from the States / UTs. The recommendations of KAG and suggestions of stakeholders were being processed in March, 2014 to propose amendments to the Chit Funds Act, 1982, however, the decision was deferred in view of the then pending General Elections. DFS is examining the recommendations of the KAG on Chit Funds for taking a final view on administrative and legislative measures including

amendments to the Chit Funds Act, 1982 and would inform the Committee shortly about the decision taken to implement specific recommendations of KAG, both non-legislative and legislative.

**Ministry of Finance (Dept. of Financial Services) O.M. No 09/02/2014-BO.II dated 29.02.2016**

### **Comments of the Committee**

(Please see Para No. 20 of Chapter I)

### **Recommendations (Serial No. 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.

### **Reply of the Government**

The subject of multi-state cooperative societies is with the Department of Agriculture, Cooperation and Farmers' Welfare, Ministry of Agriculture and Farmers' Welfare. It has been informed by the Department of Agriculture, Cooperation and Farmers' Welfare that so far, no such irregularity has been proved that huge amount of money has been transferred out of ponzi schemes to Multi-State Cooperative Societies (MSCSs). However, certain complaints have been received in the Department of Agriculture, Cooperation and Farmers' Welfare, Ministry of Agriculture and Farmers' Welfare alleging that the following companies against whom strictures have been passed by SEBI for financial bungling in Collective Investment Schemes (CIS), have transferred their funds by forming the Multi-State Cooperative Societies and vice-versa and the same has been referred to the Ministry of Corporate Affairs vide the Department of Agriculture, Cooperation and Farmers Welfare letter dated 04.11.2015 for investigation through Serious Fraud Investigation Office (SFIO):

SI No.	Name of the entity	Registered Office / State
1	Samruddha Jeevan Foods Ltd.	Samruddha Jeevan Multi- State Multipurpose Cooperative Society Ltd., Pune, Maharashtra
2	Saiprasad Foods Ltd. Sai Prasad Properties Ltd. Sai Prasad Corporation Ltd.	Sai Prasad Global Multi-Purpose Cooperative Society Ltd., Pune, Maharashtra
3	Utkarsh Plotters & Multi Agro Solutions India Ltd.	Utkarsh Agro Multi State Cooperative Ltd., Jalgaon, Maharashtra.
4	PGF Ltd.	Lotus Agricultural and Marketing Cooperative Society Ltd., Pitampura, Delhi.
5	PACL Ltd.	Kisan Agrotech Cooperative Society Ltd; Pitampura, Delhi.

The Department of Agriculture, Cooperation and Farmers' Welfare depends on Registrars, Cooperative Societies of State Governments to do inspection, inquiry etc. into the affairs of MSCSs in case of complaints. The Department of Agriculture, Cooperation and Farmers' Welfare is also in the process of establishing a panel of chartered Accountants / Auditors etc. to look into the affairs of MSCSs in case of complaints etc. Further, it is mentioned that as on 31.12.2010, 545 MSCSs had been registered under the MSCS Act, 2002 and as on 31.12.2015, a total number of 1250 societies have been registered. From this, it is observed that registration has not increased 100 times as stated in the report since 2010. To conduct special audit on the affairs of the Multi-State Cooperative Credit Societies as stated in the Report, it requires not less than 51% of the paid up share capital holding of the Government of India / State Government in the total paid up share capital of the society as per the provision of section 77 of the MSCS Act, 2002 and therefore, conduct of special audit of these societies is not feasible as per the provisions of the MSCS Act, 2002.

The Department of Agriculture, Cooperation and Farmers' Welfare has stated that it is in agreement with the suggestion of the Committee that the regulatory regime in respect of MSCSs should be streamlined to protect the interest of the small investors / members of these societies.

**Ministry of Finance (Dept. of Financial Services) O.M. No 09/02/2014-BO.II dated 29.02.2016.**

### **Comments of the Committee**

(Please see Para No. 23 of Chapter I)

## **CHAPTER - V**

RECOMMENDATIONS/OBSERVATIONS IN RESPECT OF WHICH FINAL REPLIES  
BY THE GOVERNMENT ARE STILL AWAITED

**NIL**

**NEW DELHI**  
**04 August, 2016**  
**13 Sravana, 1938 (Saka)**

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

**Minutes of the Twentieth sitting of the Standing Committee on Finance**  
**The Committee sat on Thursday, the 04 August, 2016 from 1500 hrs. to 1700 hrs.**  
**in Committee Room 'B', Parliament House Annexe, New Delhi.**

**PRESENT**

**Dr. M. Veerappa Moily - Chairperson**

**LOK SABHA**

2. Shri Venkatesh Babu T.G.
3. Dr. Gopalakrishnan C.
4. Shri Nishikant Dubey
5. Shri P.C. Gaddigoudar
6. Shri Shyama Charan Gupta
7. Shri Rattan Lal Kataria
8. Shri Prem Das Rai
9. Shri Rayapati Sambasiva Rao
10. Prof. Saugata Roy
11. Shri Gajendra Singh Sekhawat
12. Shri Gopal Shetty
13. Shri Anil Shirole
14. Dr. Kiritbhai Solanki
15. Dr. Kirit Somaiya
16. Shri Shivkumar Udasi

**RAJYA SABHA**

17. Shri Naresh Gujral
18. Dr. Mahendra Prasad
19. Shri C.M. Ramesh
20. Shri Ajay Sancheti
21. Shri Digvijaya Singh
22. Dr. Manmohan Singh

**SECRETARIAT**

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

**WITNESSES**

	XX	XX	XX	XX	XX	XX
2.	XX	XX	XX	XX	XX	XX.

(The witnesses then withdrew)

A verbatim record of the proceedings has been kept

3. Thereafter, the Committee took up the following draft reports for consideration and adoption:

- (i) Draft Report on the subject "State of Rural / Agricultural Banking and Crop Insurance".
- (ii) Draft Report on Action Taken by the Government on the Recommendations contained in the Twenty First Report (16<sup>th</sup> Lok Sabha) on "Efficacy of Regulation of Collective Investment Schemes (CIS), Chit Funds, etc."
- (iii) Draft Report on Action Taken by Government on the Recommendations contained in the Thirty-Second Report on Demands For Grants (2016-17) of the Ministry of Corporate Affairs.

After some deliberations, the Committee adopted the above draft Reports with modification and authorised the Chairperson to finalise them and present these Reports to Parliament.

The Committee then adjourned.

## APPENDIX

(Vide Para 4 of the Introduction)

### ANALYSIS OF THE ACTION TAKEN BY THE GOVERNMENT ON THE RECOMMENDATIONS CONTAINED IN THE TWENTY-FIRST REPORT (SIXTEENTH LOK SABHA) ON THE SUBJECT "EFFICACY OF REGULATION OF COLLECTIVE INVESTMENT SCHEMES, CHIT FUNDS ETC."

		Total	% of total
(i)	Total number of Recommendations	13	
(ii)	Recommendations/Observations which have been accepted by the Government (vide Recommendation Nos. 1,2,3,4,6,7,8,11,12 and 13)	10	76.92%
(iii)	Recommendations/Observations which the Committee do not desire to pursue in view of the Government's replies	Nil	0.00
(iv)	Recommendations/Observations in respect of which replies of the Government have not been accepted by the Committee (vide Recommendation at Sl. Nos. 5, 9 and 10)	03	23.07%
(v)	Recommendations/Observations in respect of which final reply of the Government are still awaited	NIL	0.00