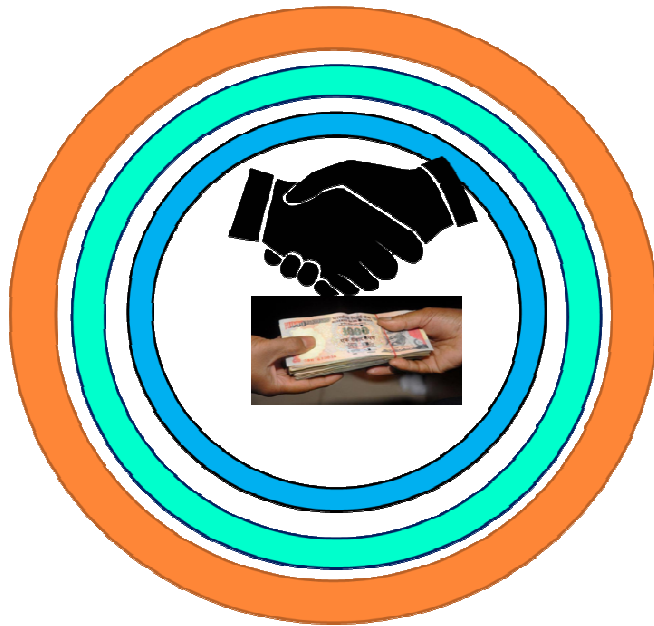


MULTI-STATE CO-OPERATIVE SOCIETIES

ACCEPTANCE OF DEPOSITS:



ISSUES &

CHALLENGES

PRESENTED BY

RUPENDRA PORWAL

B.Com., FCS, LL.M. (UNIVERSITY OF MANCHESTER, UK)



FUNDAMENTAL PRINCIPLES FOR ACTIVITIES OF THE MULTI STATE CO-OPERATIVE SOCIETIES :

Section 3(g) of the MSCS Act, 2002 provides that a multi state co-operative society shall base its activities on the principles as envisaged in First Schedule of the Act. The principles are as:

- 1. Voluntary and open membership;**
- 2. Democratic member control;**
- 3. Member's economic participation;**
- 4. Autonomy and independence;**
- 5. Education and training and information;**
- 6. Co-operation among co-operative; and**
- 7. Concern for the community.**



INTENT OF THE MSCS ACT FOR ACCEPTANCE OF DEPOSITS OR CONTRIBUTIONS:

1. The preamble of MSCS Act defines the intent, objectives and scope of activities, which could/shall be carried out by the multi state co-operative societies, on its registration. Preamble is as given herein:

An Act to consolidate and amend the law relating to cooperative societies, with objects not confined to one State and serving the interests of members in more than one State, to facilitate the voluntary formation and democratic functioning of cooperatives as people's institutions based on self-help and mutual aid and to enable them to promote their economic and social betterment and to provide functional autonomy and for matters connected therewith or incidental thereto.

2. The preamble of Act explicitly defines the intent of the legislation, wherein multi state co-operative societies by its objectives are under obligation to serve the interest of members. MSCS Act further facilitates formation and democratic functioning of the co-operatives societies on the principles of self-help and mutual aid, and thus promote the economic and social interest of the members.

3. **The MSCS Act enables the multi state co-operative societies to base their activities having sole and exclusive intent to work in the interest of the members in more than one state including acceptance of deposits or contributions from the members and apply the same in serving the interest of members including extending loan facilities to the members.**
4. **Sec. 8 of MSCS Act provides that Certificate of Registration issued by Central Registrar signifies that society has complied with the conditions provided in Sec.7(1) of the Act and thus it has complied with applicable provisions of MSCS Act and rules made there under. Further Certificate of Registration is conclusive evidence of valid registration of a multi state co-operative society.**
5. **Sec. 9 of the MSCS Act provides that, on issuance of Certificate of Registration, a multi state co-operative society shall be permitted to carry out its activities as per the objectives specified in the approved Bye -Laws of the society.**

6. **Sec. 49 (2) (k) of MSCS Act, 2002 provides that a multi state co-operative society shall have power to raise funds for accomplishing its objectives.**
7. **Further Sec. 67 (1) of MSCS Act, 2002 enables a multi state co-operative society to receive deposits from the members, however such deposits shall not exceed 10 times of share capital and reserve.**
8. **Accordingly, a multi state co-operative society shall commence and carry out its activities in the social and economic welfare or betterment of the members, and, in order to accomplish those objectives, the society may raise funds by one or more methods including by accepting deposits and contributions from the members. Thus presently MSCS Act, 2002 does not place restriction on Multi State Co-operative Societies on acceptance of deposits or contributions from the members, except as provided above.**

METHODS OF RAISING FUNDS UNDER BYE LAWS OF THE SOCIETY:

The Bye Laws of the society may provide for raising of funds through various methods, such as:

- 1. Share Capital;**
- 2. Admission Fee;**
- 3. Deposits from Members under various schemes;**
- 4. Loans, credits and overdrafts from banks and financial Institutions;**
- 5. Donations, grants and subsidies; and**
- 6. Contribution from the Members etc.**



RIGHTS OF MULTI STATE CO-OPERATIVE SOCIETIES TO ACCEPT DEPOSITS OR CONTRIBUTIONS FROM THE MEMBERS:

- 1. The present legal position enables the multi state co-operative societies to accept deposits and contributions from the members strictly in compliance with the provisions of MSCS Act, 2002, rules made there under and bye-laws of the society.**
- 2. The deposits and contributions, so received, shall exclusively be applied/used in the interest and welfare of the members.**
- 3. A multi state co-operative society shall invest or deposit the funds of the society with/in co-operative banks, shares or securities of multi state co-operative society(s) or shares , securities or assets of subsidiary institutions or any bank. A multi state co-operative society is permitted to invest its fund as per Bye Laws of society, and, which may provide for investment in land, real estate, establishment of system for distribution of seeds, fertilizers or other useful purposes in the interest and benefits of the members.**

WHETHER ACCEPTANCE OF DEPOSITS OR CONTRIBUTIONS WOULD BE HELD AS BANKING ACTIVITIES?

Section 5(b) of Banking Regulation Act, 1949 provides as:

(b) *"banking" means the accepting, for the purpose of **lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or other wise.***

1. The definition of banking covers activities such as acceptance of **deposits from the public for the purpose of lending or investment** and to honor cheques, issue and accept drafts and other instruments, deal in foreign exchange and carry out other activities in the present banking scenario. Thus banking is NOT limited to the members only but banking companies carry out banking activities for general public and enable every person of the public to do banking with it.

Continues to next page..

2. Whereas Multi State Co-operative Societies can accept deposits or contributions from the members only. A person from the public can not directly deposit or contribute in society unless he is granted membership of the society. Further multi state co-operative societies do not involve in any kind of banking activities such as issuance of cheque(s) for withdrawal of amount, issue and acceptance of drafts and other instruments, dealing in foreign exchange or operating ATMs etc.
3. Merely because the co-operative societies, are required to advance loans to their members, the co-operative societies do not/will not cease to be co-operative societies and nor be governed by the banking regulation act, and, accordingly co-operative societies can not be treated as banking companies.¹
4. The objectives and intent of MSCS Act envisage the scope of activities for multi state co-operative societies including but not limited to acceptance of deposits and contributions from the members only. Accordingly activities of a multi state co-operative society as provided, are not banking activities nor can be designated as banking activities.

¹*V.S.S.S. Niyamitha v. State of Karnataka, (7997) 72 Com. Cas. 409 at pp. 474 Was*

IS MULTI STATE CO-OPERATIVE SOCIETY A BANKING COMPANY? -

1. Section 5(c) of Banking Regulation Act, 1949 provides as:

"banking company" means any company which transacts the business of banking in India.

Explanation.—Any company which is engaged in the manufacture of goods or carries on any trade and which accepts deposits of money from the public merely for the purpose of financing its business as such manufacturer or trader shall not be deemed to transact the business of banking within the meaning of this clause.

2. The word or expression banking company signifies that for carrying out banking activities, there must be a company and which is engaged in banking activities. Now the issue arises whether a multi state co-operative society is a company or not. Section 5(d) of Banking Regulation Act, 1949 provides that a banking company means a company under the provisions of the Companies Act. Hence a banking company must first be a "company" before being classified as Banking Company. **Therefore multi state co-operative society is not a "Company" under banking regulation act, and, consequently it can not be a "Banking Company".**

WHETHER MULTI STATE CO-OPERATIVE SOCIETIES ARE REQUIRED TO REGISTER OR OBTAIN LICENSE FROM THE RESERVE BANK OF INDIA?

- 1. Section 5 (c) of Banking Regulation Act, 1949 provides that Multi State Co-operative Societies are not the banking companies, hence such societies are not required to register or obtain any license from the Reserve Bank of India for carrying out its permitted activities among the members.**
- 2. Section 22 of Banking Regulation Act, 1949 provide that no banking company shall carry on banking business in India unless it holds a license issued by the Reserve Bank of India and subject of such other conditions as the Reserve Bank of India may impose. The Multi State Co-operative Societies are not banking companies under Section 5 (c) of Banking Regulation Act, 1949 nor carry out banking activities as defined under Section 5 (b) Banking Regulation Act, 1949.**



3. Central Registrar, (Department of Agriculture and Co- Operation) has clarified that a Multi State Co-operative Society may carry out its activities as per approved /registered bye –laws of the society. This authenticate that if bye laws of the society provide for raising of funds by way of acceptance of deposits or contributions from the members, and, if society does so, then it can not be deemed to be carrying out banking activities.
4. Further Central Registrar also clarified that a Multi State Co-operative Society doing credit business with its members shall be regulated under MSCS Act, 2002.
5. The role of the RBI in the regulation and supervision of co-operative societies is limited to those of "co-operative banks". The Co-operative societies do not accept deposits from the public (non-members), hence do not fall within the regulatory purview of RBI.
6. Additionally Central Registrar in a response to a RTI application conveyed that Multi State Co-operative Societies, carrying out credit business are **NOT REQUIRED TO REGISTER OR OBTAIN ANY LICENSE FROM THE RESERVE BANK OF INDIA.**

POSITION HELD BY HON'BLE SUPREME COURT:

1. Hon'ble Supreme Court in the Case of *Greater Bombay Co-Op. Bank Ltd Vs M/S United Yarn Tex. Pvt. Ltd. & Ors [Appeal (civil) 432 of 2004]* held that:

“Multi-State Co-Operative Societies registered under Multi State Co-operative Societies Act, 2002 are not banking companies under Section 5(C) of the Banking Regulation Act 1949 .

2. The similar position has been reiterated by Hon'ble Supreme Court in its interim order dated 27.5.2015, passed in the case of *“Vinayak Credit Co- Operative Society Ltd. Vs. State of Rajasthan & others”* (SLP to Appeal 9733/2015 and others).



3. HON'BLE SUPREME COURT IN ITS INTERIM ORDER DATED 27.5.2015 HELD/DIRECTED AS:

- i. Multi-State Co-operative Societies registered under MSCS Act, 2002 are not banking companies under Section 5(c) of the Banking Regulation Act 1949 and such Multi State Co-operative Societies cannot be granted registration and given license under Section 22 of Banking Regulation Act 1949 by RBI.**
- ii. Multi-State Co-operative Societies shall not engage in banking activities.**
- iii. Multi-State Co-operative Societies shall not accept any deposits from the non members i.e. public or from the nominal members.**
- iv. Multi-State Co-operative Societies shall not pay interest on fresh deposits exceeding the interest rate allowed by RBI to nationalized banks.**
- v. Hence, the acceptance of deposits from the members, other than nominal members, shall not fall within the ambit of banking activities and accordingly Multi-State Co-operative Societies are not /shall not be required to obtain registration or license from Reserve Bank of India.**

EMERGING ISSUES WITH ACTIVITIES OF MULTI-STATE CO-OPERATIVE SOCIETIES:

1. Hon'ble Rajasthan High Court in *Sajjan Singh Bhati v. State of Rajasthan & Ors. DB Civil Writ (PIL) Petition No. 26/2013* vide its order dated 14.5.2015 held /directed as:

- i. That Multi- State Co-operative Societies accepting deposits for the purpose of lending and investment, making repayment on demand and permitting withdrawal of deposits are engaged in banking activities and such activities shall fall within the definition of “banking” under section 5(b) of BR Act, 1949.
- ii. That word “*public*” in section 5(b) of BR Act, 1949 can not be restricted to general public but it will include all kinds of members as per bye laws of the society, so long the deposits are accepted without any restriction on the membership of the society.
- iii. That membership is granted to any person who makes deposit with the Multi- State Co-operative Societies i.e. deposit is sole criteria for grant of membership, so eventually there is no restriction for any member of public to become member of the society.
- iv. That Multi- State Co-operative Societies can not accept any kind of deposit under any scheme from public including members of any category without license from RBI under section 22 of BR Act, 1949. *Continues to next page*

- v. That even though order of Hon'ble Rajasthan High Court has been stayed by Hon'ble Supreme Court vide its interim order dated 27.5.2015 but following issues/aspects are likely to be examined by the Hon'ble Supreme Court in its final order:
- ❖ Whether present activities of acceptance of deposits from members including lending and investment are banking activity?
 - ❖ Whether enrollment of any person as member and transaction with him be deemed as dealing with public at large?
 - ❖ Where deposit is sole criteria for grant of membership to any person, will this activity be held is banking activity with general public?
 - ❖ May restrict the present mode of business activities and lay down guidelines for activities which can be carried out by multi-State cooperative societies without obtaining a license from Reserve Bank of India.
 - ❖ May lay down other measures to prevent misuse of provisions of multi-State cooperative societies enacted with noble intent to work on principles of self help and mutual aid for the welfare of the members.

ISSUES AND CHALLENGES FOR MULTI STATE CO-OPERATIVE SOCIETIES:

A. INITIATIVES BY CENTRAL REGISTRAR (GOVT.OF INDIA):

1. The States/UTs Registrars of co-operative societies have been authorized to conduct inspection u/s 108 of the MSCS Act. Inspections of various societies have been carried out and subsequently, on the basis of inspection reports, winding up orders have been issued against many societies.
2. For registration of a new multi-state cooperative credit society, the following documents have been made compulsory vide this Department Order dated 29.05.2013:
 - i. NOC from States/UTs Registrars of co-operative societies; and
 - ii. Verification certificate from the Registrar of Cooperative Societies of the State where Registered Office of the proposed society is to be located.
3. It has also been decided that primary multi-state cooperative societies shall be registered initially with only two contiguous States/UTs as its area of operations.

Continues to next page..

B. REPORT OF PARLIAMENTARY STANDING COMMITTEE ON FINANCE:

Parliamentary Standing Committee on Finance under Chairmanship of Dr. M. Veerappa Moily prepared a report under the title *"Efficacy of Regulation of Collective Investment Schemes, Chit Funds etc"* and submitted with Honble Speaker of Lok Sabha on 7.10.2015. The important issues/aspects noticed or recommended by committee are as:

1. Some bogus companies are running ponzi schemes and have transferred their funds and assets to multi-state co-operatives societies.
2. There have been abnormal increase in registration of multi-state credit co-operative and multipurpose societies in the country.
3. There have been several cases of un-authorized collection of money and deposits by fraudulently inducing public to invest in dubious schemes and promising unusually high returns or offering gifts in kind.
4. The menace of such illegal financial and marketing schemes has grown immensely in recent years.
5. There are diverse and disperse regulations for curbing un-authorized collection of money and deposits, thereby resulting in unchecked growth of these entities and recommended a central legislation and also suggested for setting up of an effective and accountable administrative machinery.

Continues to next page..

- 6. Government should promote financial literacy and awareness on a big scale by launching country wide campaign through different mediums.**
- 7. State Government machinery should be utilized to gather market intelligence about developing scams and mechanism should be developed to promptly disseminate the information to the investors/prospective investors.**
- 8. Dedicated desks should be set up for lodging the complaints by the aggrieved depositors.**
- 9. Deposit-linked Insurance for all the collective investment schemes should be ensured.**
- 10. An effective whistle blower mechanism should be developed for this purpose.**
- 11. New courts should be set in every state for trial of economic offences of this nature.**
- 12. The regulatory regime in respect of multi-state co-operatives societies should be streamlined and tightened, so that, they do not become an instrument of diverting and shielding illegal funds from ponzi companies.**

Continues to next page..

C. ENACTMENT OF LEGISLATION & OTHER MEASURES :

1. The Government of India (“GOI”) simultaneously also constituted a Inter Ministerial Group (“IMG”) on 30.12.2014 in order to find out the gaps/ shortcomings in present legislations and administrative machineries. The IMG recommend legislative as well as administrative measures to curb the menace of illegal and disguised deposit schemes being floated in the market to collect deposits from the public.
2. IMG noted that use of multi state co-operative societies in raising public deposits is weakest link in regulatory frame work of un-authorized deposit taking activities.
3. IMG examined various legislations and evaluated efficacy of present administrative machineries and accordingly recommended legislative and administrative measures to curb the menace of illegal deposit taking activities across country.
4. Accordingly **“Banning of Unregulated Deposit Schemes and Protection of Depositors Interest Bill 2015” (“Banning of Unregulated Deposit Schemes Bill 2015”)** has been drafted and expected to be placed in **Parliament during forthcoming session.**

Continues to next page..

D. IMPORTANT FEATURES OF BANNING OF UNREGULATED DEPOSIT SCHEMES BILL 2015 :

- 1. Definition of term “Deposit” is very wide covers receipt of money whether by advance, loan or in any other form except those exempted.**
- 2. The term “ Regulated Deposit Scheme” has provided very extensive definition and described in a separate schedule, and, if a scheme does not fall within ambit of Regulated Deposit Scheme, it will be deemed as Unregulated Deposit Scheme.**
- 3. Appointment of designated authority by State Governments and who shall not be below the rank of District Magistrate.**
- 4. Any wrongful inducement to any person to become member of Unregulated Deposit Scheme is prohibited and person contravening the provision shall be punishable with imprisonment for a minimum term of 1 year and which may extend to 5 years AND fine which may extend to Rs.10 lakh .**
- 5. Repeat offenders shall be punishable with imprisonment for a minimum term of 5 years and which may extend to 10 years AND fine which will not be less than Rs. 10 lakh, and, which may extend to Rs. 50 Crore.**

Continues to next page..

6. Establishment of designated courts to deal in any matter falling under the proposed legislation.
7. Powers have been delegated to the competent authority of the state to pass order for attachment of any property of establishment, its promoters and beneficiary(s).
8. The offences under the proposed legislation shall be cognizable and non-bailable.
9. Police will have power to enter the premises, search and seize documents without the warrant.
10. Appeal against the order of designated authority or special courts shall be filed before the High Court.
11. The proposed legislation shall amend various acts such as Reserve Bank of India Act 1934, SEBI Act, 1992 and Section 67 of Multi State Co-operative Societies Act, 2002.
12. The word “Receive Deposit” from Sec. 67(1) shall be omitted and an explanation shall be added as “ For avoidance of doubt, it is hereby declared that a Multi State Co-operative Society shall NOT be entitled to receive deposits from the members or external sources and further proviso shall also be amended.

CONCLUSION :

1. The GOI has announced in the Budget 2016-17 that it proposes to bring a stringent legislation to curb unregulated deposits and ponzi schemes in the country and we have strong view that legislation shall be enacted, after incorporation of convincing changes, as suggested by the public and other stakeholders.
2. Hon'ble Supreme Court may also pronounce final judgment on definition of banking activities and may also accept few of interim measures provided by Hon'ble High Court of Rajasthan in its interim order dated 18.3.2015 (As upheld by Hon'ble Supreme Court in its interim order dated 27.5.2015) .
3. Deposit schemes of Multi State Co-operative Societies floated with sole objective to mobilize deposits under the costume of members may not continue after enactment of the proposed law.
4. We suggest that Multi State Co-operative Societies should work inline with the objectives and intent of MSCS Act, 2002 and re-plan its business strategy to avoid any untoward situation.

THANKING YOU

RALLYMARK LEGAL

ADVOCATES & LEGAL CONSULTANTS

4th Floor, Premier Car Sales Building

(Opp. St. Francis College) Shahnajaf Road, Lucknow- 226001-India

E Mails: porwal_acs@yahoo.com, rupendra.porwal@gmail.com

M-+91 9838597775

Website: www.rallymarklegal.com

© 2016- RallyMark Legal (“RallyMark Legal”). All rights reserved

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. RallyMark Legal shall not be liable for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, advice should be sought from appropriate consultant.