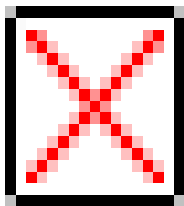


How safe are public deposits with press baron Ramoji Rao, HUF? Will MoF or RBI answer this question, please?

By K L Narasimham, FCA



"ONE cannot claim a fundamental right to carry on the business of financing with other people's money....." Supreme Court.

Recently, Congress MP, V. Arun Kumar let out a steam of accusations against the Andhra Pradesh Press Baron Ramoji Rao owned *Margadarsi Financiers*. The charges are *Margadarsi Financiers* owned by Ramoji Rao, HUF, collected over Rs 2,200 Crores from the Public and diverted that money into other group companies. This financial entity has accumulated a loss of Rs 1100 Crores. The MP's question is "who is responsible for such large sums of public money, and is collecting such huge sums from the public patently illegal?"

Nobody doubts Ramoji's integrity or capacity to pay and there has been no complaint. After all, the group runs the largest circulated Newspaper in Andhra Pradesh apart from 11 Popular TV channels. The group is also into film production and claims to have the largest Film Studio in the world. The group also runs three successful hotels and a Textile Show room - and is manufacturer of the famous Priya pickles.

Is *Margadarsi Financiers*

contravening any Law by accepting deposits from the Public? Their plea is that, being a HUF, they are outside the purview of the RBI Act.

The issue is of utmost importance and needs debate and immediate clarification from the Reserve Bank of India, as to whether HUF are indeed outside the purview of the provisions of Section 45-S of the RBI Act. The relevant provision of the RBI Act reads as follows:

45S. Deposits not to be accepted in certain cases

(1) No person, being an individual or a firm or an unincorporated association of individuals shall, accept any deposit-

(i) if his or its business wholly or partly includes any of the activities specified in clause (c) of section 45-I; or

(ii) if his or its principal business is that of receiving of deposits under any scheme or arrangement or in any other manner, or lending in any manner:

PROVIDED that nothing contained in this sub-section shall apply to the receipt of money by an individual by way of loan from any of his relatives or to the receipt of money by a firm by way of loan from the relative or relatives of any of the partners.

(2) Where any person referred to in sub-section (1) holds any deposit on the 1st day of April, 1997 which is not in accordance with sub-section (1), such deposit shall be repaid by that person immediately after such deposit becomes due for repayment or within three years from the date of such commencement, whichever is earlier :

PROVIDED that if the bank is satisfied on an application made by any person to the bank that such person is unable to pay a part of the deposits for reasons beyond his control or such repayment shall cause extreme hardship to him, it may, by an order in writing, extend such period by a period not exceeding one year subject to such conditions as may be specified in the order.

(3) On and from the 1st day of April, 1997, no person referred to in sub-section (1) shall issue or cause to be issued any advertisement in any form for soliciting deposit.

The words, "No person, being an Individual, Firm and unincorporated association of individuals..." are prohibited to accept deposits would naturally bar a HUF as well.

The role of Reserve Bank of India

It is the apex body empowered by the Government of India which controls, regulates and monitors the activities of Banks and Financial institutions dealing in finance, banking and related activities. The acceptance of deposits from Public by these entities is totally controlled and regulated by the RBI. The main stress is to safeguard the interests of the public in repayment of deposits and monitor interest structure etc.

Many people are still not aware of the fact that the fixed deposits accepted by even Banks are not secured and the

RBI guarantees repayment only to the extent of Rs.1.00 lakh per individual. Any amount in excess of this limit is totally unsecured and not guaranteed by RBI or even Central Government.

If that being the case, the deposits accepted by individuals, firms and or unincorporated association of individuals are absolutely risky investments and public should keep away from such investments.

Example of Global Trust Bank

In the interests of depositors, the RBI has forced the merger of the bank with Oriental Bank of Commerce. While shareholders got nothing, the interests of the Depositors is protected. How RBI or Government can protect the interests of public if such investments are made by unorganized sector, consisting of individuals, HUFs etc. Who will come to the rescue of the public if such individual or HUFs die suddenly?

Who will be made accountable for thousands of crores already collected as deposits?

Now it is rather strange on the part of the present Kartha of HUF, Mr Ramoji Rao to say openly that he is personally responsible for every paisa he borrowed. His statements are that he has made investments in group companies and that they are safe. What is the mode of investment in those companies, whether by way of share capital or in the form of loans? If those companies have invested these monies in the business, are they in a position to repay the same back to HUF at short notice? **Why is that his HUF is showing accumulated losses of over Rs.1100 Crores ?**

Normally investments are made by promoters in their group companies either in the form of unsecured loans or by way of contribution to the Share Capital. Here no details are given as to the type of investment made by the HUF in the so-called group companies.

If unsecured loans are given to companies, they should pay interest to HUF

and if the investment is in the form of Share Capital, then no income accrues to HUF other than dividend, provided the Companies are in profit.

Since the Kartha of HUF says that his HUF is not covered by the provisions of Section 45-S of the RBI Act, he is not accountable or answerable to anyone, including RBI.

His HUF is unique and he relies on some 'so-called' opinion of two retired Supreme Court Judges. Assuming that they opined in such a way, will that be binding on Reserve Bank or any other Court? Is RBI functioning on the opinions of retired judges or they have law of their own?

The words 'UNINCORPORATED ASSOCIATION OF INDIVIDUALS' has not been defined in the RBI Act. While we can infer who an 'INDIVIDUAL' is and what a 'FIRM' is, the general reading of 'UNINCORPORATED ASSOCIATION OF INDIVIDUALS' should include any association of persons, including HUFs. Even the Income Tax Act has not defined the term HUF anywhere in the Act or Rules. Only that the HUF is recognized as a separate entity for the purpose of levy and assessment of Income Tax. The expression HUF is defined only under the Hindu Law, which reads as follows :

This definition consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters. The relation of Hindu Undivided Family does not arise from a contract but arises from status.

The issue came up before the Supreme Court in the case of

BHAVESH D. PARIKH AND OTHERS Vs. UNION OF INDIA AND ANOTHER (AIR 2000 SC 2047)

The Supreme Court has discussed the issue at length and certain extracts of the case are reproduced below.

• The beginning is made by Reserve Bank of India by an amendment in the year 1963 by which a new Chapter III-B was inserted in the RBI Act incorporating Sections 45-H to 45-Q which contain provisions relating to Non-Banking Financial Institutions. In the Statement of Objects and Reasons it was provided that the existing enactments relating to Banks did not provide for any control over companies or institutions, which, although are not treated as banks, accept deposits from the general public or carry on other business which was allied to banking. For ensuring more effective supervision and management of the monetary and credit system by the RBI, it was observed that the RBI should be enabled to regulate the conditions on which deposits may be accepted by these non-banking companies or institutions.

• However, the provisions of the said Chapter III-B did not apply to individuals or firms like the appellants who are not incorporated but still do business which is akin to that of banking.

• In order to place some restrictions on the acceptance of deposits by individuals, Firms and unincorporated bodies, by the Banking Laws (Amendment) Act, 1983 (Act 1 of 1984), Chapter III-C and Section 58-B(5A) were inserted into the Act. The relevant portion of principal restrictions in Chapter III-C which were contained in Section 45-S read as under:

STATEMENTS FILED BY RBI BEFORE SUPREME COURT

The Reserve Bank of India has stated in its affidavit that the growing volume of deposits with unorganized financial sector affected the operation of monetary and credit policy to the extent that it involved a loss of control by the central monetary authority on the use of these funds. Further, the unincorporated bodies were susceptible to default as the costs of funds and returns could not be matched in a viable way leading to adverse selection i.e., *the funds being directed to risky illiquid investments.*

While the incorporated bodies viz Companies incorporated under the Companies Act, are subject to stringent regulatory controls, and since it is impossible to regulate unincorporated bodies, the Government has taken up the issue seriously and Chapter III-C was added to the RBI Act. Restrictions were placed on the maximum number of depositors. Even then the prohibition to accept the deposits was partial in the sense that unincorporated bodies were allowed to accept deposits from a limited number of depositors with no ceiling on the amount of deposit. The working of the provisions of Chapter III-C did not result in healthy development but there was a proliferation of such unincorporated bodies engaged in financial intermediation.

As stated in para 3 of the Statement of Objects and Reasons, the existing provisions were flouted by unscrupulous entities by floating different partnership firms when a firm reached the level of 250 depositors. This multiplication of firms took place with a view to circumvent the law.

The Reserve Bank also contended that under the guise of being flexible and convenient to its clients, the said unincorporated bodies tried to fool the gullible public. Unquestionably high interest rates were charged by such firms from the borrowers, but when the time came for the return of money borrowed by such firms, a number of such firms had folded up resulting in great loss to the depositors. The RBI, being a statutory expert body entrusted with monetary management, came to the conclusion that these unincorporated bodies which were functioning as financial intermediaries in an informal and unorganized manner be restrained from having access to deposits from public. The spread of formal financial agencies such as, commercial banks, development financial institutions and non-banking financial companies etc. had taken care of the need to mobilize the domestic savings of the nation and to deploy the same in a proper manner.

It was to rectify the imbalance where the non-corporate sector was virtually free from all disciplines even though its activities were same or similar to the corporate sector, the difference only in some cases, that first an Ordinance was issued which sought to completely prohibit any receipt of deposits by unincorporated associations in the non-corporate sector. When certain hardships were pointed out by those who did not carry on the business comparable to the companies which were under Chapter III-B i.e., who did not borrow money or receive advances to carry on business in the financial sector but borrow money for their own trade or manufacture, the Act, which replaced the ordinance, watered down the rigor to some extent.

Further, the impugned Section 45-S does not in any way prohibit or restrict any unincorporated body or individual from carrying on the business that it likes. It is open to unincorporated bodies to carry on their financial business either from their own funds or the funds borrowed from the relatives or from financial institutions. The restriction, which is placed by Section 45-S is on the carrying on of such business by utilizing public deposits.

Observations of the Court

The Supreme Court ruled that

• *The appellants cannot claim a fundamental right to carry on the business of financing with other people's money.*

• *An other words, there cannot be an unrestricted fundamental right to accept deposits from the public.*

• *The provisions in the nature of the amended Section 45-S are necessary and unincorporated bodies should do their business with their own money or institutional finance or money borrowed from relatives.*

• *The restrictions imposed against acceptance of deposits by unincorporated bodies carrying on financial activity or the business of deposit acceptance or lending in any manner are in the larger interest of general public vis-a-vis few persons accepting such deposits.*

• *The need for such restrictions had become acute and imperative in view of large scale mismanagement of public funds by such unincorporated bodies.*

CONCLUSION:

In a democracy, every citizen of this country has a right to raise his voice and caution the citizens of this country about the dangers to the society. The Government is more responsible where public safety is critical. When a cyclone is spotted, the entire Government machinery will be put on alert and every effort is taken to look after the safety of the people. Not only lives, even the money, property, health, education, employment and various other issues are the prime concern of the Government. No person or individual is worth the trust when it comes to financial dealings. Even the currency note is signed and guaranteed by the Governor of RBI. Let us all hope and pray that public money is safely protected.

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