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Long-Standing Issues in The Chit Fund Act, 1982: A Subscriber-Centric Perspective

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ABSTRACT

Chit funds are a vital financial instrument in India, particularly for low-income households often excluded from the formal financial system. Despite their historical significance and popularity, subscribers of chit funds face persistent issues that undermine their financial security and trust. The Chit Funds Act, 1982, designed to regulate the industry, falls short in areas such as subscriber protection, transparency, timely payouts, high commissions, dispute resolution, fraud prevention, and awareness. This article, explores these issues from a subscriber-centric perspective.

The article traces the historical evolution of chit funds, from traditional community savings schemes to modern commercial enterprises, highlighting regional variations and regulatory developments. It examines the pre-enactment period, the establishment of the Chit Funds Act, 1982, and its impacts. Key subscriber rights and duties under the Act are outlined to underscore the intended legislative protections.

A critical analysis reveals significant gaps in the Act leading to delayed payments, non-compliance by foremen, lack of subscriber awareness, ineffective dispute resolution mechanisms, financial mismanagement, and a lack of transparency. To address these issues, the article proposes strengthening regulatory oversight, enhancing subscriber education, streamlining dispute resolution, and implementing robust legal protections.

Specific amendments to the Act are suggested to expedite dispute resolution, impose penalties for non-payment, and ensure fair treatment of subscribers. Recommendations aim to improve protections, foster transparency, and enhance the overall credibility of the chit fund industry.

In conclusion, the article emphasizes the need for a comprehensive approach to reform the regulatory framework, safeguard subscriber rights, and ensure the sustainability of chit funds in India. By implementing these proposed solutions, the industry can better serve the financial needs of low-income households, maintaining trust and reliability in this traditional financial system.

Keywords: Chit-fund, Subscribers, Protection, Foreman.

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I. INTRODUCTION

A chit fund is a savings scheme practiced in India, alongside various other savings options provided by public and private sector banks, post offices, and insurance corporations. Chit funds are traditional financial institutions in India that serve the financial needs of low-income households often excluded from the formal financial system². The concept of chit funds has existed for over a thousand years, originally as informal associations of traders and households within communities, where members contributed money to receive an accumulated sum at the end of the term. Despite the long history and popularity of chit funds in India, subscribers face several challenges and issues that compromise their financial security and trust in the system. These problems stem from gaps and inadequacies in the Chit Funds Act of 1982, which, although designed to regulate the industry, falls short in several critical areas. Issues such as inadequate subscriber protection, lack of transparency, delays in payouts, high commissions, ineffective dispute resolution mechanisms, vulnerability to fraud, and limited awareness and education among subscribers are prevalent. Addressing these issues is crucial for ensuring that chit funds remain a reliable and secure financial instrument for low-income households and small investors in India. This article attempts to propose several solutions to these persistent problems of the subscribers.

II. PRE-ENACTMENT OF CHIT-FUND ACT

Legally, a "*chit*" refers to a transaction, known by various names such as chit fund, chitty, or kuri, where an individual enters into an agreement with a group of people. Each participant contributes a fixed sum of money (or grain in rural areas) in periodic installments over a specified period. Each member then takes turns, determined by lot, auction, tender, or other specified methods, to receive the prize amount³.

While traditional chit funds have been prevalent in South Indian villages for centuries, the concept of commercial chit funds is relatively recent. Ardener (1964) suggests that commercially organized chit-fund groups emerged in the early 20th century, mainly in Chennai (formerly Madras), and to some extent in Travancore and Cochin. Initially, these commercial chit funds were primarily utilized by businessmen to raise working capital and were quite rare even by the 1970s. Anderson (1962) notes that the first registered chit fund company in Hyderabad, the capital of Andhra Pradesh and another significant center for chit fund activity

² Dr. V N Santhisree, *A Study on the Role of Chit Funds as Multifacet Financial Companies in the State of Andhra Pradesh* (2020).

³ Abhimanyu Singh 'Chit Funds - Innovating the Lower Strata of Society..!!' Manupatra <https://articles.manupatra.com/article-details/Chit-Funds-Innovating-the-Lower-Strata-of-Society> accessed 28 July 2024

today, was established in 1951 as S.N. Chit Fund Co. Shriram Chits and Investments Pvt. Ltd., one of Chennai's oldest and most established companies, was founded in 1974. According to company founders, only a few commercial chit fund companies existed in Chennai before that time. The nationalization of the banking system marked the emergence of commercial chit funds in their current form, attracting thousands of borrowers and lenders across different income groups⁴.

In the early 1970s, following the collapse of major chit companies, the Government of India established a special committee to study chit funds, their implications, and their impact on the Indian economy⁵. Based on the committee's recommendations, the Parliament enacted 'The Chit Funds Act, 1982'. This institutionalization of chit funds through this Act provided several advantages: it made understanding various chit schemes easier for poor or illiterate individuals; allowed participation without needing to know other members, which diversified individual risks and was beneficial in urban areas with weaker social ties; It enhanced transparency in operations; regulated bidding sizes and commissions, encouraged competition among chit fund companies to improve their services; and offered legal recognition, enabling operators to expand their operations⁶.

III. HISTORICAL AND REGIONAL CONTEXT

The various studies traced the history of chit fund business from its ancient inception to its development in various states, particularly the South Indian states of Karnataka, Tamil Nadu, Andhra Pradesh, Telangana, and Maharashtra. These states had their own laws regulating chit fund business, which were in force for decades, catering to the savings needs of poor and middle-class individuals. However, instances of misappropriation and misuse of public money by some companies were noted, resulting in pecuniary losses to poor investors. Recognizing the importance of protecting subscribers' interests, who are often from below-poverty or middle-class backgrounds, the government conducted detailed studies comparing chit funds with the banking sector and small-scale money investments.

ROSCA: Chit funds are similar to the Rotating Savings and Credit Associations (ROSCA) found worldwide, which allow individuals to save and borrow simultaneously. They are considered effective financial tools for the poor, enabling them to turn small savings into lump sums. Historically, participation in chit funds was primarily for purchasing property or

⁴ Jan Eeckhout and Kaivan Munshi, 'Matching in Informal Financial Institutions' (2010) 8(5) *Journal of the European Economic Association* 947.

⁵ Report of the James S. Raj Committee on Chit Funds (Government of India, 1974).

⁶ *Ibid.*

consumption purposes. However, there have been significant changes in the structure and operation of chit funds in recent times⁷. However in India, There are three types of chit funds. *First*, chit funds run by state governments and public sector undertakings (PSUs), which are managed and regulated by the state, ensuring safety, limited risk, and transparent business processes. *Second*, private registered chit funds, established under the Chit Funds Act of 1982 by prominent financial institutions or business houses. While not as secure as government-run funds, they offer a calculated and manageable risk under reputable private management. *Third*, unregistered chit funds, which operate illegally and involve higher risk, as they rely solely on the integrity and honesty of a close-knit group of participants and should be avoided⁸.

Current Regulations: Currently, chit funds are regulated by the Chit Funds Act of 1962, the Reserve Bank of India (RBI) Act of 1934, and the Securities and Exchange Board of India (SEBI) Act of 1992, among others⁹. The Chit Funds Act of 1962 mandates that businesses can be registered and regulated only by the respective state governments. The Registrar of Chits, appointed by the state governments under Section 61 of the Chit Funds Act, serves as the regulator for chit funds¹⁰. The RBI includes chit funds within the definition of Non-Banking Financial Companies (NBFCs) under the sub-category Miscellaneous Non-Banking Company (MNBC). However, the RBI has not established a distinct regulatory framework specifically for chit funds¹¹.

IV. SUBSCRIBER RIGHTS UNDER THE CHIT FUNDS ACT: A SIMPLIFIED OVERVIEW

It is important to briefly understand the rights of subscribers under the Chit Funds Act. A clear understanding of these rights is essential for subscribers to protect themselves against potential malpractices and to ensure they can fully benefit from their participation in chit funds.

(A) Rights and Duties of Non-Prized Subscribers¹²:

- **Subscription Payments:** Non-prized subscribers must pay their subscriptions on the specified dates and locations as outlined in the chit agreement and are entitled to receipts upon payment¹³.
- **Default and Removal:** If a non-prized subscriber defaults on payments, their name can

⁷ Timothy Besley, Stephen Coate and Glenn Loury, 'The Economics of Rotating Savings and Credit Associations' (1993) 83(4) *The American Economic Review* 792 <http://www.jstor.org/stable/2117> accessed 28 July 2024

⁸ Sneha Banerjee, 'Chit Funds: A Socio-Economic Analysis' (2019) 7(3) *Journal of Social Sciences* 112.

⁹ *Ibid.*

¹⁰ Chit Funds Act 1962, s 61.

¹¹ Reserve Bank of India, 'Master Circular - Miscellaneous Non-Banking Companies (MNBCs) Directions, 2016' (2016).

¹² Chit Funds Act 1982, Ch IV.

¹³ Chit Funds Act 1982, s 27.

be removed from the list of subscribers. They will receive a written notice within fourteen days. If they pay the defaulted amount with interest within seven days of receiving the notice, their name will be reinstated. This removal and reinstatement process must be recorded and reported to the Registrar¹⁴.

- **Amounts Due to Defaulting Subscribers:** The foreman must deposit the contributions of defaulting subscribers into a separate account. This amount can only be withdrawn for payment to the defaulting subscriber. If the defaulting subscriber is not replaced, their contributions must be paid to them within fifteen days of the chit's termination¹⁵.

(B) Rights and Duties of Prized Subscribers¹⁶:

- **Security Requirement:** Prized subscribers must provide sufficient security for the payment of future subscriptions unless they opt to deduct future subscriptions from their prize amount. The foreman, if a prized subscriber, must also provide security¹⁷.
- **Regular Payments:** Prized subscribers must pay their subscriptions regularly as per the chit agreement. Failure to do so results in a liability for consolidated future payments¹⁸.
- **Foreman's Demand for Future Subscriptions:** The foreman must issue a written notice to demand consolidated payments from defaulting prized subscribers. If the subscriber settles the arrears and associated costs before the dispute hearing, the Registrar may order them to continue payments as due, with the foreman entitled to recover future subscriptions through execution if defaults occur. Payments must be deposited in an approved bank and cannot be withdrawn except for future subscription payments¹⁹.
- **Security for Consolidated Payments:** If property is offered as security instead of consolidated payments, it must remain as security for future subscription payments²⁰.

(C) Key Problems Faced by Subscribers under the Chit Funds Act, 1982

1. Delayed Payments:

- Subscribers often face significant delays in receiving their prize amounts, causing financial distress and eroding trust in the system.

¹⁴ Chit Funds Act 1982, s 28.

¹⁵ Chit Funds Act 1982, s 30

¹⁶ Chit Funds Act 1982, Ch V

¹⁷ Chit Funds Act 1982, s 31.

¹⁸ Chit Funds Act 1982, s 32.

¹⁹ Chit Funds Act 1982, s 33.

²⁰ Chit Funds Act 1982, s 32.

2. Non-Compliance by Foremen:

- Foremen frequently fail to adhere to statutory provisions, such as timely disbursement of prize amounts and maintaining accurate records.

3. Lack of Awareness:

- Many subscribers are unaware of their rights under the Chit Funds Act, 1982, and the legal recourse available to them, preventing timely redressal of grievances.

4. Ineffective Dispute Resolution Mechanisms:

- The arbitration and Registrar's processes are often slow, perceived as biased, and fail to provide timely resolutions.

5. Financial Mismanagement and Fraud:

- Instances of financial mismanagement and fraudulent practices by foremen undermine the financial security of subscribers.

6. Lack of Transparency:

- Subscribers struggle with accessing accurate and timely information about chit-fund operations, hindering their ability to make informed decisions.

Hence, subscribers under the Chit Funds Act, 1982, encounter several key issues that impact their financial security and trust in the system. Firstly, significant delays in receiving prize amounts cause considerable financial distress and undermine confidence in the chit-fund mechanism. Additionally, foremen frequently fail to adhere to statutory provisions, such as timely prize payment disbursement and accurate records²¹. A lack of awareness among many subscribers regarding their rights and available legal recourse further exacerbates the situation, preventing timely redressal of grievances. The dispute resolution mechanisms, including arbitration and processes handled by the Registrar, are often slow, perceived as biased, and fail to provide timely resolutions²². Instances of financial mismanagement and fraudulent practices by foremen further undermine subscribers' financial security. Moreover, a lack of transparency in chit fund operations hinders subscribers' ability to make informed decisions, as they struggle to access accurate and timely information²³.

²¹ Dr. Vini Infanta, 'Perceptions of Households and Their Level of Satisfaction Towards Chit Funds', JETIR June 2019, Volume 6, Issue 6, 412.

²² Ibid.

²³ *Sriram Chits and Investment Pvt. Ltd., Vs. Union of India* (1993) AIR 1993 SC2063

V. WAY FORWARD: SOLUTIONS AND RECOMMENDATIONS

To address these issues, several solutions and recommendations can be implemented. Strengthening regulatory oversight through regular audits and inspections can ensure compliance with statutory provisions and identify issues early. Enhanced monitoring systems can track the financial health of chit funds, detecting potential problems at an early stage. Improving subscriber awareness through educational campaigns and training programs can inform subscribers about their rights, financial management, and dispute resolution procedures²⁴.

Streamlining dispute resolution mechanisms by establishing fast-track arbitration processes with strict timelines can expedite dispute resolution. Transparent procedures, with clear guidelines and regular updates to subscribers, are essential. Enhancing legal protections by implementing robust penalties for non-compliance and introducing whistleblower protections can deter fraudulent activities and encourage reporting without fear of retaliation.

Facilitating access to legal resources by providing legal aid services, including pro bono legal representation, and making information about legal rights and dispute resolution procedures easily accessible through user-friendly platforms like mobile apps and online portals is crucial. Establishing independent consumer protection bodies, similar to those in the UK and Australia, can offer impartial dispute resolution and compensation schemes. Proactive regulatory approaches can prevent non-compliance and fraud, ensuring regular monitoring and safeguarding subscribers' interests.

(A) Amendment Proposals: Solutions for Unpaid Prized Subscribers:

Amending Section 64 to introduce a timeframe for resolving claims, specifically addressing disputes related to the sufficiency of security furnished by the prized subscriber, can ensure swift resolution of claims. Introducing penalties under Section 76 for foremen who intentionally evade paying the net chit amount to prized subscribers can hold foremen accountable and deter arbitrary actions. Clarifying foremen's duties under Section 22 to explicitly cover their responsibility to act fairly in determining the sufficiency of security can prevent arbitrary decisions that harm subscribers²⁵.

²⁴ Subhomoy Bhattacharjee, 'When chit funds are legit, and how cheats thrive on concept' (The Indian Express, 29 April 2013) <https://indianexpress.com/article/news-archive/web/when-chit-funds-are-legit-and-how-cheats-thrive-on-concept/> accessed on 18 March 2024 at 7:39AM.

²⁵ CH Venkatachalam, 'Public Sector Banking and the Unmet Expectations of Rural India' (The Hindu Centre for Politics and Public Policy, 22 December 2017)

(B) Solutions for Non-Prized (Defaulting) Subscribers

Amending Section 30 to mandate that the foreman directly pays the collected amounts from the substituted subscriber to the defaulting non-prized subscriber immediately can ensure timely access to funds. Incorporating interest on deposits for defaulting non-prized subscribers can address the unfair burden of interest payments. Clearly defining permissible deductions under Section 30 can prevent arbitrary and excessive deductions by the foreman, ensuring fair amounts for defaulting subscribers²⁶.

(C) General Solutions to Improve Subscriber Protections

Appointing specialized officers solely responsible for chit-fund regulation and administration can ensure adequate attention and effective enforcement of the Chit Funds Act, 1982. Providing comprehensive training and resources to auditors and inspectors can enable effective monitoring and identification of lapses in chit-fund operations. Establishing an independent body to handle disputes and grievances of chit-fund subscribers can ensure impartial and prompt resolution. Implementing robust whistleblower protections can encourage the reporting of fraudulent activities without fear of retaliation. Conducting regular and thorough audits of chit-fund operations, with findings made transparent and accessible to subscribers, can build trust and ensure compliance.

VI. CONCLUSION

The challenges faced by subscribers under the Chit Funds Act, 1982, highlight the urgent need for reform and enhanced protections. Subscribers encounter issues such as delayed payments, non-compliance by foremen, and lack of awareness, ineffective dispute resolution mechanisms, financial mismanagement, and lack of transparency. These problems not only cause financial distress but also erode trust in the chit fund system. To address these challenges, a multi-faceted approach is essential. Strengthening regulatory oversight, improving subscriber awareness, streamlining dispute resolution mechanisms, enhancing legal protections, facilitating access to legal resources, and establishing independent consumer protection bodies are critical steps forward. Amendments to the Act, such as introducing timeframes for dispute resolution, imposing penalties for non-payment, clarifying foremen's duties, and ensuring fair treatment of defaulting subscribers, can significantly improve the situation. By implementing these solutions and recommendations, the regulatory framework can be strengthened, ensuring the protection of subscriber rights and fostering a more transparent, fair, and trustworthy chit-fund system.

²⁶ K J S Satyasai anad Abhishek Tiwari, 'Rural Credit: Can we make it more inclusive?' *NABARD* Mumbai, 23rd Annual Conference, 24-28 February 2021, pp 143-160

This holistic approach will not only safeguard the financial interests of subscribers but also enhance the overall credibility and sustainability of the chit fund industry in India.
