REGULATING THE UNREGULATED: A CRITICAL ANALYSIS OF THE PROPOSED BANNING OF UNREGULATED LENDING ACTIVITIES BILL IN INDIA

by

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1. Introduction: The Regulatory Vacuum and the Legislative Response

The architectural stability of India's retail credit ecosystem has been profoundly disrupted by the intersection of smartphone ubiquity, data-driven underwriting, and regulatory arbitrage. While traditional credit delivery mechanisms—ranging from scheduled commercial banks to non-banking financial companies (NBFCs)—operate within a highly codified, risk-averse supervisory matrix managed by the Reserve Bank of India (RBI), an expansive, shadow parallel economy has flourished. This shadow network comprises unregulated entities that leverage digital infrastructure to extend credit outside the perimeter of prudential oversight[1]. The proposed Banning of Unregulated Lending Activities (BULA) Bill represents the state's ultimate legislative counter-offensive. It aims to establish an absolute statutory prohibition on any credit-extending activity that lacks the explicit imprimatur of an official regulator. However, by choosing a sweeping prohibitory mechanism rather than a nuanced regulatory or licensing framework, the draft bill risks colliding with fundamental constitutional guarantees, disrupting federal legislative competence, and aggravating the very socio-economic vulnerabilities it seeks to cure.

The BULA Bill remains, at the time of writing, in draft form. The Department of Financial Services released it for stakeholder comment on 13 December 2024 and kept the initial comment window open until 13 February 2025, and it has not yet been formally introduced as a Bill in Parliament.[2] This procedural posture matters for the analysis that follows: because the text remains open to revision before formal introduction, the constitutional and federal vulnerabilities identified in this paper are not academic post-mortems on a settled statute but live drafting choices that Parliament retains a genuine opportunity to correct.

1.1 Predatory Unregulated Lending in India: Scale, Documented Harm, and the Digital Acceleration

The historical archetype of the informal Indian moneylender, the rural *sahukar* or *mahajan* operating via physical ledgers and localized social coercion, has undergone a radical digital transformation. The contemporary crisis of unregulated lending is fundamentally an algorithmic one. Over the past decade, and accelerated exponentially by the macroeconomic shocks of the COVID-19 pandemic, hundreds of unauthorized digital lending applications (DLAs) migrated into the mainstream digital commerce ecosystem. These platforms utilize frictionless, instant-access credit architectures that bypass traditional, document-heavy credit assessment protocols. By relying on alternative data

[1] Department of Financial Services., Ministry of Finance, Govt. of India, *Draft Banning of Unregulated Lending Activities Bill, 2024* (Dec. 13, 2024) [hereinafter "Draft BULA Bill"]

[2] Ministry of Finance, Department of Financial Services, *Draft Banning of Unregulated Lending Activities Bill* (13 December 2024); Aarambh Legal, *The Banning of Unregulated Lending Activities Bill, 2024* (7 March 2025) (noting the 13 February 2025 deadline for stakeholder comments)

harvesting, requiring users to grant comprehensive access to smartphone telemetry, including contacts, geographic location data, personal galleries, and SMS logs, these apps construct deeply invasive risk profiles.[3]
The scale of this predatory ecosystem is vast. Investigations by enforcement agencies and market intelligence reports thousands of illicit DLAs operational at any given time, frequently masking their corporate identities through complex layers of shell companies and unregulated fintech intermediaries. The structural harm inflicted by these entities is dual-pronged: macroeconomic and deeply personal.

The RBI's own Working Group substantiated this scale of the shadow lending economy with concrete figures. Of the approximately 1,100 lending applications available on major app stores at the time of its study, the Working Group found that roughly 600 were operating without any regulatory sanction whatsoever, most of them offering short-tenure, high-cost micro-credit.[4] Complaints against these platforms, routed through the RBI's dedicated Sachet grievance portal, numbered 2,562 between January 2020 and March 2021 alone, a period that closely tracks the pandemic-driven surge in demand for instant, document-light credit described above.

At the retail level, the business model relies on usurious pricing structures, with effective annual percentage rates (APRs) regularly exceeding 100% to 300%, supplemented by opaque processing fees and immediate interest deductions at the point of disbursement. Because these entities operate beyond the reporting mandates of credit information companies, they actively encourage systemic over-indebtedness among economically fragile cohorts who lack access to formalized banking rails.
The crisis is further compounded by predatory recovery tactics. When borrowers inevitably default due to compound usury, operators deploy automated and human-led harassment campaigns. By weaponizing the personal data harvested during onboarding, collectors engage in “shame-mongering”, morphing personal photographs, sending defamatory messages to the borrower’s entire contact list, and utilizing relentless psychological coercion. This systemic abuse has led to well-documented clusters of suicides and profound mental health crises across several states, transforming a peripheral financial infraction into an urgent national public safety emergency that standard consumer protection guidelines have failed to arrest.

The limits of existing enforcement machinery in the face of this crisis are illustrated by the Enforcement Directorate's investigation into the “Kudos Finance” network, in which a company with a declared net owned fund of barely ₹10 crore was found to have disbursed loans worth over ₹2,224 crore in partnership with several dozen unlicensed fintech applications, funds that were routed through arrangements designed to frustrate tracing under the Prevention of Money Laundering Act, 2002. The documented human cost of this ecosystem is not abstract: the death by suicide, in November 2020, of a Mumbai-based television writer following sustained harassment by loan-recovery agents who had accessed his personal contact list is one of several such cases that prompted the RBI to expedite its Working Group's mandate.[5] These episodes demonstrate that existing anti-money-

[3] Reserve Bank of India, *Report of the Working Group on Digital Lending Including Lending Through Online Platforms and Mobile Apps* ch. III, para 3.2, (Nov. 18, 2021) [hereinafter “RBI Digital Lending Report”]
[4] Reserve Bank of India, *Report of the Working Group on Digital Lending including Lending through Online Platforms and Mobile Apps* (18 November 2021) ch III; *RBI Spots 600 Illegal Lending Apps Out Of 1,100 Available* (Inc42, 22 November 2021)
[5] *'ED Summons Senior Google Executives On Probe Into App-Based Micro-Lending Fraud'* (Inc42, 6 April 2022)

laundering and consumer-protection statutes, which operate only after the fact and depend on protracted investigation, have proved structurally incapable of pre-empting harm at the scale the digital lending crisis demands, a gap that lends real weight to the case for a dedicated, ex-ante statutory bar of the kind BULA proposes, even as the drafting problems identified later in this paper remain.

1.2 The BULA Bill: Provenance, Scope, and Structure in Brief

The BULA Bill emerges as a direct central institutional response to this regulatory deficit. Designed as an omnibus, zero-tolerance statutory framework, the bill abandons the incrementalist approach of issuing localized circulars or technological app-store bans. Instead, its architectural premise mirrors a penal prohibition: it seeks to declare the very act of engaging in an "unregulated lending activity" an absolute, strict liability criminal offense.[6]

The structural scope of the bill is sweeping. It is designed to act as a dragnet, capturing every imaginable iteration of credit extension that does not possess an active registration under a law listed in its First Schedule. Under Clause 2(18), "Unregulated lending activities" are defined explicitly as any lending activities not covered under regulated lending.[7]

By criminalizing both the operation and the promotion of unregulated credit channels, the legislation attempts to cut off the supply-side dynamics of predatory lending at the root.

2. Legislative Genealogy and the Lessons of the BUDS Precedent

The BULA Bill does not exist in a vacuum; it represents the culmination of a specific legislative lineage that has consistently favoured absolute prohibition over structural formalization when dealing with shadow financial markets. Tracing this genealogy is essential to understanding the drafting choices that inform the current bill and identifying the structural flaws inherited from its legislative precursors.

2.1 The RBI Working Group Report (November 2021): What Was Recommended and Why

The immediate policy anchor for comprehensive legislative intervention was established by the *Report of the Working Group on Digital Lending, including Lending through Online Platforms and Mobile Apps*, constituted by the RBI in January 2021 and published in November of that year. The Working Group was tasked with mapping the unregulated digital credit terrain and devising a defensible regulatory perimeter.

The report made a foundational analytical distinction between two categories of market participants:

1. Regulated Entities (REs) such as commercial banks and registered NBFCs utilize digital front-ends.

[6] Draft BULA Bill, 2024, Preamble

[7] Id. Clause 2(18) read with Clause 3

2. Unregulated entities, including pure-play fintech platforms, third-party loan service providers (LSPs), and wholly unauthorized digital entities operating outside any legal framework.[8]

The Working Group noted that the regulatory vacuum persisted because the RBI's traditional statutory powers under the Reserve Bank of India Act, 1934, and the Banking Regulation Act, 1949, are structurally tethered to *entities* it licenses, rather than the broad *activity* of lending when conducted by non-banking corporate or individual actors. To resolve this, the Working Group recommended a multi-layered strategy. It urged that the state set up a dedicated legislative framework, a "Digital Lending Compliance Act", to specifically target illegal lending. Crucially, however, the report did not envision a blunt, undifferentiated criminal ban on all unlisted credit. Instead, it advocated for a combination of technological gatekeeping (such as verifying apps through a nodal agency), the establishment of a sector-specific Self-Regulatory Organisation (SRO) for the fintech market, and the deployment of targeted technological compliance standards as an entry barrier.[9] The policy intent was clear: protect consumers through active market governance while keeping the digital financial ecosystem open to responsible innovation. The proposed BULA Bill, however, extracts the Working Group's emphasis on strict enforcement but completely discards its nuanced appreciation for market formalization, opting instead for a singular, prohibitory hammer that criminalizes the absence of compliance rather than the presence of predatory behavior.

2.2 The BUDS Act 2019 as Drafting Precedent: Applied and Abandoned

In designing the architecture of absolute prohibition, the drafters of the BULA Bill heavily relied on the legislative blueprint of the *Banning of Unregulated Deposit Schemes (BUDS) Act, 2019*. The BUDS Act was enacted to dismantle illicit Ponzi schemes, unauthorized chit funds, and multi-level marketing scams that had exploited structural gaps between state-level protection of depositors' laws and central regulations. The BUDS Act achieved this by employing a radical drafting technique: it defined "Deposit" exhaustively, declared any deposit scheme *not* expressly registered with a recognized regulator as an "Unregulated Deposit Scheme" under Section 2(17), and placed a blanket statutory ban on their operation under Section 3. This "residual framing" reversed the traditional burden of legality, everything not explicitly permitted was criminalized.[10]

This drafting technique had already attracted legislative scrutiny when it was first used. When Parliament's Standing Committee on Finance, chaired by Dr M. Veerappa Moily, examined the predecessor Unregulated Deposit Schemes Bill, 2018, it specifically flagged that leaving the term "unregulated deposit scheme" to residual, catch-all interpretation would permit open-ended and potentially arbitrary determinations by enforcement authorities, and it recommended that the category instead be defined more precisely and listed indicatively in a schedule.[11] That recommendation was not incorporated into the BUDS Act, 2019 as finally enacted, and the same unresolved definitional weakness identified by the Committee has now been carried forward, largely unexamined, into the BULA Bill's own residual formula.

[8] RBI Digital Lending Report, Chapter V, 5.1

[9] Id. ch. IV, para 4.4, (emphasizing technological gatekeeping, verification frameworks, and the establishment of a sector-specific Self-Regulatory Organisation rather than undifferentiated penal prohibition)

[10] The Banning of Unregulated Deposit Schemes Act, No. 21 of 2019, India Code (2019) [hereinafter "BUDS Act"]

[11] Standing Committee on Finance (2018–19), Sixteenth Lok Sabha, cited in Varsha Banta (n 38)

The BULA Bill transplants this exact structural DNA. It adopts the BUDS model of establishing a central, negative prohibition supported by state-level "Competent Authorities" and designated special courts. However, the legal and economic realities of *deposits* and *lending* are fundamentally asymmetrical, making this legislative transplant highly problematic:[12]

- **Asymmetry of Risk:** The BUDS Act protects public savings from fraudulent conversion where the public stands as the *creditor* and the scammer is the *debtor*. In contrast, in unregulated lending, the platform or individual is the *creditor* risking its own capital, while the consumer is the *debtor*.
- **The Problem of Reversal:** When an unregulated deposit scheme collapses, public wealth vanishes. When an unregulated lender operates, wealth is pushed into the market. While the *tactics* of recovery are predatory, the economic transaction itself is an extension of liquidity, not asset extraction.

By blindly copying the BUDS drafting precedent, the BULA Bill treats the provision of credit as an inherent public fraud equivalent to a Ponzi scheme. In doing so, it abandons the critical distinction between protecting consumer deposits and regulating credit availability, setting up a head-on collision with constitutional protections and the realities of financial exclusion.

3. The Definitional Problem: Residual Framing, Constitutional Vagueness, and the Right to Trade

The constitutional validity of any penal statute hinges upon the clarity of its prohibitory perimeter. In criminal jurisprudence, a citizen cannot be subjected to deprivation of liberty or property under a law whose boundaries are shifting, ambiguous, or defined by mere omission. The draft Banning of Unregulated Lending Activities (BULA) Bill introduces a foundational architectural vulnerability by employing a "residual framing" technique to identify its subject matter. Rather than codifying what constitutes an illicit, predatory, or usurious lending practice, the bill criminalizes all credit extensions that do not possess an active regulatory registration. This negative drafting approach creates severe doctrine-level conflicts with the Constitution of India, specifically regarding the due process protections of Article 21 and the freedom to practice a trade or profession under Article 19(1)(g).

3.1 How the Bill Constitutes "Unregulated Lending Activity" Through Absence

The BULA Bill structures its primary offense by defining "Unregulated Lending Activity" as any business of extending credit, advances, or loans that is not explicitly registered, licensed, or exempted under a designated list of recognized federal or state regulatory regimes. This mechanism replicates Section 2(17) of the Banning of Unregulated Deposit Schemes (BUDS) Act, 2019.[13] Under this drafting framework, legality is not determined by the conduct of the actor or the fairness of the contract, but by the presence of a statutory safe harbor.

If an individual or an informal cooperative extends a short-term, interest-free, or low-interest advance to a peer, and that specific transaction category is not formally enumerated within the schedule of "Regulated Lending Activities," the transaction technically falls into the residual bucket of an "Unregulated Lending Activity." By defining the offense through

[12] Compare BUDS Act,2019 with Draft BULA Bill, 2024, Clause 7

[13] BUDS Act, 2019

a vacuum, meaning an activity is criminalized simply because no regulator has written a rule to govern it, the statute shifts the burden of structural mapping onto citizens, creating an overbroad dragnet that fails to distinguish between predatory fintech corporations and harmless, community-level informal credit.

3.2 The Void-for-Vagueness Doctrine and Its Application to the BULA Bill's Definition

A statute that either forbids or requires the doing of an act in terms so vague that individuals of common intelligence must necessarily guess at its meaning and differ as to its application violates the first essential of due process. In Indian constitutional law, this principle has been firmly read into the guarantee of life and personal liberty under Article 21. In *Shreya Singhal v. Union of India*, the Supreme Court struck down Section 66A of the Information Technology Act, 2000, holding that where no reasonable standards are laid down to define an offense, the law is void for vagueness.[14] The Court observed that a penal law is unconstitutionally vague if it fails to give fair notice to the citizen of what is prohibited, and fails to provide clear guidelines to prevent arbitrary or discriminatory enforcement by executive agencies.

The BULA Bill's residual definition directly triggers this void-for-vagueness vulnerability. Because the definition of the offense changes depending on what other regulators (such as the RBI or state cooperative departments) choose to actively regulate or exempt from time to time, the internal core of the criminal offense is structurally unstable. A citizen cannot definitively know whether a private, non-commercial loan extended to a family member, a tenant, or an employee constitutes a punishable offense. The lack of clear boundaries leaves the enforcement of the act completely to the discretion of the "Competent Authority," opening the door to the exact kind of arbitrary policing that the Supreme Court condemned in *State of Madhya Pradesh v. Baldeo Prasad*.[15]

3.3 Blanket Prohibition and Article 19(1)(g): The Proportionality Challenge

The right to engage in the business of moneylending or financial intermediation is a protected economic liberty under Article 19(1)(g) of the Constitution, subject only to "reasonable restrictions" enacted in the interest of the general public under Article 19(6).[16] To pass constitutional muster under Article 19(6), a restrictive measure must satisfy the four-pronged test of proportionality as codified by the Constitution Bench in *Modern Dental College & Research Centre v. State of Madhya Pradesh*[17] and applied strictly to economic regulations in *Internet and Mobile Association of India v. Reserve Bank of India*.[18] The proportionality standard requires that:

1. The measure must designate a legitimate state purpose;
2. It must be rationally connected to the fulfilment of that purpose;
3. It must be the least restrictive means available (necessity); and
4. There must be a proper balance between the social benefit and the infringement of rights.

[14] Shreya Singhal v. Union of India, (2015) 5 SCC 1
[15] State of Madhya Pradesh v. Baldeo Prasad, AIR 1961 SC 293
[16] IND. CONST. art. 19, cl. 1(g), amended by The Constitution (First Amendment) Act, 1951
[17] Modern Dental College & Research Centre v. State of Madhya Pradesh, (2016) 7 SCC 353
[18] Internet and Mobile Association of India v. Reserve Bank of India, (2020) 10 SCC 1

While the prevention of predatory digital lending and extortionate recovery is undeniably a legitimate state purpose, the deployment of a blanket, absolute *prohibition* fails the third and fourth prongs of this test. In *Internet and Mobile Association of India*, the Supreme Court struck down the RBI's circular, effectively banning crypto-assets, because the regulator failed to show that less restrictive interventions, such as licensing, setting caps on interest, or regulating recovery practices, were considered and found unworkable.[19]

By choosing to ban all unlisted lending rather than regulating the *terms* of lending (such as capping APRs or outlawing data-harvesting practices), the BULA Bill represents a disproportionate response. It destroys legitimate informal credit networks along with the predatory ones, failing to balance consumer protection with economic freedom.

3.4 The Positive Schedule Solution: Drafting a Constitutionally Defensible Definition

To remedy this constitutional vulnerability, the bill's drafting architecture must be inverted from a negative residual framework to a positive schedule system. A constitutionally defensible model requires the legislature to explicitly codify a "Positive Schedule of Illicit Lending Conduct."

Under this approach, lending activity would not be criminalized based on its registration status alone. Instead, the penal provisions of the Act would apply only when an entity engages in specific, defined predatory behaviors. These explicit triggers should include:

- The deployment of non-consensual smartphone data-harvesting mechanisms as a condition for credit;
- The use of defamatory or coercive third-party recovery practices; or
- The ex-ante structuring of interest rates that exceed a legally specified ceiling linked to the RBI's benchmark repo rate.

By shifting from a negative definition ("anything not regulated is banned") to a positive, behavioral definition ("lending accompanied by specific predatory traits is banned"), the statute provides fair notice to citizens, prevents executive overreach, and easily survives judicial review under Articles 19(1)(g) and 21.

4. The Federal Competence Problem: Centre–State Collision in the Lending Regulatory Space

India's constitutional architecture distributes legislative authority between the Parliament and State Legislatures through the three lists of the Seventh Schedule. When the Central Parliament enacts an omnibus statute like the BULA Bill to regulate an economic activity across the territory of India, it must do so within its assigned fields of competence. The BULA Bill, however, operates in a regulatory space where the boundaries of "Banking" (a Central subject) and "Money-lending" (a State subject) are deeply entangled, creating significant risks of federal overreach and statutory repugnancy.

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[19] *Id.* paras 6.105–6.110

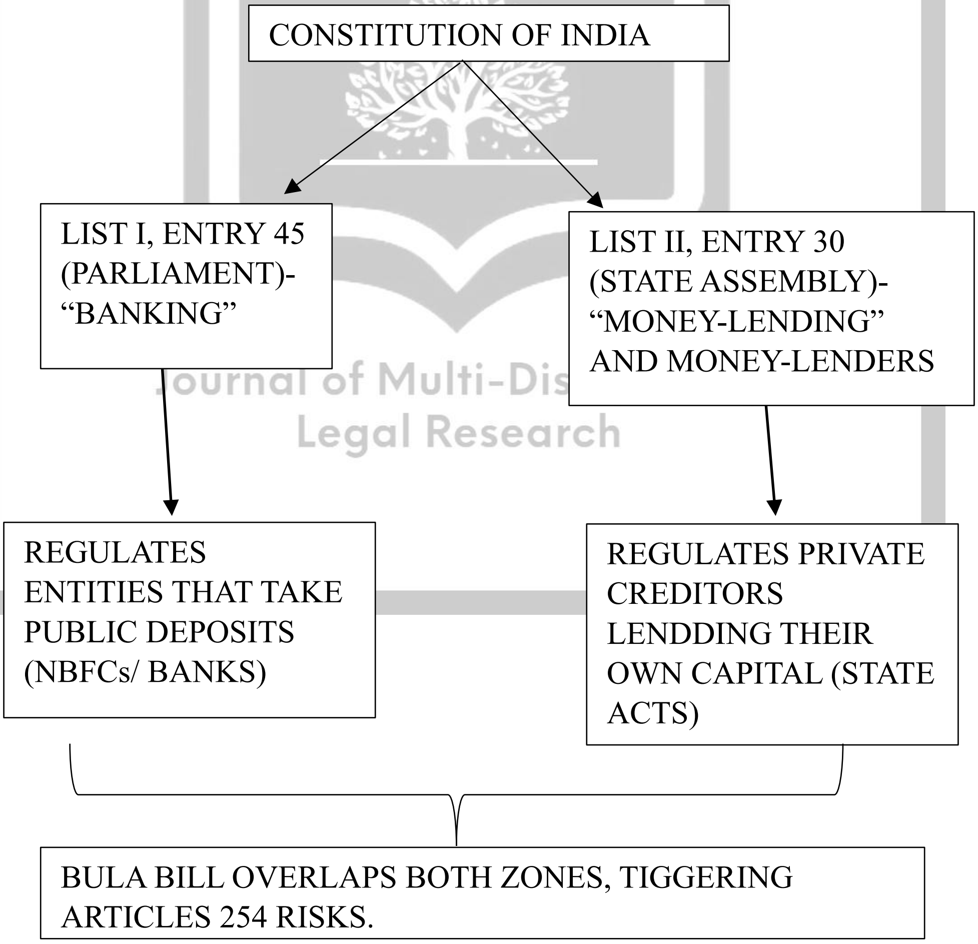
4.1 The Seventh Schedule Tension: Entry 45 (List I: Banking) vs. Entry 30 (List II: Money-Lending)

The distribution of financial legislative powers under the Seventh Schedule creates a clear division of fields:

- **List I (Union List), Entry 45** grants Parliament exclusive jurisdiction over "Banking."[20]
- **List II (State List), Entry 30** grants State Legislatures exclusive jurisdiction over "Money-lending and money-lenders; relief of agricultural indebtedness."[21]

The constitutional boundary between "banking" and "money-lending" has been thoroughly mapped by the Supreme Court. In *Nedumpilli Finance Co Ltd v State of Kerala*, the Court observed that "money-lending" as a field of legislation under Entry 30 of List II is an independent, distinct economic activity that is not subordinate to the Union's power over banking.[22] A person or corporation does not become a bank simply by lending money; banking requires the acceptance of deposits from the public for the purpose of lending or investment.

SEVENTH SCHEDULE LEGISLATIVE SEPARATION



[20] IND. CONST. annex VII, List I, Entry 45

[21] IND. CONST. annex VII, List II, Entry 30

[22] *Nedumpilli Finance Co Ltd v State of Kerala* 2022 LiveLaw (SC) 464 (holding that Chapter III-B of the Reserve Bank of India Act 1934 is a complete code governing non-banking financial companies, and that state money-lending statutes do not apply to entities regulated thereunder)

This distinction was decisively reinforced by the Supreme Court in Nedumpilli Finance Co Ltd v State of Kerala, which considered whether non-banking financial companies regulated by the RBI under Chapter III-B of the Reserve Bank of India Act, 1934 could simultaneously be subjected to state money-lending statutes such as the Kerala Money Lenders Act, 1958. The Court held that Chapter III-B constitutes a "complete code" governing NBFCs from incorporation to winding up, such that the borrower-protection function of state money-lending law is subsumed once an entity is RBI-regulated.[23] Crucially, the Court also confirmed that an entity does not become a "banking company" merely because it lends money; under Section 5(b) of the Banking Regulation Act, 1949, banking requires the acceptance of public deposits, a threshold that the vast majority of unregulated digital lenders targeted by the BULA Bill do not meet. This precedent cuts both ways for the draft Bill. It confirms that Parliament may validly reach RBI-regulated NBFCs without displacing state money-lending law, but it equally confirms, by negative implication, that non-deposit-taking, non-RBI-registered lenders remain within the states' Entry 30 competence, reinforcing the argument that BULA's blanket central prohibition over all unlisted lending activity, irrespective of whether the lender accepts public deposits, reaches beyond the field that Nedumpilli Finance recognised as validly occupied by the Centre.

Because the BULA Bill attempts to regulate and ban lending activities conducted by non-banking entities, entities that use their own equity or private capital rather than public deposits, the core subject matter of the bill falls squarely within Entry 30 of List II. By enacting a central law that completely prohibits unregulated private money-lending, Parliament risks stepping into an exclusive domain of the State Legislatures, violating the principle of federal balance, which forms part of the basic structure of the Constitution.[24]

4.2 Coexistence in Collision: The Tamil Nadu and Karnataka Regimes

The practical dangers of this central overreach become clear when analyzing existing state statutory regimes. Most states in India have long-established legislation governing private money-lending under Entry 30 of List II. For example, the *Tamil Nadu Money-lenders Act, 1957*[25] and the *Karnataka Money-lenders Act, 1961*[26] set up robust state-level systems that require moneylenders to obtain licenses from local registrars, cap maximum allowable interest rates, and penalize usurious practices.

These state regimes do not *ban* non-banking private lending; they *license* and regulate it to ensure credit flows to rural and semi-urban informal economies safely. If the central BULA Bill takes effect with its current negative residual structure, an individual who holds a valid license under the *Karnataka Money-lenders Act* but does not have a formal registration with a central regulator like the RBI could see their business branded as an "Unregulated Lending Activity." This creates an immediate operational conflict between central and state authorities, leaving local, licensed businesses caught in an unworkable crossfire of competing compliance demands.

[23] *Nedumpilli Finance Co Ltd v State of Kerala* 2022 LiveLaw (SC) 464; Banking Regulation Act 1949, s 5(b)

[24] S.R. Bommai v. Union of India, (1994) 3 SCC 1

[25] The Tamil Nadu Money-lenders Act, 1957 (Tamil Nadu Act 26 of 1957)

[26] The Karnataka Money-lenders Act, 1961 (Karnataka Act 12 of 1962)

4.3 The Harmonisation Gap: Article 254, Repugnancy, and the Absent Savings Clause

This legislative overlap creates an immediate constitutional conflict under Article 254 of the Constitution. Article 254(1) states that if State law is repugnant to a Central law enacted on a subject in the Concurrent List (List III), the Central law prevails.[27] However, this rule of federal supremacy does not automatically apply when the conflict involves the Union List (List I) and the State List (List II). In such cases, courts apply the doctrine of *pith and substance* to determine the true character of the legislation.[28]
If a court finds that the "pith and substance" of the BULA Bill is the regulation of money-lending rather than banking, the entire central statute could be struck down as *ultra vires* (beyond the legal power) of Parliament. To avoid this fatal flaw, the draft bill lacks a critical structural feature: an express "Savings Clause."

Without an explicit statutory provision stating that the provisions of the BULA Act operate in addition to, and not in derogation of, existing state money-lending enactments, the bill creates a massive harmonisation gap. The absence of a clear savings mechanism triggers systemic legal challenges under Article 254, paralyzing enforcement and plunging the retail credit market into years of constitutional litigation.

5. The Prohibitory Architecture's Structural Flaw: Displacement Rather Than Elimination

Statutory prohibitions aimed at complex, demand-driven economic markets often produce consequences that directly subvert the legislature's intent. When a state chooses to criminalize the absolute supply of a commodity or service without suppressing its underlying demand, the market does not vanish; it transforms. The draft BULA Bill's primary operational vulnerability lies in its reliance on absolute prohibition to solve a crisis of market conduct. By imposing a blanket penal ban on all credit activities lacking active regulatory formalization, the bill introduces severe structural distortions into India's retail credit landscape.

5.1 The Financial Exclusion Paradox: Who Bears the Cost of Prohibition

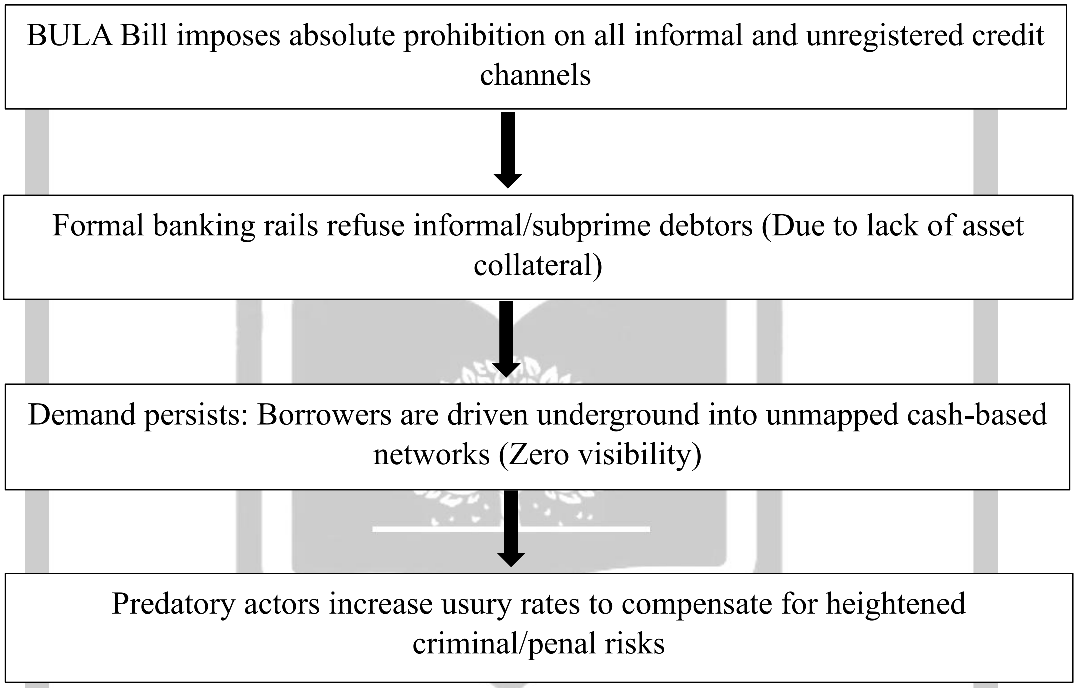
The foundational flaw of the BULA Bill is its failure to account for the structural realities of financial exclusion in India. Retail credit demand among low-income households, micro-entrepreneurs, and gig-economy workers is driven by stark structural necessities- such as smoothing volatile consumption patterns, meeting health emergencies, or financing informal working capital. Despite the expansion of the *Pradhan Mantri Jan Dhan Yojana* (PMJDY) and formal banking rails, a massive credit deficit persists at the bottom of the economic pyramid.[29] Formal banking institutions remain structurally risk-averse, bound by rigid, asset-backed collateral mandates and documentation protocols that automatically disqualify the informal workforce.

The scale of the formal banking system's continued failure to convert account access into usable credit is stark. Government data shows that the PMJDY had, by early March 2025, opened over 55 crore bank accounts nationwide, extending savings infrastructure to nearly the entire adult

27 IND. CONST. art. 254, cl. 1
28 Hoechst Pharmaceuticals Ltd. v. State of Bihar, (1983) 4 SCC 45
29 Reserve Bank of India, Report of the Committee on Medium-term Path on Financial Inclusion, Ch II, para 2.4 (December 2015)

population.[30] Yet account ownership has not translated into credit access at a comparable scale: retrospective assessments of the scheme note that a large proportion of these accounts continue to function chiefly as conduits for direct benefit transfers, with holders still relying on microfinance institutions or informal lenders, including unregulated digital platforms, for their actual borrowing needs.[31] It is precisely this gap between formal deposit inclusion and formal credit inclusion that unregulated digital lenders have moved to fill, and that the BULA Bill, in its current punitive form, threatens to widen rather than close.

<u>THE CREDIT DISPLACEMENT SPIRAL</u>



When the BULA Bill imposes an absolute prohibition on all unregistered credit, it triggers a “financial exclusion paradox.” Instead of pulling vulnerable borrowers into the formal financial fold, the bill strips them of their immediate liquidity lifelines. Because the law suppresses digital informal alternatives without expanding the risk appetite of formal commercial banks, it drives desperate borrowers deeper into unmapped, completely opaque, cash-based networks. In these underground spaces, predatory lenders operate with total anonymity, far beyond the reach of digital enforcement agencies. This displacement increases the leverage of illicit actors over vulnerable citizens, making the cost of this total prohibition fall entirely on the very subprime debtors the law aims to protect.

5.2 <u>Proportionate Penal Calibration: Against Undifferentiated Criminal Liability</u>

In criminal jurisprudence, the state’s power to punish must be carefully calibrated to reflect both the severity of the offense and the degree of harm caused. The draft BULA Bill abandons this principle by establishing a regime of undifferentiated, strict criminal

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[30] Press Information Bureau, Government of India, *Govt's Financial Inclusion Drive Crosses Major Milestones with over 55 Crore Jan Dhan Accounts* (DD News, 7 March 2025)

[31] *Pradhan Mantri Jan Dhan Yojana (PMJDY): 11 Years of India's Financial Inclusion Revolution* (Insights on India, 27 August 2025)

liability.[32] Under its current framework, the statute applies identical penal weights to a wide range of activities. It treats an unlisted community-level micro-credit circle (*bishi* or local rotating credit network) with the same criminal severity as a multinational, algorithmic digital lending application deploying predatory spyware and running extortion schemes. This lack of proportional scaling contradicts the principles of penal calibration established by the Supreme Court. In *Modern Dental College & Research Centre v State of Madhya Pradesh*, the Court emphasized that penal provisions in economic welfare statutes must always maintain a rational relationship with the target offender's level of culpability.[33]

By making the mere absence of a central regulatory registration a strict liability, non-bailable offense under Clause 3, the bill strips judges of their judicial discretion. It exposes harmless, traditional, informal creditors, who have supported rural and semi-urban trade for generations, to severe asset attachments and multi-year prison sentences.[34] This lack of internal calibration undermines the moral authority of the law, overwhelming special courts with minor technical infractions while diluting the resources needed to hunt down major digital syndicates.

5.3 The Missing Institutional Pillar: Complementary Financial Inclusion Mandates

A penal statute cannot cure a structural economic deficiency on its own. The underlying drivers of the digital predatory lending crisis are institutional, yet the BULA Bill is drafted as a purely punitive instrument, completely detached from any broader financial inclusion strategies. It lacks any complementary mandates to compel formal banking institutions or large NBFCs to develop specialized, low-value, friction-free credit products tailored for subprime borrowers.

This regulatory choice ignores the clear policy consensus of contemporary development economics: you cannot eliminate informal markets without providing viable, regulated alternatives. The RBI's own Internal Working Group on Agricultural Credit noted that informal credit retains its hold because of its unmatched speed and administrative flexibility.[35]

By focusing entirely on criminal policing while ignoring the need for institutional mandates, such as micro-lending targets or credit-guarantee buffers for informal workers, the BULA Bill sets itself up for operational failure. It tries to use criminal law to solve what is fundamentally a structural banking delivery deficit.

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[32] Draft BULA Bill, cl 3 read with cl 11

[33] *Modern Dental College & Research Centre v State of Madhya Pradesh* (2016) 7 SCC 353 (n 13) (applying the proportionality standard to state regulation of economic and professional activity; cited here in place of the original authority, which in fact concerned strict-liability offences under the Essential Commodities Act, 1955 and does not support the proposition advanced in the text)

[34] Draft BULA Bill, 2024, cl 7

[35] Reserve Bank of India, *Report of the Internal Working Group to Review Agricultural Credit*, ch IV, para 4.2 (Sept. 2019)

6. Comparative Regulatory Architecture: Instructive Benchmarks from the UK and Australia

To design a regulatory framework that is both constitutionally durable and economically functional, India must look beyond pure prohibition and evaluate successful global alternatives. The regulatory frameworks of the United Kingdom and Australia offer highly instructive models. Both jurisdictions faced similar systemic crises with predatory, short-term "payday" loans and digital credit apps, but both rejected absolute bans, choosing instead to implement sophisticated systems built around positive inclusion and strict market-conduct oversight.

6.1 The UK FSMA 2000 Model: Positive Enumeration of Regulated Activities

The United Kingdom handles the perimeter of financial regulation through the *Financial Services and Markets Act (FSMA) 2000*.[36] The UK model rejects the "negative residual" framework used in India's BULA Bill. Instead, it relies on a clear system of "Positive Enumeration". Under Section 22 of the FSMA, an activity is subject to regulatory oversight only if it is explicitly specified as a "regulated activity" within the *FSMA (Regulated Activities) Order 2001* (RAO).[37]

COMPARATIVE DESIGN MATRIX

JURISDICTION/STATUTE	DEFINITIONAL PERIMETER	CORE DISCIPLINARY FOCUS
India: Proposed BULA Bill 2024	Negative Residual (Unregulated by Omission)	Status-Based Ban (Absence of License)
United Kingdom: FSMA 2000 / RAO 2001	Positive Enumeration (Explicitly Specified)	Conduct-Based Control (Affordability/Caps)
Australia: NCCPA 2009	Activity-Based Licensing (Comprehensive Gateway)	Consumer-Harm Prevention (Hardship Protection)

The RAO precisely defines different types of consumer credit, including entering into a regulated credit agreement as a lender or exercising the lender's rights under such an agreement.[38] If a financial practice emerges that falls outside this list, it does not instantly become a strict liability crime. Instead, the Financial Conduct Authority (FCA) uses its statutory powers to dynamically update the Regulated Activities Order, bringing the new practice within its supervisory scope.

Crucially, when the UK tackled the crisis of predatory payday lending, it did not ban high-cost short-term credit entirely. Instead, the FCA introduced strict caps on total costs, limited interest rates to 0.8%0.8% per day, and banned platforms from harvesting unauthorized digital access.[39] This positive approach protected consumers from predatory exploitation while preserving access to emergency credit within a secure, visible framework.

The durability of this conduct-based approach has since been empirically validated. When the FCA formally reviewed the price cap regime in 2017, it found that the roughly 760,000 consumers who continued to use high-cost short-term credit each year were collectively saving approximately £150 million annually compared to pre-cap costs, that default and arrears rates

[36] *Financial Services and Markets Act 2000*, c. 8 (UK) [hereinafter **"FSMA 2000"**]
[37] FSMA 2000 sec. 22 read with Schedule 2
[38] *Financial Services and Markets Act 2000 (Regulated Activities) Order* 2001, S.I. 2001/544, Article 60B (UK)
[39] *Financial Conduct Authority, Policy Statement PS14/16: DetailedRrules for the Price Cap on High-Cost Short-Term Credit*, para 1.12(Nov. 2014)

on such loans had fallen substantially, and that debt-advice charities were reporting significantly fewer clients presenting with payday-loan-related distress.[40] The FCA elected to retain the cap at its existing level rather than tighten it further, concluding that the calibration struck an appropriate balance between consumer protection and continued market access, a balance that a status-based prohibition of the kind BULA proposes does not attempt to strike at all.

6.2 Australia's NCCPA 2009: Licensing as an Inclusion Mechanism

Australia provides another powerful model through its *National Consumer Credit Protection Act 2009* (NCCPA), which contains the *National Credit Code* as its first schedule.[41] The NCCPA requires any entity engaging in a "credit activity" to hold an Australian Credit Licence (ACL) issued by the Australian Securities and Investments Commission (ASIC).[42]

The defining feature of the Australian model is that its licensing framework is designed to act as an inclusive gateway, not an exclusionary wall. Under Section 47 of the NCCPA, all licensees are bound by explicit statutory "Responsible Lending Obligations" (RLOs).[43] These RLOs require lenders to:

1. Make reasonable inquiries into a consumer's financial situation, requirements, and objectives;
2. Take reasonable steps to verify that financial information; and
3. Formally assess whether the credit contract is "unsuitable" because the consumer cannot meet the obligations without experiencing substantial financial hardship.[44]

When digital lending innovations like Buy Now Pay Later (BNPL) services began expanding across Australia, the state did not move to ban them under a general criminal umbrella. Instead, Australia chose to systematically bring BNPL contracts within the scope of the NCCPA, modifying the responsible lending rules to fit the specific risks of the product.[45] By tying the legality of a lending business to its *conduct*, specifically its commitment to preventing consumer hardship, rather than its mere corporate category, the Australian model protects consumers while keeping the market open to financial innovation.

6.3 What India Can Transplant and What It Cannot

India can draw powerful structural lessons from these global models, but any statutory adaptation must fit the unique realities of our domestic market.

- **What India Must Transplant:** The focus on conduct-based regulation rather than status-based prohibition. India should adopt the UK's approach of positive enumeration and combine it with Australia's mandatory responsible lending obligations. The legality

[40] Financial Conduct Authority, *High-Cost Short-Term Credit* (FCA, last updated 2023)
[41] National Consumer Credit Protection Act 2009 (Cth) (Austl.) [hereinafter "NCCPA 2009"]
[42] NCCPA 2009, ch. 2, sec. 29
[43] NCCPA 2009, ch. 3, sec. 47(1)(a)
[44] NCCPA 2009, ch. 3, sec. 128, 130 & 131
[45] Treasury (Austl.), *National Consumer Credit Protection Amendment (Buy Now Pay Later) Bill 2024: Exposure Draft Legislation* (Apr. 2024)

of a lender should be evaluated based on verifiable consumer protection standards, such as capping maximum APRs, banning invasive data-harvesting practices, and mandating transparent dispute resolution.

- **What India Cannot Directly Transplant:** The reliance on highly formalized, document-heavy compliance systems. In an economy where a large portion of the workforce operates informally without formal tax or payroll documentation, a rigid, copy-paste application of Australia's RLO verification rules would inadvertently lock millions of subprime borrowers out of legitimate credit.

Therefore, India's statutory framework must combine the precision of a positive regulatory boundary with flexible, low-cost compliance tiers. This allows traditional and micro-digital networks to step out of the shadows, get formalized, and be monitored, rather than being driven entirely underground by an absolute penal ban.

7. Reform Prescription: Toward a Constitutionally Defensible and Practically Effective Framework

To resolve the deep structural, constitutional, and federal issues built into the draft Banning of Unregulated Lending Activities (BULA) Bill, the legislation must be heavily overhauled before it is formally introduced in Parliament. The state can achieve its core public policy goal, dismantling predatory lending and extortionate recovery networks, without resorting to a blunt, unconstitutional ban that limits trade and worsens financial exclusion. The following four targeted, statutory amendments provide a roadmap to shift the bill from a status-based prohibition to a sophisticated, conduct-based governance framework.

7.1 Amendment 1: Replace the Residual Definition with a Positive Schedule of Permitted Lending

The foundational fix requires completely inverting Clause 2(18) of the draft bill. The current "negative residual" framework, which automatically criminalizes any lending activity not listed as regulated, must be replaced with a clear, behavior-driven definition of the offense.[46]

The penal provisions of the Act must only be triggered when an entity or individual engages in a "Prohibited Predatory Practice." The statute should explicitly define these prohibited practices as:

- The mandatory extraction of, or access to, a borrower's private digital smartphone telemetry (including contact lists, personal photo galleries, and location logs) as a condition for granting credit;
- The deployment of third-party recovery mechanisms that use defamation, public humiliation, or automated harassment; and
- The intentional structuring of credit contracts where the total cost of credit (including processing fees, compound interest, and late penalties) exceeds a statutory APR ceiling tied directly to the RBI's benchmark repo rate.

[46] Varsha Banta, *To Lend or Not to Lend? A Critical Review of the Banning of Unregulated Lending Activities Bill*, National Law School Business Law Review (March 16, 2025) (arguing that defining offenses purely by regulatory omission violates core legislative drafting principles)

By making specific predatory behaviors the trigger for criminal liability, the law removes any constitutional vagueness, satisfies the Article 19(1)(g) proportionality test, and protects innocent, community-level informal transactions while zeroing in on digital fraud syndicates.

7.2 Amendment 2: Express Harmonisation Clause for State Money-Lending Legislation

To eliminate the risk of the central law being struck down as *ultra vires* of Parliament for encroaching on exclusive State legislative powers under List II, Entry 30, the bill must include an explicit **Statutory Savings and Harmonisation Clause**.[47][48]

This new section should clearly state:

"The provisions of this Act shall be in addition to, and not in derogation of, the provisions of any State legislation governing money-lending and money-lenders. A person or entity holding a valid, active license under any State Money-lenders Act shall be deemed to be a 'Regulated Lending Activity' under this Act, provided their lending practices comply with the conduct mandates specified herein."

This amendment establishes a cooperative federal framework. It allows existing state-level licensing authorities (like those in Tamil Nadu and Karnataka) to continue managing local retail credit, while giving central enforcement agencies a clear mandate to step in and handle cross-border digital lending frauds that bypass state borders entirely.

7.3 Amendment 3: Graduated Penal Calibration by Scale and Harm

The undifferentiated penalty structure under Clause 11, which treats minor technical omissions with the same severity as systematic corporate extortion, must be broken down into a calibrated, multi-tier system. The statutory penalties should follow a distinct, tri-tiered framework:

Offense Tier	Class of Infraction	Statutory Penal Sanction
Tier I: Operational Omission	Failure by an otherwise non-predatory informal lender to intimate authorities or maintain local records under Clause 9.	Purely civil monetary penalties; absolute exclusion from criminal prosecution or asset attachment.
Tier II: Violations of Conduct	Exceeding the maximum statutory interest rate caps or failing to provide transparent loan agreement documentation.	Graduated misdemeanor liability, including structured business-suspension orders and moderate fines.
Tier III: Systematic Predation	Operating unauthorized digital platforms, using predatory spyware, and deploying extortionate recovery tactics.	Strict, non-bailable felony prosecution; 3 to 10 years of rigorous imprisonment, maximum fines, and immediate asset forfeiture.[49]

[47] Compare IND. CONST. annex VII, List I, Entry 45 with List II, Entry 30

[48] *Hoechst Pharmaceuticals Ltd. v. State of Bihar*, (1983) 4 SCC 45 (outlining judicial approaches to overlapping central and state economic entries)

[49] Draft BULA Bill, cl 11(2) (prescribing enhanced criminal liability for severe, systematic violations involving extortionate recovery)

This graduated approach ensures that the state's punitive power is concentrated directly on high-harm corporate bad actors, protecting ordinary citizens from arbitrary criminalization over minor administrative oversights.

7.4 Amendment 4: Complementary Financial Inclusion Action Plan as a Statutory Obligation

To address the financial exclusion paradox, the bill must expand beyond purely punitive measures and include an institutional mandate for market formalization. The statute should introduce a mandatory **"Financial Inclusion and Alternative Credit Delivery Transition Plan"** as a binding obligation on the Ministry of Finance and the RBI.[50]

This statutory provision should require:

- The creation of a fast-track, low-cost "Micro-Lending Registration Window" managed by state cooperative departments, allowing traditional informal creditors to easily log their operations and step into the regulated perimeter;
- Mandatory targets for Scheduled Commercial Banks and eligible NBFCs to design and deploy automated, small-ticket (under ₹10,000) emergency consumption credit lines for subprime and informal sector borrowers; and
- The establishment of a Central Credit Guarantee Buffer to offset default risks for banks expanding into unbanked retail segments.

By embedding these inclusion mandates directly into the text of the statute, the law addresses the underlying credit delivery gap that fuels the predatory market, ensuring that the suppression of illegal platforms is matched by the expansion of safe, regulated alternatives.

7.5 Institutional Architecture: The Competent Authority's Design Imperatives

The operational backbone of the **Draft BULA Bill (2024/2025)** rests upon a decentralized enforcement framework led by a government-appointed **Competent Authority**. To prevent the enforcement lag that historically diluted state-level money-lending acts, BULA weaponizes this office with sweeping administrative and judicial powers designed to bypass protracted civil litigation during early-stage interventions.

1. Appointment, Status, and Jurisdictional Mandate

- **Rank Requirement:** Under Clause 6 of the Draft Bill, the Appropriate Government (Central or State) must appoint one or more officers **not below the rank of Secretary to the Government** to function as the Competent Authority. This high administrative placement ensures sufficient bureaucratic leverage to command inter-agency cooperation.
- **Assisting Apparatus:** The government may appoint subordinate officers to assist the Competent Authority, creating a structured hierarchical task force capable of managing vast geographic jurisdictions.

2. Summary Powers and Civil Court Equivalence

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[50] *Reserve Bank of India (Digital Lending) Directions, 2025* (May 8, 2025) (setting an industry baseline for transparency that the BULA Bill must structurally reinforce rather than replace with pure penal enforcement)

To ensure swift administrative neutralizations of predatory lending syndicates, Clause 6(4) explicitly vests the Competent Authority with the same powers as a **Civil Court under the Code of Civil Procedure (CPC), 1908**, during the conduct of investigations or inquiries. This includes:

- **Discovery and Inspection:** Enforcing the attendance of any person, compelling testimony under oath, and ordering the production of accounts, digital footprints, or physical records.
- **Evidence Gathering:** Receiving evidence via affidavits and issuing commissions for the examination of witnesses or underlying financial data documents.

3. Asset Recovery and Provisional Attachment Mechanisms

The defining legislative design choice within BULA's institutional architecture is the shift toward **immediate asset preservation**. The Competent Authority does not need to wait for a criminal conviction to secure illicit funds:

- **Provisional Attachment:** If the Competent Authority has "reason to believe" (recorded in writing) that an entity is conducting unregulated public lending, it can issue a written order to **provisionally attach** the bank accounts, assets, and properties acquired by the lender, whether held in their own name or via *benami* intermediaries.[51]
- **Information Sharing and Escalation:** The Competent Authority is structurally mandated to cross-share all collected business information, intimations, and offense data with the **Central Bureau of Investigation (CBI)** and the **State Police** to ensure simultaneous criminal prosecution alongside asset freezing.

This dual-track architecture balances rapid-response administrative asset freezes (via the Competent Authority) with expedited criminal trial mechanics (via the newly established **Designated Courts**), closing the enforcement gaps traditionally exploited by digital and informal predatory lenders.

This provisional attachment power, while operationally efficient, raises a due-process concern that the draft Bill does not yet resolve. Because attachment may be ordered on the Competent Authority's own recorded "reason to believe," prior to any judicial finding of contravention, stakeholder submissions on the draft Bill have flagged the risk that a lender operating in good-faith uncertainty about its regulatory status, such as a community credit cooperative awaiting formal classification, could have its accounts frozen and working capital immobilised for the duration of an inquiry, with no express statutory provision compelling the prompt release of those funds should the inquiry ultimately clear the entity.[52] Comparable safeguards exist in the parallel BUDS Act framework only in attenuated form, and stakeholder engagement with the Ministry of Finance's consultation has recommended that any Competent Authority order of attachment be made subject to a mandatory, time-bound judicial confirmation requirement, failing which the attachment should lapse automatically. Embedding such a sunset safeguard

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[51] Draft BULA Bill, 2024, cl 6

[52] Dvara Research, *Our Observations on the Draft Banning of Unregulated Lending Activities (BULA) Act by the Ministry of Finance (MoF), GoI* (Dvara Research, 7 May 2025)

would preserve the provision's deterrent value against genuine predatory operators while insulating good-faith, unclassified lenders from indefinite pre-trial financial paralysis.

8. Conclusion

The draft Banning of Unregulated Lending Activities Bill represents a well-intentioned, urgent attempt by the state to shield vulnerable citizens from the severe harms of predatory digital lending and extortionate recovery tactics. However, in its rush to address this digital crisis, the draft relies on a heavy-handed, negative residual prohibition model borrowed from deposit-protection laws. This choice creates severe systemic flaws: it leaves definitions unconstitutionally vague, risks violating Article 19(1)(g) protections, creates direct jurisdictional conflicts with state laws, and threatens to drive millions of subprime borrowers out of the visible economy into dangerous, completely unmonitored underground cash networks.

A mature economy cannot police its way out of a structural credit deficit. To truly protect consumers and maintain financial stability, India’s legislative approach must shift from status-based exclusion to conduct-based governance. By adopting a positive schedule of prohibited predatory behaviors, preserving state-level licensing systems, calibrating criminal penalties to match actual harm, and mandating formal alternative credit options, Parliament can build a durable framework that effectively eliminates predatory exploitation while keeping credit accessible, safe, and robust at the grassroots.