

# CHARTERED ACCOUNTANT PRACTICE JOURNAL

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# Article

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## Regulating the Unregulated: SEBI Interprets What Qualifies As A Collective Investment Scheme

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(Mukul Aggarwal and Richie Sancheti)\*

### Background

For the last few years, Securities and Exchange Board of India ("SEBI"), the Indian securities regulator, has intensified its scrutiny of investment structures that raise domestic capital on an unregulated basis. Securities Appellate Tribunal ("SAT") recently passed an order<sup>1</sup> upholding SEBI's findings against Alchemist Infra Reality Limited<sup>2</sup>. The SAT order along with recent pronouncement by the Supreme Court<sup>3</sup> have probed unregulated investment arrangements to conclude whether or not they constitute a 'collective investment scheme' ("CIS"), as CIS are required to be registered with SEBI.

This Hotline analyzes SEBI's findings in the matter of Alchemist Infra Reality Limited.

### Facts

Upon being appraised that Alchemist Infra Reality Limited ("Company") was operating a scheme to mobilize money from investors, SEBI set into motion an enquiry on its activities. From its scrutiny, SEBI ascertained the following sequential steps for operating the scheme:

1. Company would invite applications in a prescribed format ("Application Form") from persons ("Purchaser") for purchase of land owned by the Company.
2. A conveyance deed for sale of land would be executed with the Purchaser ("Conveyance Deed").
3. Simultaneously with the Conveyance Deed being executed, the Purchaser was expected to enter into a supervision agreement ("Supervision Agreement") with the Company for the latter to develop and supervise the land for a fee. The Purchaser was provided an option of requesting the Company to identify a suitable party for purchasing the land for a consideration to be mutually agreed.
4. Purchaser would hand over the Conveyance Deed to the Company. Simultaneously, the Company would issue a certificate of property ("Certificate") to the Purchaser which stated the expected value of the property on the expiration of a fixed period of time.

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\* This Funds Hotline was first published by Nishith Desai Associates. For further queries and clarification please write to the authors at richie.sancheti@nishithdesai.com and mukul.aggarwal@nishithdesai.com

## Position under Law and action taken by SEBI

Section 11AA(2)<sup>4</sup> of the SEBI Act, 1992 ("SEBI Act") defines an arrangement to be in the nature of a CIS if (i) there is a contribution / pooling of investment for the purpose of a scheme or arrangement, (ii) the contribution is with an expectation to receive some return, and (iii) the property, contribution or investment forming part of scheme or arrangement, whether identifiable or not, is managed on behalf of the investors.

SEBI issued a show cause notice to the Company with the charge that the scheme/arrangement operated by the Company was in the nature of a CIS.

For an entity to be able to undertake the activities as a CIS, it is mandatory for it to obtain a certificate of registration from SEBI under Section 12(1B)<sup>5</sup> of the SEBI Act and Regulation 3 of the SEBI (Collective Investment Schemes) Regulations, 1999 ("CIS Regulations").

Under the CIS Regulations, Regulation 73 provides for the winding up of an existing scheme in certain cases viz., failure to make an application for registration to SEBI, or refusal by SEBI to grant provisional registration. Finally, Regulation 74 provides that in case an operator of a business (which is in the nature of a CIS) does not wish to obtain provisional registration with the SEBI, it may devise a scheme of repayment of money collected from investors in accordance with the CIS Regulations.

Hence, SEBI concluded that the Company was operating a CIS without obtaining a registration, and therefore in contravention of Section 12(1B) of the SEBI Act and Regulation 3 of the CIS Regulations.

## Reasoning by SEBI

SEBI carefully examined the facts and inferred that clauses (i) to (iv) of section 11AA(2) of the SEBI Act applied to the operations of the Company.

Clause (i) SEBI noted that the Company accepts contribution from investors for collective utilization, pools the investment with the object of carrying out the overall scheme / arrangement because the Company had the discretion to allot such area in its project as it considered appropriate. Further, under the Conveyance Deed the area of plot was denoted as 'proportionate undivided interest'. The Purchaser was not entitled to claim division and/or partition of the said proportionate undivided interest. The Supervision Agreement restricted the Purchaser from (a) claiming ownership vis-a-vis their interest in the land or disposing their interest, and / or (b) encumbering their interest without the express consent of the Company, and / or (c) interfere with the working, managing, controlling and supervising of the said plot in any manner whatsoever. This in SEBI's view, were not limbs of a buy-sell arrangement, but a pooling of money pursuant to a scheme or arrangement.

Clause (ii) requires that the investors pool in money with a motive of receiving profits, income, produce or property. SEBI noted that the Application Form itself assured the Purchaser towards yields and profits under the Supervision Agreement. The Company under the Supervision Agreement guaranteed the Purchaser a realization from the property after a certain period, not below a certain value, which value /the value for which was also provided in the Certificate.

Clause (iii) and Clause (iv) requires that the property, contribution or investment forming part of scheme or arrangement is managed on behalf of the investors and

such investors do not have a day to day control over the management and operation of the scheme or arrangement. On this point SEBI noted that the Purchaser does not manage his investment in the scheme at any stage and the property in question, the investment involved and the management thereof are all in the hands of the Company.

Further, SEBI noted that the Certificate stated "The Estimated value of the said undivided share after development is expected to be not less than Rs..... on expiry of tenure under the said Agreement.", thereby giving an impression that rather being a certificate of property, it is a certificate of investment as the Purchasers are allotted an unidentified portion of land from the Company's land holding which can be considered as units of large land holding.

### SEBI's findings and SAT Order

Based on the above findings, SEBI concluded that the Company's activity were in the nature of a CIS and held it to be in violation of Section 12 (1B) of the SEBI Act and Regulation 3 of the CIS Regulations, as it was carrying on the activity as a CIS without obtaining the required registration. SEBI accordingly passed directions to the Company and its directors to wind up the existing CIS and further ordered the Company to refund all the collected money.

SAT confirmed SEBI's finding and upheld the SEBI Order under appeal which was made by the Company and its directors, by adopting the reasoning similar to that provided by SEBI in the SEBI Order. However, as a relief to the Company, SAT extended the period for refunding the collected money to a period of eighteen months, with a rider that the Company shall submit a report to SEBI every six months giving accurate details regarding the progress made while executing the scheme of repayment.

### Analysis

In the recent past, SEBI has discovered several structures been deployed to raise capital from investors without following the prescribed regulatory framework. To safeguard the interest of hapless investors and curb the proliferation of unregulated schemes being operated, SEBI has brought under the scope of the CIS Regulations all such schemes launched by any operator in any field as long as they fell within the four corners of the definition of a CIS.

Recent amendments<sup>6</sup> to the SEBI Act provide more powers to SEBI for enforcement against unregistered pooling vehicles. Under the amendments SEBI has been granted powers to regulate any scheme or arrangement, if such scheme is not registered with SEBI, and involves a corpus of INR 100 Crore (INR 1 billion) or more. This power can be viewed as an attempt to limit any challenges from parties contending that a particular fund raising activity is not covered under the purview of CIS Regulations merely because it is not specifically covered under Section 11AA of the SEBI Act. Further, SEBI has now been granted the authority to carry out search and seizure operations and attach assets in case of non-compliance.

The SAT order and SEBI Order are important as they underline the regulator's seriousness into bringing the unregulated within the fold of the regulations.

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#### Endnotes

1. *Alchemist Inra Realty Limited and Ors. v SEBI*, SAT - Appeal No 124 of 2013, date July 23, 2013

2. SEBI Adjudication Order WTM/PS/NRO-CIS/JUNE/2013 dated June 21, 2013.
3. Civil Appeal No(s). 6572 of 2004 decided on March 12, 2013
4. Section 11AA: (1) Any scheme or arrangement which satisfies the conditions referred to in sub-section (2) shall be a collective investment scheme.  
(2) Any scheme or arrangement made or offered by any company under which,—
  - (i) the contributions, or payments made by the investors, by whatever name called, are pooled and utilized solely for the purposes of the scheme or arrangement;
  - (ii) the contributions or payments are made to such scheme or arrangement by the investors with a view to receive profits, income, produce or property, whether movable or immovable from such scheme or arrangement;
  - (iii) the property, contribution or investment forming part of scheme or arrangement, whether identifiable or not, is managed on behalf of the investors;
  - (iv) the investors do not have day to day control over the management and operation of the scheme or arrangement.
5. Section 12 (1B) of the SEBI Act, 1992: "No person shall sponsor or cause to be sponsored or carry on or cause to be carried on any venture capital funds or collective investment schemes including mutual funds, unless he obtains a certificate of registration from the Board in accordance with the regulations"
6. Press release dated July 18, 2013, Press Information Bureau, Government of India (available at: [http://www.finmin.nic.in/press\\_room/2013/ordinance\\_securitiesLaw\\_SEBI.pdf](http://www.finmin.nic.in/press_room/2013/ordinance_securitiesLaw_SEBI.pdf))