

Note on Collective Investment Schemes

This article enumerates the brief transaction procedure involved in the establishment of a Collective Investment Scheme (“**CIS**”) as per the laws force in India. It shall be noted that the activities described hereunder covers various relevant legislations, regulations and rules, for the time being in force in India and the legal entity has to obtain approval/register itself with Securities and Exchange Board of India (“**SEBI**”) as a Collective Investment Management Committee (“**CIMC**”) to be able to launch a CIS.

Preface

In light of a lot of news relating to shady entities garnering funds through fraudulent investment schemes with promise of huge returns mainly in the name of property development and agriculture, SEBI has in the last few years, intensified its scrutiny of investment structures that raise domestic capital on an unregulated basis. Securities Appellate Tribunal (hereinafter the “**SAT**”) recently passed an order upholding SEBI’s findings against Alchemist Infra Reality Limited. The SAT order along with recent pronouncement by the Supreme Court have probed unregulated investment arrangements to conclude whether or not they constitute CIS, as Schemes are required to be registered with SEBI in pursuance to Securities And Exchange Board Of India (Collective Investment Schemes) Regulations, 1999 (hereinafter referred to as the “**Regulation**”).

SEBI Action against Defaulting Companies

- (i) As per SEBI’s latest data, around 664 entities collected INR 3,518 crores in 1998-99.
 - Among these 75 companies wound up their schemes and returned money to investors.
 - Prosecution action has been launched against remaining 589 entities.
- (ii) As on March 31, 2013, there were 171 CIMCs still operating without SEBI approval against whom court proceedings have been initiated.
 - Penalty imposed in such from INR 30,000/- to INR 10,00,000/- (depending upon the money mobilized in contravention of the Regulation.
 - Rigorous imprisonment for promoters and associates of upto 6 months.
- (iii) Various courts in the country slapped convictions in 14 cases related to illegal CIS in fiscal year 2012-13, taking the total of such verdicts to 138.

Update on certain cases relating to illegal CIS

- (i) Maitreya Services Private Limited – SEBI issued an order in March 2013 against this company in March 2013 directing to wind up its CIS and refund the money to its subscribers.
- SEBI barred the company and its directors from the securities market till the time all its CIS were wound up and decided to initiate prosecution proceedings against them.
 - Charges like offences of fraud, cheating, criminal breach of trust and misappropriation of public funds have been filed.
 - Securities Appellate Tribunal (hereinafter referred to as “SAT”) upheld the SEBI order against SAT
- (ii) Alchemist Infra Realty Limited - The Company accepted contribution from investors for collective utilization and pooled 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 a conveyance deed the area of plot for each individual was denoted as ‘proportionate undivided interest’. The purchaser was thus not entitled to claim division and/or partition of the said proportionate undivided interest. The purchasers could not either 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.
 - Based on these findings, SEBI concluded that the company’s activity were in the nature of a CIMC and held it to be in violation of the Regulation as the company didn’t have the requisite approvals from SEBI.
 - SEBI accordingly passed directions to the Company and its directors to wind up the existing Scheme 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.

Collective Investment Scheme or CIS

CIS is defined in Section 11AA of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as the “**Act**”) as per which CIS is any scheme made or offered by a company under which –

- (i) Contribution made by individuals are pooled and utilized solely for a common scheme or arrangement;
- (ii) Contributions and payments made by individuals with a view to receive profits, income, produce or property, whether movable or immovable from such scheme or arrangement;
- (iii) Property, contribution or investment forming part of scheme or arrangement, whether identifiable or not, is managed on behalf of the investors; and
- (iv) Investors do not have day to day control over the management and operation of the scheme or arrangement.

Exclusions to CIS

There are many types of schemes and arrangements to collect funds from individuals which has been excluded by SEBI from the definition of CIS. CIS will not include schemes and arrangement –

- (i) Offered by Co-operative Societies or societies registered under any state or central act;
- (ii) Offered by Non-Banking Financial Companies to accept deposits;
- (iii) Contract of insurance to which Insurance Act applies;
- (iv) Providing for pension or insurance schemes under Employees Provident Fund and Miscellaneous Provisions Act, 1952;
- (v) Under which deposits are accepted under Section 58A of the Companies Act, 1956;
- (vi) Under which deposits are accepted by a company declared as a Nidhi or a mutual benefit society under section 620A of the Companies Act, 1956;
- (vii) falling within the meaning of Chit business as defined in clause (d) of section 2 of the Chit Fund Act, 1982; and
- (viii) Under which contributions made are in the nature of subscription to a mutual fund.

Collective Investment Management Company or CIMC

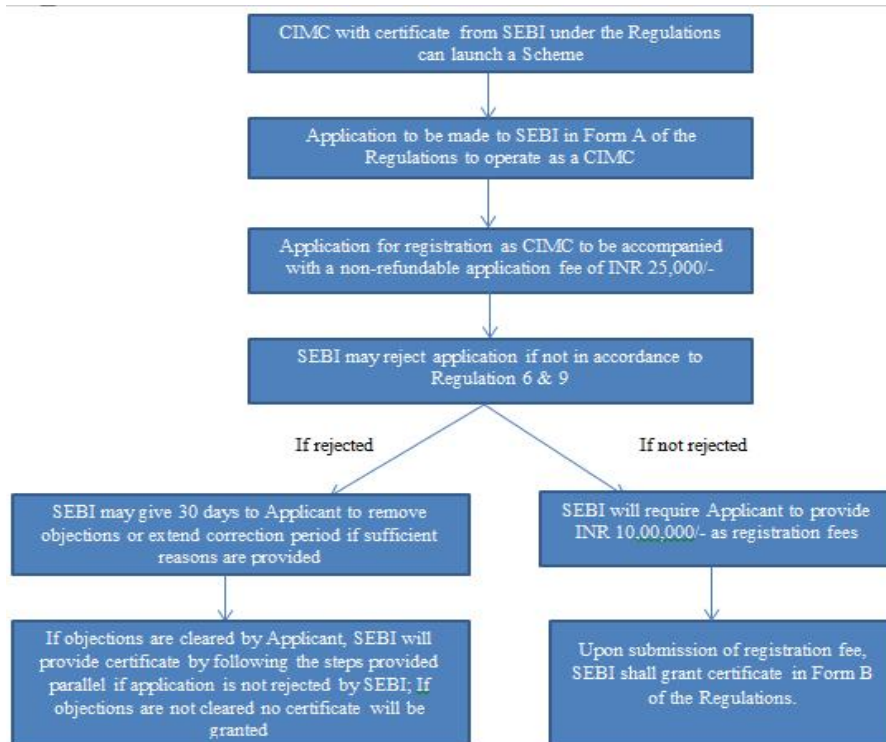
As per the Regulation no other entity other than a CIMC registered with SEBI can launch a CIS. The eligibility criteria for an entity to be granted SEBI approval for operating as a CIMC are as follows:-

- (i) Registered as a company under the Companies Act, 1956;

- (ii) Memorandum of Association specifies managing of CIS as one of its main objectives;
- (iii) Net worth of not less INR 5 crores, provided at time of making application the net worth can be INR 3 crores which is to be increased by applicant to INR 5 crores within three years of date of registration as a CIMC;
- (iv) Fit and proper person for grant of such certificate;
- (v) Has adequate infrastructure to enable it to operate CIS in accordance with the provision of these regulations;
- (vi) Directors or key personnel shall have relevant experience and have not been convicted for an offence involving moral turpitude or for any economic offence or for the violation of any securities laws;
- (vii) At least 50 percent of the directors are independent;
- (viii) No person directly or indirectly related to the applicant entity has been refused registration by SEBI under the Act; and
- (ix) At least one director not subject to retirement is representative of the trustee.

Process flow for setting up a CIMC

For your better understanding, provided below is a flow chart representing the necessary steps in formation of a CIMC.



Procedure to launch a CIS and

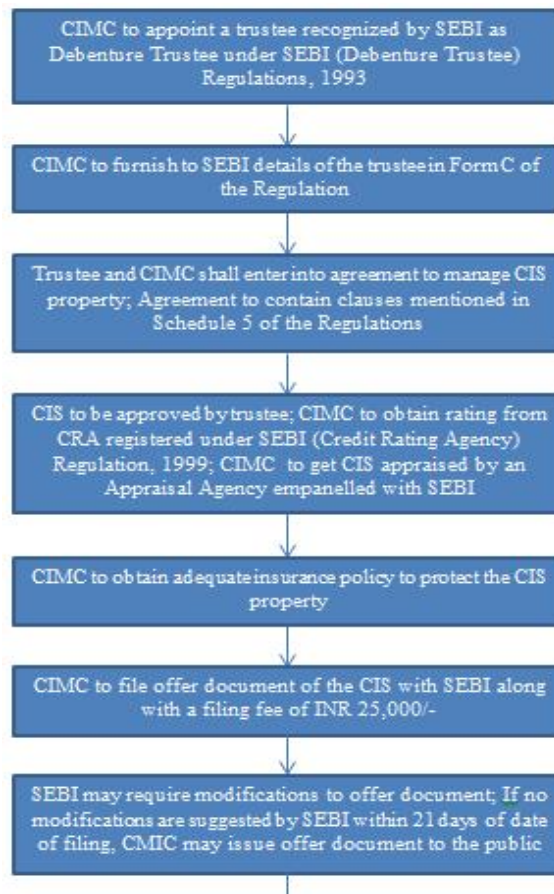
As per the Regulation, a CIS shall only be constituted in the form of a trust and the instrument of trust shall be in the form of a deed duly registered under the provisions of the Indian Registration Act, 1908 (16 of 1908) executed by the CIMC in favour of the trustees named in such an instrument. The trustee shall hold the assets of the Scheme for the benefit of the unit holders.

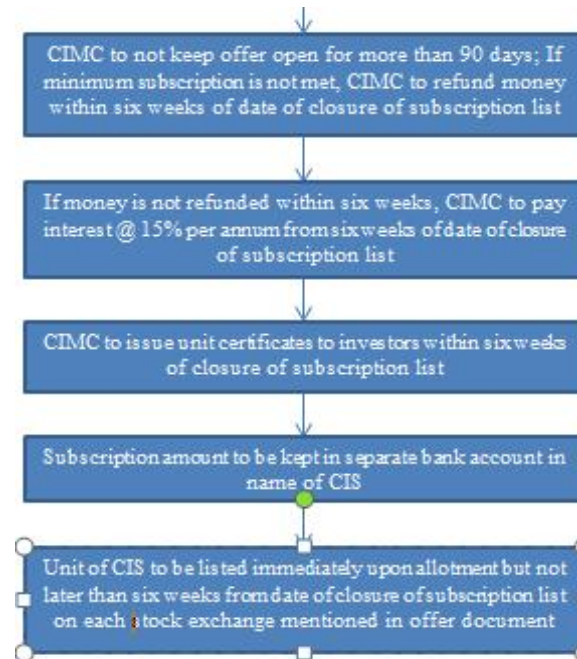
- (i) Credit Rating and Appraisal Requirement - No scheme shall be launched by the CIMC without obtaining rating from a credit rating agency (“**CRA**”) and getting the CIS appraised by an appraising agency (“**Appraising Agency**”). CRA as per the Regulation means a body corporate registered under Securities and Exchange Board of India (Credit Rating Agencies) Regulations, 1999. Appraising Agency means an agency empanelled with the SEBI for the purpose of conducting technical or financial appraisal of the CIS. Appraising Agent’s appraisal report shall form part of offer document.
- (ii) Close ended scheme and duration – CIS has to be a close ended scheme with duration not lesser than three years.
- (iii) Insurance – CIMC to obtain insurance for protection of CIS’ property.
- (iv) Returns – CIMC shall not provide guaranteed returns. Offer document can only mention indicative returns assessed by Appraising Agency.
- (v) Filing Fees – CIMC to pay filing fees to SEBI as prescribed in the Regulation;
- (vi) Disclosure in offer document - Offer Document has to contain information as set forth in Sixth Schedule of the Regulation and all information provided shall be true and enable investors to take an informed decision. SEBI may in interest of investors require CIMC to carry out changes to the offer document. CIMC can file offer document if SEBI doesn’t suggest any changes within 21 days from date of filing.
- (vii) Advertising material – Advertisement in respect of CIS have to comply with code provided in Seventh Schedule of the Regulation and shall disclose investment objectives and periodicity of valuation of the CIS property.
- (viii) Offer period – CIS shall not be open for more than 90 days for subscription.
- (ix) Allotment of units and refunds of money – CIMC to disclose in offer document the minimum and maximum subscription amount under the CIS along with allotment process in case of oversubscription. Application money has to be refunded within six weeks of closure of subscription list if CIS fails to receive minimum subscription.

- (x) Unit Certificates – CIMC has to issue unit certificates to accepted applicants no later than six weeks from date of closure of subscription list.
- (xi) Transfer of Units – Unit certificates shall be freely transferable and CIMC shall register any such transfer within thirty day of production of unit certificate along with instrument of transfer.
- (xii) Account and utilization of money – Subscription amount received shall be kept in a separate bank account in name of the CIS and shall be utilized only for the objectives of the CIS.
- (xiii) Listing of CIS - The units of every CIS shall be listed immediately after the date of allotment of units and not later than six weeks from the date of closure of the CIS on each of the stock exchanges as mentioned in the offer document.

Process flow for launch of CIS

For your better understanding provided below is a flowchart indicating the process flow in respect of launching a CIS post SEBI’s grant of approval to company to operate as a CIMC.





ECA's Commitment:

- ❑ Complete assistance for making the necessary filings, applications etc. for obtaining SEBI's approval to operate as CIMC and to launch CIS.
- ❑ Informal discussion with contact personnel within SEBI so as to perfect the application before the same is submitted.
- ❑ Follow up support at various points in time during and after the pendency of the application so as to ensure that any additional documents/records requested by SEBI is submitted in a systematic and timely manner.
- ❑ Updating Company on a regular basis as to the status of the pending application.

Disclaimer

Our article is based on the laws of India as on date. The laws and Rules mentioned herein are subject to changes from time to time and any such changes may affect the article. We have no responsibility to update our note for events and circumstances occurring after the date of this memorandum, unless specifically requested for.

We do not, in giving this article, accept or assume responsibility for any other purpose or to any other person to whom this memorandum is shown or in whose hands it may come unless expressly agreed by us in writing.