

SEBI LEVIES STRINGENT PENALTY: DEVELOPERS FEEL THE HEAT

November 2015



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INTRODUCTION

The real estate sector has been growing rapidly in the country, enticing many to participate in the exuberance of its growth. The growing appetite for risk coupled with innovative methods of investment has encouraged many to participate in it. Developers have been floating attractive schemes in the market which are not only a drift from the conventional methods of investment in real estate, but also seem to be within the reach of the common man. The common man wholeheartedly believing the same to be a platform for him to participate in real estate, a sector which he thought was not within his reach, invest his hard earned money in such schemes, unaware that the legality of such unregistered schemes has been a question.

The capital markets regulator, the Securities and Exchange Board of India ("SEBI") has time and again sprung in action against developers floating schemes that promise exceptionally high returns to lure gullible investors to invest in such schemes. The common man, relying on such companies fall prey to the attractive schemes with the cherished hope of obtaining returns that were promised but never provided. SEBI has heavily probed into such investment structures that raise capital on an unregulated basis to conclude whether or not they fall within the ambit of a collective investment scheme ("CIS"), as CIS activities are regulated by SEBI and are required to be registered with SEBI.

The advent of such activities was witnessed in the early 80's when many private entrepreneurs undertook plantation activities on a commercial scale. Though laudable an object, it was noticed that the promoters of such entities invested minimum amounts in such ventures and sourced a considerable amount from gullible investors promising them high assured returns. Such activities thereafter spread to the real estate

sector as well. Entities would craft attractive schemes, followed by tantalizing advertisements to lure uneducated and unaware investors to invest their hard earned savings with a promise of receiving hefty returns. Many a times, due to depletion of funds, the companies would go into liquidation, leaving the hapless investors with no recourse.

With the increase in the number of fraudulent activities, a need was felt to legislate appropriate regulations to curb such activities. Accordingly, in the late nineties, SEBI notified the SEBI (Collective Investment Scheme) Regulations, 1999 ("**CIS Regulations**"). A collective investment scheme, as the name suggests, is an investment scheme carried on by an entity on behalf of several individuals, wherein the entity pools in the money brought by the investors to invest in a particular asset(s), manages the same on behalf of the investors and subsequently distributes the returns received from the asset(s) amongst the investors. Entities carrying on CIS activities are required to get themselves registered with SEBI under the CIS Regulations and such entities shall be called a collective investment management company ("**CIMC**"). A registered CIMC is eligible to raise funds from the public by launching schemes after complying with the conditions set out in the CIS Regulations to ensure only genuine players enter such market. Such conditions include minimum net worth of INR 5 crores, filing of the offer document with SEBI for comments, obtaining credit rating for the scheme, appointment of a trustee, providing timely reports on the activities carried on by the CIS to the trustee etc.

The CIS Regulations however did not act as a deterrent to unregulated entities who continued with their path of duping gullible investors for their personal gains, while blatantly violating the law. Many developers floated investment

structures disguised in the form of a real estate transaction but in reality being a collective investment scheme. Entities would assure investors a piece of land or attractive returns on their investment in their colourable development of land projects. In the anticipation of huge returns, uneducated investors would settle on obtaining a proportionate undivided interest or an undefined piece of land out of the larger land. In most of these cases the land was never transferred to the investors nor was the investor provided an identified piece of land. The investors were disillusioned into making payments either in instalments or a onetime payment under the pretext of acquiring a plot of land after a particular period of time or an assured attractive return. The land was managed and developed on behalf of the investors by the company and investors had no control over such land. In some cases, the companies even offered to buy back the properties with considerable appreciation to the original investment. SEBI observed that the entities, in the guise of a genuine real estate business were pooling in the contributions of the investors for the purpose of purchase of a larger land. Further, SEBI observed that such activities were fabricated as a real estate transaction since the investors did not have a demarcated piece of land allotted to them. Accordingly, SEBI came down heavily on such unregistered entities (although not all schemes have been closed), directing them to return all the monies collected from the investors, imposing hefty penalties on such companies and barring their promoters and directors from accessing the capital markets for a particular period.

With the growing menace of unregulated CIS activities, SEBI intensified its scrutiny to prevent ordinary individuals being swindled due to their

inability to take a well informed decision. Under the Securities and Exchange Board of India Act, 1992, SEBI has the power to levy a penalty of upto three times the profits made by such entities and time and again SEBI has exercised its power to regulate unregulated schemes being floated in the market. SEBI has recently levied the highest penalty in its history of INR 7269 crores on Pearls Agrotech Corporation Limited (“**PACL**”). SEBI held that PACL was running a CIS in the garb of running a land sale-cum-development scheme. Such a severe penalty was imposed since this was the highest amount ever collected by a company running an illegal CIS, with the largest number of investors. Prior to this order, SEBI had directed the company to refund the amounts collected, which was upheld by the Securities Appellate Tribunal. While imposing such a huge penalty, SEBI observed that *it will give a strong message to securities market at large that such type of violations will not be viewed lightly. In the recent past, the country has suffered a lot in the hands of entities who indulge in such illegal money mobilization under various schemes, wherein the hard earned money of the common man has been duped. Thus, imposition of deterrent penalty is the need of the hour.*

CONCLUSION

The legislation in relation to CIS has been in place for more than a decade. Although SEBI has been proactive in time and again cracking down upon illicit schemes, it did not completely eradicate fraudulent companies from floating such schemes. It is vital that investors must be more proactive and vigilant so that they do not fall prey to such schemes. . It is also hoped that the PACL order may set an example and act as a deterrent for companies engaging in such illicit activities from duping monies from the common man.

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