

COLLECTIVE INVESTMENT SCHEME: AN ANALYSIS

Aryan Sinha*

Abstract

A collective Investment Scheme (CIS) is a popular investment scheme in the securities market. In this, several people come together and invest their finances collectively in a specific or many asset(s) and share the profits according to their share of investment. Each investor has a specific stake in the Collective Investment Scheme which depends on how much investment they have made. Large-scale misutilization of pool of money, dishonesty and mischievous activities lead to the establishment of a regulatory system for the operating the Collective Investment Scheme. Under the Chairmanship of Dr. S. A. Dave, a committee was constituted to examine the shortcomings of such scheme and prepare a draft for the regulations of Collective investment scheme. Along with this SEBI issued the regulations for Collective Investment Scheme; SEBI (collective investment schemes) Regulations, 1996. In this research paper, we will be discussing the concept of CIS, its applicability under SEBI, History, Characteristics/Features of CIS, Exceptions, Registration, and conditions of Collective Investment Management Company (CIMC), Certificate of CIS, Trustee for CIS, Procedure for launching CIS, Action, and Penalties in case of default CIS.

Keywords: *Collective Investment Schemes, SEBI, Collective Investment Management Company, Securities Law*

* Student @ Galgotia University, Greater NOIDA

INTRODUCTION

We have heard about the collective efforts of an individual in a group for the betterment of the entire group. Similarly, the concept of CIS is based on this ideology. “Collective Investment Scheme (CIS) is a mechanism where several individuals mutually pool their money to invest it in a particular asset. Further, when profits are arising out of that particular investment, it gets shared between the investors as per the finalized agreement, before the act.”¹ This form of scheme is somehow similar to a mutual fund. However, it is not a mutual fund.

In more depth, “the collective investment scheme is a plan of action that comprises a pool of assets that are managed & handled by the collective scheme manager and is governed by the Collective Investment Schemes Regulations issued by the Securities & Exchange Board of India. Thus, this regulation provided by the SEBI acts as a provision for the Investor’s Protection”². The main objective of having this sort of collective investment scheme is to get some form of income or profit as a result of this investment.

COLLECTIVE INVESTMENT SCHEME: UNDER THE PURVIEW OF SEBI

1. Securities Exchange Board of India (Collective Investment Schemes) Regulation, 1999: SEBI regulations on the CIS specifically

¹ Rajdeep Saini, “Collective Investment Scheme: An Overview”, *Enterslice* (Dec 03, 2020). <https://enterslice.com/learning/collective-investment-schemes-an-overview/> (Last visited on: November 25, 2022)

² Deyasini Chakrabarti, “All About Collective Investment Scheme”, *iPleaders* (Mar 31, 2020). <https://blog.ipleaders.in/collective-investment-scheme-2/#Introduction> (Last visited on: November 25, 2022)

talk about the establishment of Collective Investment Management Company (CIMC) which means a corporation incorporated under the “Companies Act 2013”³ and also enrolled with the SEBI, whose purpose is to manage, deal, work, and arrange CIS. Only the Collective Investment Management Company which has obtained all the necessary certifications under the guidelines should only be allowed to support and continue the collective investment scheme.⁴

2. ***Securities Exchange Board of India Act, 1992:*** “After the Securities Laws (Amendment) Act 31 of 1999, Section 11AA was inserted under the Securities Exchange Board of India Act 1992, which was effective from 22.02.2000. Section 11AA defines the Collective Investment Scheme. A CIS scheme or arrangement made or offered by any company under which the contributions, or payments made by the investors, by whatever name called, are pooled and utilized solely for the scheme or arrangement. The contributions or payments are made to such scheme or arrangement by the investors to receive profits, income, produce, or property, whether movable or immovable from such scheme or arrangement. The property, contribution, or investment forming part of the scheme or arrangement, whether identifiable or not, is managed on behalf of the investors. The investors do not have day-to-day control over the management and operation of the scheme or arrangement.”⁵

COLLECTIVE INVESTMENT SCHEME: HISTORY

In the earlier 1990s, some businessmen took plantation activities to a commercial level to support the Government’s efforts to prevent the destruction of forests in the country and also to channel private investments

³ The Companies Act, 2013, (Act 18 of 2013).

⁴ Securities Exchange Board of India (Collective Investment Scheme) Regulations. 1999.

⁵ The Securities Exchange Board of India Act, 1992, (Act 15 of 1992), Collective Investment Scheme.

towards Agro plantation activities. The Government of India observed these private investments and decided to regulate of such instruments (Agro Bonds & Plantation Bonds) and should be treated as a “Collective Investment Scheme” under the SEBI Act, 1992. On November 18, 1997, a press release was declared for the same. For the implementation of such a scheme, SEBI was asked to draft a regulation for investor protection and promotion of legitimate investment activity. “SEBI formulated a committee under the chairmanship of Dr. S.A. Dave along with the representatives from Regulatory Bodies, Plantation Industries & Consumer Forums.”⁶ Accordingly, Section 11AA was inserted under the SEBI Act 1992 for the concept of a Collective Investment Scheme. Such a Scheme was brought within the purview of securities to give statutory protection to the investors. “The phrase ‘units or any other instrument issued by any collective investment scheme to the investors in such schemes’ was inserted by the Securities Laws (Amendment) Act, 1999 within the definition of ‘securities’ in Section 2(b) of the Securities Contract (Regulation) Act, 1956.”⁷

COLLECTIVE INVESTMENT SCHEME: OBJECTIVES

The main objectives of this schemes are:

1. Protection of the investors belonging to the class of average income group of people, retired group of people, illiterate group of people, lower category group of people.
2. People who seek to invest their savings in order to gain benefits from such scheme.

⁶ Dave Committee, “Report of the Committee on Collective Investment Schemes”, *Securities Exchange Board of India* (Apr 05, 1999).

⁷ The Securities Contract (Regulation) Act, 1956, (Act 42 of 1956), s. 2(h)(ib).

3. Sharing of profits through several activities.

COLLECTIVE INVESTMENT SCHEMES: CHARACTERISTICS

In India, Collective Investment Scheme is an arrangement offered by any “person”⁸. It includes:

1. The financial investment of people is pooled together and is utilized for the realisation of Collective Investment Scheme.
2. To gain income or other benefits from the financial investment made in the Collective Investment Scheme.
3. To manage such scheme on behalf of investors.
4. The investors have partial control on the management and operation of such scheme.

COLLECTIVE INVESTMENT SCHEME: EXCEPTIONS

Following scheme or arrangement shall not be considered a Collective Investment Scheme:

1. **Co-operative Societies:** If any arrangement made or scheme offered by a co-operative society registered under the “Co-operative Societies Act, 1912”⁹
2. **Non-Banking Financial Companies (NBFC):** If any arrangement made or scheme offered under which deposits are accepted by non-banking financial companies is defined under “Section 45-I(f) of Reserve Bank of India Act, 1934”¹⁰.
3. **Insurance:** If any scheme or arrangement was made or offered to be a

⁸ The Income Tax Act, 1961, (Act 43 of 1961), s. 2(31).

⁹ The Co-operatives Societies Act, 1912, (Act 2 of 1912).

¹⁰ The Reserve Bank of India Act, 1934, (Act 2 of 1934), NBFC.

contract of insurance under the “Insurance Act, 1938”¹¹.

4. **Provident Fund/Pension Fund:** If collection is made for any Scheme, Pension Scheme or Insurance Scheme framed under the “Employees Provident Fund and Miscellaneous Provisions Act, 1952”¹².
5. **Public Deposit:** If any collection is made under which deposits were accepted under “Section 73 of the Companies Act, 2013”¹³.
6. **Nidhi Company:** If any collection has been made under the purview of “Section 405 of the Companies Act, 2013”¹⁴.
7. **Chit Fund:** If any collection is falling within the meaning of Chit business under the provision of “2(d) of Chit Fund Act, 1982”¹⁵.
8. **Mutual Fund:** If any collection is made under which contributions made are like a subscription to a mutual fund.
9. **Residuary Provision:** Any collection made in consultation with the Securities Exchange Board of India.

COLLECTIVE INVESTMENT SCHEME: REGISTRATION OF COLLECTIVE INVESTMENT MANAGEMENT COMPANY

CIMC is a company registered under SEBI and incorporated under the Companies Act 2013 to organize, operate & manage a CIS.¹⁶ Any person who proposes to sponsor, launch or carry on any scheme or arrangement shall be deemed to be a collective investment scheme under the CIMC on

¹¹ The Insurance Act, 1938, (Act 4 of 1938).

¹² The Employees Provident Funds and Miscellaneous Provisions Act, 1952, (Act 19 of 1952).

¹³ The Companies Act, 2013, (Act 18 of 2013), Prohibition on acceptance of deposits from public.

¹⁴ The Companies Act, 2013, (Act 18 of 2013), Power of Central Government to direct companies to furnish information or statistics.

¹⁵ The Chit Funds Act, 1982, (Act 40 of 1982), Chit Amount.

¹⁶ Regulation 2 (1) (h) of the Securities and Exchange Board of India (Collective Investment Schemes) Regulations, 1999.

or after the commencement of SEBI (Collective Investment Schemes) Regulations, 1999 shall make an application for the grant of registration to SEBI.¹⁷ CIMC shall not indulge in any other activities, except managing such scheme, acting as a trustee of any scheme, launching any scheme to invest in securities. A CIMC may invest in the scheme if it gives a declaration of purpose of investment in the scheme and shall not charge any fees for that investment.¹⁸ Only a certified CIMC shall carry on or sponsor or launch a collective investment scheme.¹⁹

COLLECTIVE INVESTMENT SCHEME: CONDITIONS FOR CIMC

“When the SEBI is satisfied with the application, SEBI calls upon the applicant to pay registration fees. On receipt of registration fees, SEBI shall grant the certificate only when certain terms and conditions are satisfied by the SEBI and must be in the interest of investors.”²⁰

Certain Conditions for registration of CIMC are:

1. The applicant must be registered as a company under the Companies Act, 2013.
2. The applicant must specify the managing of CIS as one of the main objectives under its Memorandum of Association (MoA).
3. The applicant must have a minimum net worth of rupees five crores. The exception to this is if the applicant does not have the minimum net worth, then at the time of making the application, the

¹⁷ Ibid, Regulation 4 & 4A

¹⁸ Ibid, Regulation 13

¹⁹ Ibid, Regulation 3

²⁰ Ibid, Regulation 9 & 10

applicant must have a minimum of rupees three crores which shall be increased to rupees five crores within three years from the date of registration.

4. The applicant must follow the criteria specified in Schedule II of the “Securities and Exchange Board of India (Intermediaries) Regulations, 2008”²¹
5. The applicant must follow the criteria specified in the Securities Exchange Board of India (Collective Investment Schemes) Regulations, 1999.
6. The directors and key personnel of the applicant have not been convicted for an offense involving moral turpitude or for any economic offense or the violation of any securities laws.
7. At least 50% of the directors of CIMC must be independent. They shall not be directly or indirectly associated with the persons who have control over the Collective Investment Management Company.
8. No person, directly or indirectly connected with the applicant has in the past been refused registration by the SEBI. That person connected with the applicant has been rejected by the Board or any disciplinary action has been taken against such person under the rules and regulations made under the act.
9. At least one of the directors, on the Board of the CIMC who is not subject to retirement must be a representative of the trustee.
10. The CIMC must not be a trustee of any CIS.
11. The applicant must follow the criteria specified in the provisions of Chapter IX of the SEBI (Collective Investment Schemes)

²¹ Securities Exchange Board of India (Intermediaries) Regulations 2008.

Regulations, 1999.”²²

COLLECTIVE INVESTMENT SCHEME: TERMS & CONDITIONS FOR CERTIFICATE

The certificate shall be granted after fulfilling the certain “terms & conditions”²³:

1. Any director of the Collective Investment Management Company must not be a director of another CIMC unless he’s an independent director and that person must be approved by the board of directors of other CIMC.
2. The CIMC must inform the board of directors about the change of information in the previously published information.
3. The trustee shall give approval for appointment of director of CIMC.
4. CIMC shall adhere the regulations of SEBI (Collective Investment Schemes) Regulations, 1999.
5. SEBI, Trustee & Unit Holders must approve the changes made for the controlling & management interest of CIMC.
6. CIMC must address the grievances & complaints of investors within the prescribed time limit.
7. CIMC shall agree with a depository for the dematerialization of the units of CIS proposed to be issued.
8. Subscription of units of CIS shall be paid back through payment channels of cheque, demand draft, or other but not through cash.
9. The CIMC must comply with the KYC (Know your client) Norms

²² Supra note 16, Regulations 68 - 74

²³ Ibid, Regulation 11

specified by the SEBI.

*Terms & Conditions 7-9 were inserted after the 2014 Securities Law Amendment.²⁴

COLLECTIVE INVESTMENT SCHEME: THE TRUSTEE

1. For the purpose of holding the assets of CIS, the CIMC must appoint a trustee.²⁵
2. Persons registered as a Debenture Trustee under the “SEBI (Debenture Trustee) Regulations, 1993”²⁶ are eligible for the position of trustee of such CIS but if that person directly or indirectly indulged with the control of CIMC is not eligible to be appointed as trustee.²⁷
3. As per the recommendations of the Dave Committee, it was stated that CIS shall be constituted in the form of a deed registered under the “Indian Registration Act, 1908”²⁸ And shall be executed by CIMC in the favor of the trustee.²⁹
4. The Trustee and the CIMC shall agree on managing the scheme according to the SEBI Regulations to fulfill the scheme’s objectives.³⁰
5. No scheme shall be launched by CIMC unless approved by the

²⁴ Securities and Exchange Board of India (Collective Investment Schemes) (Amendment) Regulations (Jan 09, 2014).

²⁵ Supra note 16, Regulation 16(2)

²⁶ Securities Exchange Board of India (Debenture Trustees) Regulations, 1993.

²⁷ Supra note 16, Regulation 18(1)

²⁸ The Registrations Act, 1908, No. 16, Acts of Parliament, 1908 (India).

²⁹ Dave Committee, “Report of the Committee on Collective Investment Schemes”, *Securities Exchange Board of India*, p. 14 (Apr 05, 1999).

³⁰ Supra note 16, Regulation 20

Trustee.³¹

COLLECTIVE INVESTMENT SCHEME: PROCEDURE FOR LAUNCHING CIS

Every scheme shall be launched after following the due compliances:

1. CIMC must take the approval of the Trustee for launching the scheme.
2. CIMC must take ratings from a Rating Agency.
3. CIMC must take appraisals for such scheme by an appraising agency.
4. CIMC must take an insurance policy for the protection of such schemes.
5. CIMC shall launch close-ended schemes (CES) whose duration shall not be less than of three calendar years.
6. CIMC must publish disclosure information stating that such schemes do not provide guaranteed returns.³²
7. The CIMC must issue Unit Certificate to its applicants within six weeks from the subscription list's closure date.
8. If the units are issued through depositories, then the "Securities Exchange Board of India (Depositories and Participants)"³³ Regulations must be followed.³⁴
9. The scheme units shall be listed with each stock exchange within six

³¹ Supra note 16, Regulation 24

³² Supra note 16, Regulation 24-25

³³ Securities Exchange Board of India (Depositories and Participants) Regulations, 1996.

³⁴ Supra note 16, Regulation 32

weeks from the scheme's closure.³⁵

COLLECTIVE INVESTMENT SCHEME: ACTION IN CASE OF DEFAULT BY CIS

1. Violation of SEBI Provisions and CIS Regulations.
2. Publishing of false or misleading information related to such regulations.
3. Does not cooperate with any inquiry, investigation or inspection conducted by the SEBI under such provisions or regulations.
4. Fails to adhere the directions issued by the SEBI.
5. Fails to resolve the complaints of investors by the SEBI.
6. Breach of the Third Schedule provided under the Act.
7. Fails to pay the appropriate fees provided under the Second Schedule of the Act.
8. Fails to make an application for listing of units with the Stock Exchange.

Then the CIMC will be dealt with under the Chapter-V of the “Securities and Exchange Board of India (Intermediaries) Regulations, 2008”³⁶

COLLECTIVE INVESTMENT SCHEME: APPEAL

Any person who has been aggrieved by any order of the SEBI may appeal to the Securities Appellate Tribunal having jurisdiction in the matter.³⁷

³⁵ Supra note 16, Regulation 36

³⁶ Securities Exchange Board of India (Intermediaries) Regulations, 2008.

³⁷ Ibid.