

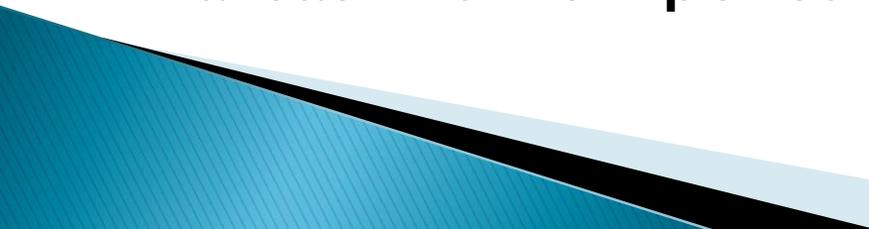
Investor Protection and Corporate Fraud



Categories of Investors in Indian Context

- ▶ Investors who normally invest in shares, debentures of listed companies, bonds of such companies, mutual funds etc.
 - ▶ Small and marginal investors from whom commission agents of dubious companies mobilise deposits in various disguises by luring them with very attractive interest rates.
- 

Salient features of second category of Investors

- ▶ Normally less educated investors, if educated then less aware.
 - ▶ Normally belonging to small towns or semi urban areas.
 - ▶ Lured by very attractive interest rates.
 - ▶ Attracted by services provided by commission agents at their door steps for collection of funds in areas with low penetration of banking services.
- 

What makes such Investors confident of investing their money?

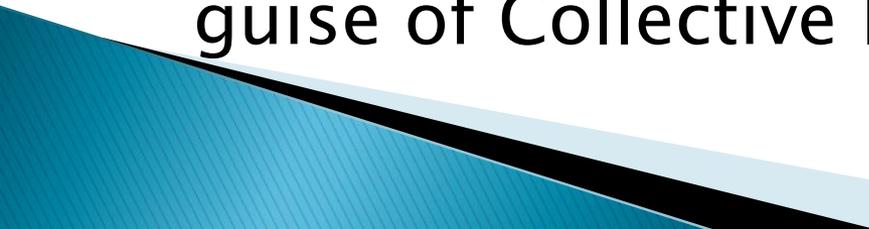
- ▶ One feels confident because of high profile of such companies with chain of posh offices and in most of the cases high visibility businesses like hotels, resorts, amusement parks etc.
 - ▶ In many cases, such companies are in media business running newspapers, TV Channels which in addition to creating high visibility & profile, also creates credibility and confidence in the minds of such investors.
- 

What makes such Investors confident of investing their money?

Contd.....

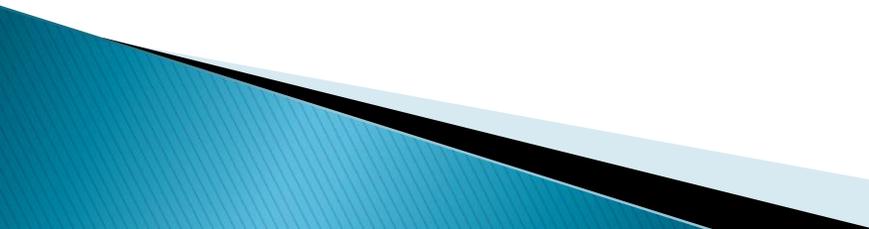
- ▶ Also feel confident because commission agents are normally men or women from their own social circle of friends, relations or local youth from their own community.
- 

Broad Categories of Unauthorised/ Fraudulent Public Deposit Mobilisation Schemes.

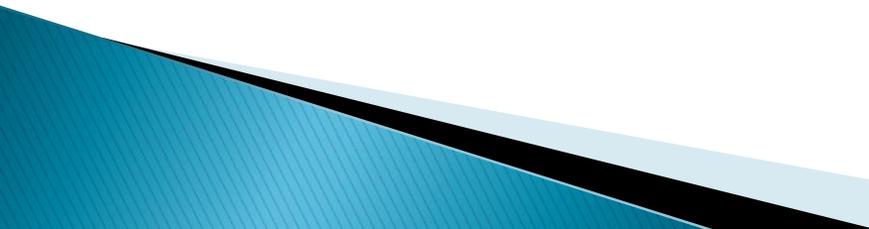
- ▶ Fraudulent mobilization of Public Deposits in the guise of receiving ‘advances’ for booking of products or services or assets.
 - ▶ Fraudulent mobilization of Public Deposits in the guise of providing certain services.
 - ▶ Fraudulent mobilization of Deposits in the guise of Collective Investment Schemes.
- 

Broad Categories of Unauthorised/ Fraudulent Public Deposit Mobilisation Schemes

contd.....

- ▶ **Unauthorised / Fraudulent mobilisation of funds by issue of preference shares in private placement but actually funds mobilised from public at large.**
 - ▶ **Unauthorised/ Fraudulent mobilisation of public funds by companies/ business entities functioning as NBFCs (Non Banking Finance Companies) without getting registered with the RBI.**
- 

Fraudulent Mobilisation of Public Funds in the guise of 'Advances' for booking Products / Services / Assets

- ▶ Taking monthly payments as advances for :
 - ▶ Booking in Real Estate projects flats / plots etc
 - ▶ Booking of consumer durables like cars, Motor cycles, Air Conditioners etc.
 - ▶ Booking of Tour Packages.
 - ▶ Booking of rooms in Hotels / Resorts.
- 

Real Nature of Activity

- ▶ While Professed Nature of Activity is advances for booking products/ assets/ services with option of refund with attractive interest & maturity. Typically not even 1% of customers/ depositors actually buy the product/ service/ assets.
- ▶ Most of the members (investors) do not understand the documents they sign.
- ▶ Both the company and the investors actually know that so called 'advances' are actually deposits carrying attractive returns.

Why disguise of Advances?

- ▶ Advances taken in the course of business activity are exempted from the legal definition of Public Deposits. Thus such schemes fraudulently circumvent RBI Act/ Company Law.

Fraudulent Mobilisation of Deposits in the Guise of Providing Services.

- ▶ Cases of making deposits with attractive interest to avail services like online gaming or market survey kits have come to notice.
 - ▶ Actually no revenue from the professed activity.
 - ▶ Schemes out rightly fraudulent.
- 

Collective Investment Schemes

Any scheme or arrangement made or offered by any company under which the contributions, or payments made by the investors, are pooled and utilised with a view to receive profits, income, produce or property, and is managed on behalf of the investors is a Collective Investment Scheme. Investors do not have day to day control over the management and operation of such scheme or arrangement.



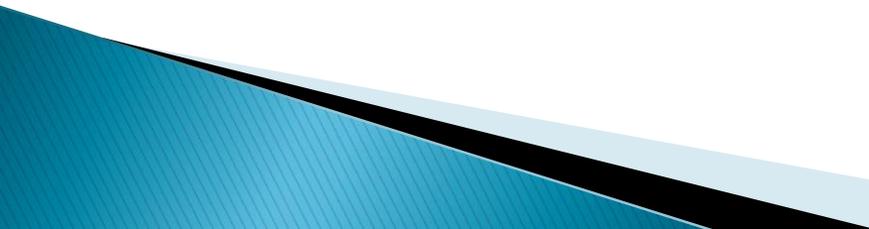
Fraudulent mobilization of Deposits in the guise of Collective Investment Schemes.

- ▶ Offer of participation in schemes like plantations, agrotech, live stock, poultry, social forestry, real estate, city taxi service or any other scheme.
 - ▶ Investors are assured of returns which normally ranges from upwards of 20% & in some cases can be more than 100% p.a. This makes the scheme fraudulent public deposit scheme.
- 

Unauthorised / Fraudulent mobilisation of funds by issue of preference shares in 'private placement' but actually funds mobilised from public at large.

- ▶ **Under Company Law Private placement of shares in a single offer cannot be to more than 50 persons.**
- ▶ **Such schemes are Violation of the above provision as offer to more than 50 persons become a public offer inviting the regulatory regime of SEBI.**

**Unauthorised/ Fraudulent
mobilisation of public funds
by companies/ business
entities functioning as NBFCs
(Non Banking Finance
Companies) without getting
registered with the RBI.**



Enrolment of Members / Agents / Participants

- ▶ Pyramidal Enrolment.
 - ▶ Normal enrolment of Commission Agents.
- 

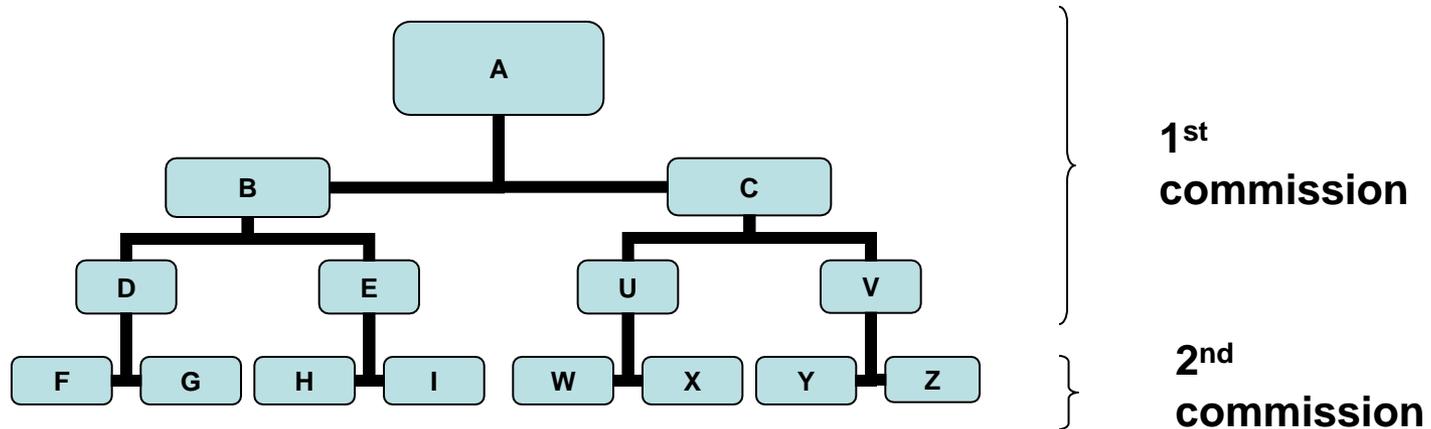
Pyramidal/ Multi Level Marketing Strategy

- ▶ Almost two-third of schemes mentioned above are types of pyramidal marketing strategies for enrolment of members which is violative of Prize Chits & Money Circulation & Money circulation schemes (banning) Act, 1978. This leads to quick & wide penetration of fraudulent schemes.

The compensation plans are designed to inevitably motivate the participants in the scheme to concentrate on recruiting more participants to make quick & easy money.



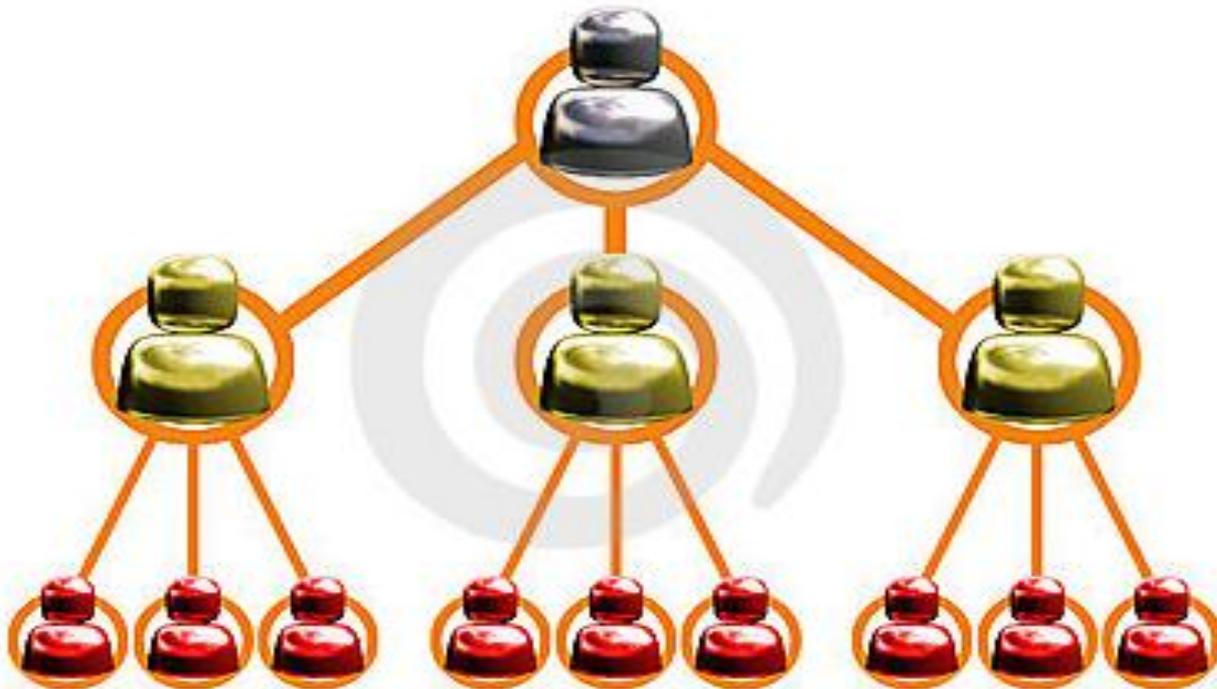
A typical compensation plan is as follows:



A pays a certain amount fixed by the company to become a member who may be called a ‘Distributor/ Independent Representative’ or any other such title. He has to enroll two members (say B & C) in the down line of the pyramid. He does not get commission till one more level gets enrolled by B & C. He gets one more extra commission if D, E, U & V enroll further members and thus the chain goes on. There may be the disguise of selling a product.



There can be another variant i.e each enrolled member enrolling three members:



Mathematically speaking, in the pyramid mentioned above, in 32 levels the entire population of the world would be covered. The saturation is reached much earlier and more members cannot be enrolled as enrolment is feasible only in the limited social circle of the participants.



Such schemes enrich the company and the top of the pyramid participants (TOPPs) at the cost of vast majority of the participants who are at the bottom two levels of the pyramid.



Range & Magnitude of the Problem

- ▶ In July 2011 the High Court of Madhya Pradesh directed the CBI to conduct preliminary enquiry in relation to 33 companies suspected to be violating 'Prize Chits & Money Circulation Scheme (Banning) Act, 1978'.
- ▶ One of these companies could make a total of more than one crore members.

Range & Magnitude of the Problem

contd...

- ▶ **Similarly such schemes adopt the disguise of selling a product or a service.**
 - ▶ **A company trading in gold coins in Tamil Nadu, through MLM pricing coins at 5 to 6 times its real value amount collected nearly 900 crores.**
- 

Range & Magnitude of the Problem

contd...

A foreign internet company mobilised a few thousand crores and siphoned off from the country (Sham survey kits).



Use of Internet

- ▶ Many fraudulent companies based abroad are also exploiting gullible Indian public by offering certain 'services' through internet. One company based in Singapore used pyramidal scheme to sell sham 'Survey' Kits for which they were charging Rs 11000/- each. Thousands of gullible Indians participated in it. In this process, a few hundred Crores of the cheated amount was remitted abroad.

Coordination of State Government and Central Government Agencies

- ▶ Under the constitution, crime investigation like fraud, money circulation scheme is the responsibility of state government agencies.
 - ▶ Regulation of public deposit Collective deposit scheme is the responsibility of Central Agencies like RBI, SEBI & Ministry of Corporate Affairs.
- 

Coordination of State Government and Central Government Agencies

contd....

- ▶ Effective coordination and information sharing between Central & State agencies would help state police in early detection of frauds and would help Central agencies in better regulation.