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COLLECTIVE INVESTMENT SCHEMES AND PONZI FRAUD: LEGAL INSIGHTS AND WAY FORWARD

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ABSTRACT

Ponzi schemes, often disguised as "Collective Investment Schemes," operate without regulatory oversight, leveraging continuous influxes of new capital to sustain their fraudulent activities. These schemes inherently suffer from insolvency, requiring an ever-increasing number of new investors to pay returns to earlier ones, ultimately leading to collapse when new investments wane. This paper scrutinizes the existing legal framework's shortcomings in addressing the chaos caused by Ponzi schemes. The primary objectives for resolving these schemes should include ensuring uniform outcomes for all investors, equitable loss distribution, and cost minimization. However, current insolvency laws fail to achieve these goals effectively. By analyzing notable cases and the intricacies of Ponzi scheme operations, this study highlights the need for a more robust legal mechanism to protect investors and ensure fair resolution. The examination covers regulatory and judicial interventions, emphasizing the importance of consistent and fair treatment of defrauded investors. This comprehensive analysis aims to inform the development of more effective policies and legal strategies to mitigate the impact of Ponzi schemes and safeguard investor interests.

I. INTRODUCTION

Ponzi schemes, often in the form of "Collective Investment Schemes," are unregulated investment operations and not falling within the SEBI Act[2], marked by fundamental insolvency right from the start. The functionality of such schemes depends upon a uniform amount of new capital to sustain their operations[3]. As these operations expand and come to a critical mass, new investments are harder to come by. This leads to the diversion of funds from investors, financing the schemes' initial insolvency. By definition, each unit of money paid into the scheme has a larger corresponding liability left behind. In order to service this debt, there must be a constant stream of new investments; when this stream ceases up, the scheme will necessarily fail[4]. Grasping the

[1] 4th year, BA.LLB (Hons.) at Institute of Law, Nirma University.

[2] Securities and Exchange Board of India Act, 1992, No. 15, Acts of Parliament, 1992

[3] 30 TOURO L. REV. [ix] (2014)

[4] Upasana Chandrashekaran, Ponzi Schemes In India: A Brief Overview Of The Regulatory Landscape, Mondaq

complexities of Ponzi schemes requires a proper understanding of their defining features. But the nature of such schemes shifts, making it impossible to define precisely elusive. Therefore, courts and the regulatory authorities concentrate on their identification of general patterns instead of following definite criteria to identify such fraud activities. This pattern-based strategy has been observed in various cases, including the Shraddha Group Financial Schemes[5], the Sanchita Investment Scams[6], and the IMA Ponzi Scam[7] etc.

A. HISTORY

These fraud schemes are so called because they are attributed to Charles Ponzi, an Italian immigrant who had moved to Boston, America. Ponzi was enticing people to invest in his purported business of selling and purchasing international postal coupons at a 100% profit margin. This business was a mere cover, for there was no such business. Ponzi promised investors a return of $150 on a $100 investment in 90 days[8]. For a while, the steady flow of fresh investments allowed Ponzi to meet his commitments. As the scheme expanded exponentially, authorities started investigating his business. Once the findings of the investigation were released revealing the reality of Ponzi's business, investors started asking for a return of their money. Though Ponzi refunded part of them temporarily, his scheme finally collapsed. The absence of any genuine economic activity to generate profits made it impossible to continue the repayments, which led to Ponzi's bankruptcy.

(Oct. 11, 2021),

https://www.mondaq.com/india/white-collar-crime-anti-corruption--fraud/1119950/ponzi-schemes-in-india-A-brief-overview-of-the-regulatory-landscap

[5] GN, Pooja, Case Study on Saradha Chit Fund Scam, https://ssrn.com/abstract=4268352 or http://dx.doi.org/10.2139/ssrn.4268352.

[6] Sanchayita Chit Fund Scam, The Hindu, https://www.thehindu.com/news/national/other-states/sanchayita-chit-fund-scam/article4641524.ece

[7] It is a long and endless wait for victims of IMA scam, The Hindu, https://www.thehindu.com/news/cities/bangalore/it-is-a-long-and-endless-wait-for-victims-of-ima-scam/article67383254.ece

[8] Spencer A. Winters, The Law of Ponzi Payouts, 111 MICH. L. REV. 119 (2012).

B. TYPES OF PONZI SCHEMES

Ponzi schemes exist in different forms, such as Pyramid Schemes and Chit Fund Schemes, among others. Pyramid Schemes: In contrast to other Ponzi schemes, Pyramid Schemes have several layers of promoters by whom the product is delivered to the end user. The central concept of a Pyramid Scheme is its reliance on the ongoing recruitment of new members, who enroll in an effort to acquire commissions instead of from the sale of goods to consumers[9].

Chit Fund Schemes: If registered under the Chit Funds Act of 1982[10],Chit Funds are treated as legal. Under this plan, you make a contract with a number of others to form a fund by paying a sum of money within a specified period of time. Received money is then distributed under an auction or tender system where the lowest bidder gets the lot prize. The balance is distributed among the members after the deduction of the commission for the foreman, the person operating the scam. This continues until all the investors have earned a lot of money at once[11]. All the other non-regulated schemes like Assured returns on investment by builders were were held to be declared as Ponzi by SEBI in 2016, unregistered promissory notes are also

another type of the same.

II. KEY FACTORS LEADING TO THE SUCCESS OF PONZI SCHEMES

Unregulated investment schemes still manage to attract a large number of investors, even with a series of investor education initiatives, tight regulation, and government initiatives to check such scams. Such schemes take advantage of a range of factors from technological, psychological, economic, to demographic, to entice people to invest their hard-earned funds in them. In order to make more effective policies, it is necessary to know how these factors are employed to manipulate and deceive the public[12].

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[9] Pyramid Schemes, N.Y. State Off. Att'y Gen.,

https://ag.ny.gov/pyramid-schemes#:~:text=A%20pyramid%20scheme%20is%20a,more%20investors%2C%20and%20so%20o

[10] Chit Funds Act, 1982, No. 40, Acts of Parliament, 1982.

[11] All about Chit Fund in India, TaxGuru,

https://taxguru.in/finance/chit-fund-india.html

[12] Kimberly D. Krawiec, Turning Winners into Losers: Ponzi Scheme Avoidance Law and the Inequity of Clawbacks, 96 MINN. L. REV. 1179 (2012).

A. PSYCHOLOGICAL MANIPULATION WITHIN INVESTMENT SWINDLES

Fraudulent investment schemes often thrive by exploiting several psychological factors. One the most critical factor is the intrinsic greed of people lured by the prospective vast returns in the short run[13]. The second reason is the investors' gullibility, which leads them to indulge in risky endeavors in spite of obvious warning signs. The scenario in which an investor also significantly affects their vulnerability; strong social and situational pressures can leave investors exposed to these frauds[14]. Schemers are also prone to use a tactic commonly referred to as affinity fraud, using common affinities like religious or ethnic associations. This common background will be truthful to them, as victims feel that an individual from their same background would not mislead them[15]. Awareness of these psychological factors is important for developing plans to protect potential victims.

B. DEMOGRAPHIC RISKS TO INVESTMENT SCAMS

Demographic elements play an important role in the continuation of fraudulent investment schemes. The elderly are most victimized by Ponzi schemes because of a lack of technological acumen and the necessity of counteracting inflation and market volatility with guarantees of higher returns[16]. Similarly, lower classes of society are extremely susceptible to these scams as they pursue quick financial expansion. Lower financial literacy is the most significant consideration; people with weak financial literacy are likely to depend on cognitive and heuristic biases, hence are prone to the scammers[17]. These demographic vulnerabilities are paramount in developing effective measures to safeguard such vulnerable populations from fraudulent investment schemes.

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[13] Roy F. Baumeister, Yielding to Temptation: Self-Control Failure, Impulsive Purchasing, and Consumer Behavior, 28 J. CONSUMER RES. 670 (2002).

[14] MICHAEL L. BENSON & SALLY S. SIMPSON, UNDERSTANDING WHITE-COLLAR CRIME: AN OPPORTUNITY PERSPECTIVE (2d ed. 2015), https://ebookcentral.proquest.com/lib/dmu/detail.action?docID=1864767

[15] Kristy Holtfreter et al., Low Self-Control, Routine Activities, and Fraud Victimization, 46 CRIMINOLOGY 189 (2008).

[16] Marguerite DeLiema et al., Financial Fraud Among Older Americans: Evidence and Implications, PENSION RES. COUNCIL WP 2018-3 (Pension Rsch. Council, Univ. of Pa., 2018).

[17] Jyoti Jain, Why People Fall Prey to Ponzi Schemes? – An Analysis of Attitudes, Behaviours, Demographics & Motivations, ResearchGate (Oct. 2018),

C. TECHNOLOGICAL EXPLOITATION THROUGH DECEPTIVE SCHEMES

Technological advancement has greatly contributed to the success of the investment fraud schemes. The advent of cryptocurrency and encrypted communication channels has increased anonymity and pseudonymity, which complicate the identification and prosecution of offenders[18]. Social networking sites are also used to market to prospective investors, through online marketing techniques to create a fake legitimacy. The use of automated investment programs and artificial intelligence gives the illusion of sophisticated financial management, producing the illusion of uniform returns and further misleading investors[19]. Understanding the role of technology in these scams is essential in coming up with strategies to fight against and stop such forms of fraud. By examining these factors, policymakers can better understand the multifaceted nature of these scams and develop more effective measures to protect potential victims.

III. UNCOVERING THE PONZI SCHEME

Unlinking the Ponzi schemes is a process of its own complexity and usually starts after investors' money had been siphoned off. At this stage, the Ponzi scheme runners frequently become involved in insolvency proceedings. In such situations, courts and insolvency experts have the responsibility to enforce provisions of applicable law, such as the Companies Act[20], the Securities and Exchange Board of India (SEBI) Act[21], and the Insolvency and Bankruptcy Code (IBC)[22], including provisions for voidable transactions, to recover investors' sanction funds and prosecute the company for fraud. These legislative actions were initially meant to equilibrate the trade creditors' interests, guarding against cases where the main goal of the business was to cheat investors. Even though several courts have grappled with how to apply such principles to different Ponzi schemes,

https://www.researchgate.net/publication/328797929

[18] Weili Chen et al., Exploiting Blockchain Data to Detect Smart Ponzi Schemes on Ethereum, 7 IEEE ACCESS 216 (2019).

[19] Artificial Intelligence (AI) and Investment Fraud, FINRA (Aug. 30, 2021),

https://www.finra.org/investors/insights/artificial-intelligence-and-investment-fraud

[20] Companies Act, 2013, No. 18, Acts of Parliament, 2013.

[21] Securities and Exchange Board of India Act, 1992, No. 15, Acts of Parliament, 1992

[22] Insolvency and Bankruptcy Code, 2016, No. 31, Acts of Parliament, 2016

it is unclear whether subsequent courts will then follow the same procedure, as the analysis is extremely fact-dependent.

A short summary of the process of unwinding Ponzi schemes is as follows[23]:

• A request is made to declare the scheme a Ponzi scheme.

• The court holds there are grave doubts to be resolved but not enough evidence to declare the scheme a Ponzi scheme.

• The court appoints an insolvency practitioner to investigate the scheme's affairs.

• The court finally determines the scheme to be a Ponzi scheme.

• An insolvency practitioner is appointed to liquidate the Ponzi scheme.

• The liquidator determines or approximates the date on which the scheme began or became a Ponzi scheme.

• The liquidator recovers amounts recoverable from the scheme operator and third parties.

• The liquidator recovers funds withdrawn and fictitious gains paid out to investors after scheme's fraudulent inception date.

• Following payment of fair costs and expenses, the liquidator distributes all available funds to investors.

If an unregulated Collective Investment Scheme is found to be a Ponzi scheme, it may be charged under different acts, after conviction under applicable legislative provisions. The insolvency proceedings of the company take place only in the IBC provisions, which have overriding operation on other law under Section 238 of the IBC[24]. The applicable law will be dealt with in great detail in the subsequent section.

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[23] A New Regime for Unravelling Ponzi Schemes - Discussion Paper, N.Z. Ministry Bus. Innovation & Emp. (May 2018),

https://ppl-ai-file-upload.s3.amazonaws.com/web/direct-files/20785097/10ae1921-c01b-4a10-bc0e-6e689f28aba5/ponzi-discussion-paper.pdf

[24] Insolvency and Bankruptcy Code, 2016 § 238, No. 31 of 2016.

IV. LEGISLATIONS

In India, the regulation of entities collecting public funds operates under several distinct legislative frameworks overseen by different regulatory bodies. The Reserve Bank of India (RBI)[25] holds responsibility for supervising Non-Banking Financial Companies (NBFCs), exercising its authority under the provisions of the RBI Act, 1934[26]. Concurrently, the Securities and Exchange Board of India (SEBI) regulates all collective investment agreements, as mandated by the SEBI Act, 1992[27]. The authority to regulate chit funds and money circulation schemes rests with state governments, acting under the Chit Funds Act, 1982[28].

Apart from these core legislations, a range of other acts and rules govern activities falling under unregulated schemes. This broader regulatory net includes the Prize Chits and Money Circulation Schemes (Banning) Act of 1978[29], the Companies Act of 2013[30], and the Companies (Acceptance of Deposits) Rules established in 2014[31]. The SEBI Act, 1992, along with the SEBI (Collective Investment Scheme) Regulations formulated in 1999 (commonly referred to as the CIS Regulations)[32], also play vital roles in this oversight. The Banning of Unregulated Deposit Schemes (BUDS) Act[33] specifically targets the suppression of illicit deposit-taking schemes.

This article focuses its examination on the relevant provisions within the Companies Act and the BUDS Act. It will also explore how the Corporate Insolvency Resolution Process (CIRP), governed by the Insolvency and Bankruptcy Code (IBC), applies to companies entangled in operating Ponzi schemes. Through this analysis, the paper aims to offer a thorough understanding

[25] Reserve Bank of India Act, 1934, No. 2, Acts of Imperial Legislative Council, 1934.

[26] Reserve Bank of India Act, 1934, Ch. III-B, No. 2, Acts of Imperial Legislative Council, 1934.

[27] Securities and Exchange Board of India Act, 1992, No. 15, Acts of Parliament,1992.

[28] Chit Funds Act, 1982, No. 40, Acts of Parliament, 1982.

[29] Prize Chits and Money Circulation Schemes (Banning) Act, 1978, No. 43, Acts of Parliament, 1978

[30] Companies Act, 2013, No. 18, Acts of Parliament, 2013.

[31] Companies (Acceptance of Deposits) Rules, 2014, S.O. 663(E), Ministry of Corporate Affairs, Government of India (2014).

[32] Securities and Exchange Board of India (Collective Investment Scheme) Regulations, 1999, S.O.748(E), Securities and Exchange Board of India (2022)

[33] Banning of Unregulated Deposit Schemes Act, 2019, No. 21 of 2019

of the legislative and regulatory framework controlling public fund collection, alongside the mechanisms available for addressing insolvency arising from fraudulent operations.

A. THE COMPANIES ACT 2013

The Companies Act 2013 primarily addresses corporate fraud committed by entities. Section 447 of this Act[34] defines and penalizes Fraud. It explains Fraud comprehensively as any act, omission, concealment of a fact, or abuse of position undertaken by any person intending to deceive, gain an advantage, or cause harm to the company, its investors, or its shareholders. This applies irrespective of whether the act results in wrongful gain or wrongful loss. This Act empowers the central government to order an investigation into a company's affairs. This power can be triggered upon receiving a report from an inspector or registrar, or upon notification that the company itself has passed a special resolution indicating its affairs require investigation. The government can also initiate such an investigation if it deems it necessary in the public interest.

Section 211 of the Act[35] grants the Central Government the authority to establish a Serious Fraud Investigation Office (SFIO) specifically tasked with investigating fraud committed by companies. The SFIO has the mandate to initiate investigations and possesses the power to arrest an individual if it possesses sufficient grounds, supported by material evidence, to believe they are involved. Following the completion of an investigation, the SFIO submits its report to the central government. Prosecution can then commence, but only after obtaining clearance from the central government.

The voidable transactions regime detailed in Sections 292-296 of the Companies Act provides a mechanism for a liquidator to take action against investors. These sections allow the liquidator to reclaim payments made to investors prior to the collapse of a Ponzi scheme operated by the company.

B. COMPANIES (ACCEPTANCE OF DEPOSITS) RULE, 2014

The 2014 Rules[36] provide a critical definition: any funds raised by a company under a promise of repayment, with or without interest, after a specified period, are classified as deposits. This detailed

[34] Companies Act, 2013, § 447, No. 18 of 2013.

[35] Companies Act, 2013, § 211, No. 18 of 2013.

[36] Companies (Acceptance of Deposits) Rules, 2014, S.O. 1094(E), Ministry of Corporate Affairs, Government of India (2014).

and stringent definition has effectively restricted operators from raising funds indirectly through intermediaries. The rules stipulate specific eligibility criteria: companies intending to solicit public deposits must possess a minimum net worth of INR 100 crores or achieve a turnover of at least INR 500 crores. The rules also introduce the concept of "deemed deposits." This provision clarifies that any scheme offering returns to investors, whether in the form of cash or kind, will be treated as a deposit. This definition addresses a loophole that was previously exploited.

C. SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 & SECURITIES AND EXCHANGE BOARD OF INDIA (COLLECTIVE INVESTMENT SCHEME) REGULATIONS, 1999

The Securities and Exchange Board of India (SEBI) has been active in enforcement, initiating 567 cases against illegal investment schemes involved in collecting public funds[37]. These Collective Investment Schemes (CIS) are formally defined under Section 11AA of the SEBI Act, 1992[38], and their operation is governed by the SEBI (CIS) Regulations, 1999[39]. Schemes that fail to register under this regulatory framework are classified and treated as Ponzi schemes.

A Collective Investment Scheme (CIS) is defined as an investment arrangement involving key participants: the Collective Investment Management Company, the Fund Manager, the trustee, and the shareholders or unit holders. The core principle involves multiple individuals pooling their funds collectively to invest in designated assets. The returns generated from these collective investments are then distributed among the participants according to the terms of a pre-established agreement.

The constitutional validity of Sections 11AA[40] and 12(1)(b)[41] of the SEBI Act has been challenged. These sections mandate that no entity can launch or operate a Collective Investment Scheme (CIS)

[37] SEBI Goes After Ponzi Schemes, Files 567 Cases So Far, ECON. TIMES (Aug. 30, 2021), https://economictimes.indiatimes.com/sebi-goes-after-ponzi-schemes-files-567-cases-so-far/articleshow/53508762.cms?from=mdr

[38] Securities and Exchange Board of India Act, 1992, § 11AA, No. 15 of 1992.

[39] Securities and Exchange Board of India (Collective Investment Scheme) Regulations, 1999, S.O. 748(E), Securities and Exchange Board of India (2022)

[40] Securities and Exchange Board of India Act, 1992, § 11AA, No. 15 of 1992.

[41] Securities and Exchange Board of India Act, 1992, § 12(1)(b), No. 15 of 1992.

without registering with SEBI. Challenges were raised on grounds of excessive delegation of legislative power and alleged violation of Article 14 (Right to Equality) of the Indian Constitution[42]. The Supreme Court upheld these provisions. In its reasoning, the Court emphasized that the provisions' primary intent is investor protection. It further stated that SEBI possesses adequate internal safeguards to prevent any potential abuse of its power. This position was solidified in the case of M/s PGF Ltd. vs. Union of India[43]. Applying the doctrine of pith and substance, the Court concluded that Parliament introduced these provisions to safeguard investors, an objective that aligns perfectly with SEBI's fundamental mandate.

D. THE BANNING OF UNREGULATED DEPOSIT SCHEMES ACT, 2019

The BUDS Act, 2019[44], specifically targets fraudulent and unregulated deposit-taking activities. It achieves this by first outlining specific deposit schemes that are considered valid because they fall under the regulation of established authorities like the Ministry of Corporate Affairs (MCA), SEBI, RBI, and others. These permissible regulated schemes include:

1. Certain collective investment schemes and alternative investment funds.
2. Portfolio management services.
3. Employee benefit schemes.
4. Mutual fund schemes regulated by SEBI.
5. Deposits accepted by Non-Banking Financial Companies (NBFCs) regulated by the RBI.
6. Insurance contracts regulated by the Insurance Regulatory and Development Authority of India (IRDAI).
7. Schemes offered by cooperative societies and chit funds regulated by State or Union Territory Governments.
8. Activities of housing finance companies regulated by the National Housing Bank (NHB).
9. Pension funds regulated by the Pension Fund Regulatory and Development Authority (PFRDA).

[42] CONSTITUTION OF INDIA, Article 14.

[43] PGF Ltd. v. Union of India, [2015] 13 S.C.C. 50.

[44] Banning of Unregulated Deposit Schemes Act, 2019, No. 21 of 2019.

10. Pension schemes or insurance schemes established under the Employees' Provident Fund and Miscellaneous Provisions Act, 1952[45].
11. Deposits accepted under the Companies Act, 2013, regulated by the MCA.

The BUDS Act explicitly prohibits and imposes penalties for the solicitation, operation, and acceptance of deposits through any scheme or means that are unregulated or fall outside the ordinary course of business. It also stipulates penalties for the failure to return funds accepted even under regulated deposit schemes upon the maturity of the promised service associated with those deposits. To adjudicate matters under this Act, it establishes a designated court or authority. This authority is appointed by the Government of India in consultation with the Chief Justices of the respective High Courts. The designated court must be presided over by a judge of a rank not lower than a District Judge or Sessions Judge, or an Additional District Judge or Additional Sessions Judge.

E. INSOLVENCY AND BANKRUPTCY CODE, 2016

Following the application of the previously discussed legislation, if a scheme is conclusively determined to be a Ponzi scheme and the operating company is declared insolvent, the formal insolvency process is initiated under the Insolvency and Bankruptcy Code (IBC), 2016[46], through the Corporate Insolvency Resolution Process (CIRP). CIRP can be initiated by a Financial Creditor, an Operational Creditor, or the Corporate Debtor itself when the Corporate Debtor defaults on its obligations (as per Section 6, which details the persons who may initiate CIRP)[47]. The minimum default amount required to initiate CIRP is set at not less than Rs. 1 crore (as stated in Section 4)[48].

The CIRP unfolds through six distinct stages:

STAGE 1: Petition to NCLT: A creditor holds the right to file a CIRP petition before the Appropriate Adjudicating Authority, which is the National Company Law Tribunal (NCLT). This

[45] Employees' Provident Funds and Miscellaneous Provisions Act, 1952, No. 19 of 1952.

[46] Insolvency and Bankruptcy Code, No. 31 of 2016.

[47] Insolvency and Bankruptcy Code, 2016, § 6, No. 31 of 2016.

[48] Insolvency and Bankruptcy Code, 2016, § 4, No. 31 of 2016.

is governed by Section 7 (initiation by Financial Creditors)[49], Section 9 (initiation by Operational Creditors)[50], and Section 10 (initiation by the Corporate Applicant itself)[51]. After the application is filed, the Adjudicating Authority (AA) is required to hear the matter within 14 days.

STAGE 2: Appointment of Interim Resolution Professional (IRP): Until the Committee of Creditors (CoC) appoints a Resolution Professional (RP) under Section 27, the AA appoints an Interim Resolution Professional (IRP)[52]. The IRP's role is crucial: ensuring the continuation of the insolvency process and maintaining the operations of the corporate debtor as a going concern.

STAGE 3: Moratorium: The moratorium period commences when the Tribunal admits the petition[53] (under Section 14). During this moratorium period, the Tribunal prohibits several actions:

1. The institution of fresh lawsuits or the continuation of pending lawsuits (specifically concerning financial debts) against the Corporate Debtor.
2. The transfer, encumbrance, disposal, or alienation by the Corporate Debtor of any assets, whether operational, financial, legal, or marginal.
3. Any foreclosure or recovery of debts against the Corporate Debtor under laws like the SARFAESI Act[54], 2002.
4. The recovery of possession of any property occupied by the Corporate Debtor or held by it at the commencement of the Insolvency Process. The moratorium period remains in effect until the CIRP is concluded. Its maximum duration is 180 days, although this can be extended by up to an additional 90 days in exceptional circumstances. If a resolution plan is accepted by the CoC and approved by the NCLT, the moratorium ceases to apply as per Section 31(3)(a)[55].

[49] Insolvency and Bankruptcy Code, 2016, § 7, No. 31 of 2016.

[50] Insolvency and Bankruptcy Code, 2016, § 9, No. 31 of 2016.

[51] Insolvency and Bankruptcy Code, 2016, § 10, No. 31 of 2016.

[52] Insolvency and Bankruptcy Code, 2016, § 27, No. 31 of 2016.

[53] Insolvency and Bankruptcy Code, 2016, § 14, No. 31 of 2016.

[54] Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, No. 54 of 2002

[55] Insolvency and Bankruptcy Code, 2016, § 31(3)(a), No. 31 of 2016.

STAGE 4: Collation and Analysis of Facts: The IRP is responsible for categorizing and verifying the claims submitted by petitioners, a duty outlined under Section 18(b)[56]. This process requires the IRP to gather and analyze information regarding the claims. The Code also authorizes the IRP to call meetings with petitioners concerning these claims. Crucially, the IRP is required to constitute the Committee of Creditors (CoC) under Section 18(c) within 30 days of the commencement of the CIRP[57]. Once the CoC is formed, its primary task is to appoint a Resolution Professional (RP). The CoC may choose to retain the IRP as the RP or appoint a new professional.

STAGE 5: Resolution Plan: As defined under Section 5(26), once the IRP/RP has verified the claims, the CoC must make a public announcement inviting prospective resolution applicants[58]. Interested bidders, who could be prospective investors, creditors, or other eligible entities, are invited to submit resolution plans. Depending on the number of plans received, the plan that secures the approval of more than 75% of the voting share of the CoC members is then presented before the NCLT for final approval.

STAGE 6: Decision: If the resolution plan approved by the CoC is presented before the NCLT and subsequently sanctioned (approved) by the NCLT, that plan becomes binding on all stakeholders. If the NCLT does not sanction the resolution plan, or if the CoC is unable to finalize a plan within the stipulated time frame (including any extensions), the Tribunal will order the liquidation of the corporate debtor. This liquidation process must be concluded within one year of the liquidation order being passed.

Post completion of this CIRP process, the company operating the Ponzi scheme is formally declared insolvent and subsequently wound up. The individuals responsible for perpetrating the fraud are then held accountable under the various legislations discussed earlier (Companies Act, BUDS Act, etc.). The CIRP framework provides a structured mechanism through which investors

[56] Insolvency and Bankruptcy Code, 2016, § 18(b), No. 31 of 2016.

[57] Insolvency and Bankruptcy Code, 2016, § 18(c), No. 31 of 2016.

[58] Insolvency and Bankruptcy Code, 2016, § 5(26), No. 31 of 2016.

who were defrauded by these schemes have an opportunity to recover at least a portion of their lost investments.

V. CASE STUDY

This section explores several significant Ponzi schemes that have operated in India, deceiving millions of unsuspecting investors and causing substantial financial losses at different points in time. To provide a clearer picture, we will analyze two major scams in detail. This analysis will highlight the involvement of key government authorities like SEBI (Securities and Exchange Board of India), RBI (Reserve Bank of India), and CBI (Central Bureau of Investigation), alongside the crucial role played by the Indian judiciary in facilitating the return of funds to affected investors.

A. THE HBN DAIRIES AND ALLIED INDUSTRIES CASE

The HBN Dairies scam centered around HBN Dairies & Allied Limited[59], a company that illegally collected funds from more than 2 million investors, amounting to roughly ₹1,136 crore[60]. This was achieved through deceptive investment schemes promising high returns linked to the purchase of cattle and the sale of ghee. Crucially, these schemes operated without the required regulatory approvals.

In response to these fraudulent activities, SEBI stepped in. The regulator ordered the company to return all collected funds to investors by March 9, 2015. The SEBI also imposed significant restrictions: it barred the company and its directors, Harmender Singh Sran and Amandeep Singh Sran, from accessing the securities market for a period of four years. It also prohibited them from launching any new collective investment schemes (CIS)[61]. This decisive action was aimed at

[59] M/s Bhanu Ram & Ors. v. M/s HBN Daries & Allied Ltd., NCLT Principal Bench, IBC Law, https://ibclaw.in/m-s-bhanu-ram-ors-vs-m-s-hbn-daries-allied-ltd-nclt-principal-bench/?print=print&print-posts=print

[60] SEBI Slaps Rs 1 Cr Fine on HBN Dairies Directors, Bus. Standard, https://www.business-standard.com/article/pti-stories/cis-sebi-slaps-rs-1-cr-fine-on-hbn-dairies-directors-117122900920_1.html

[61] HBN Dairies Scam: HC Directs CCB to Identify Properties Owned by Promoters, TIMES INDIA (Apr. 4, 2018), https://timesofindia.indiatimes.com/city/chennai/hbn-dairies-scam-hc-directs-ccb-to-identify-properties-owned-by-promoters/articleshow/63250637.cms.

protecting investors and preventing the company and its associates from continuing their fraudulent practices.

Frustrated by the lengthy delays in SEBI's handling of the HBN Dairies scam recovery, a group of investors took a different legal route. They approached the National Company Law Tribunal (NCLT), filing an insolvency petition under Section 7 of the Insolvency and Bankruptcy Code (IBC) to initiate the Corporate Insolvency Resolution Process (CIRP)[62]. The Principal Bench of the NCLT in Delhi accepted this CIRP application. It appointed Mr. Rohit Sehgal as the Resolution Professional (RP) and issued orders to de-attach HBN's properties. This NCLT decision directly conflicted with SEBI's earlier attachment order and also imposed a moratorium on actions against the company. This case is formally recorded as Bhanu Ram v. HBN Dairies & Allied Ltd[63].

HBN Dairies argued that SEBI's ongoing efforts to recover funds violated the moratorium period mandated under the CIRP. The key question before the NCLT was whether SEBI could legally pursue recovery or sell the corporate debtor's assets during this moratorium. SEBI countered by asserting its authority under Sections 11 and 11B of the SEBI Act, read together with Regulation 65 of the SEBI (Collective Investment Scheme) Regulations, 1999. SEBI also contended that its orders, which had been upheld by the Securities Appellate Tribunal (SAT), were beyond the NCLT"s jurisdiction to challenge[64].

The NCLT invoked Section 238 of the IBC. This section explicitly states that the provisions of the IBC override any other laws to the extent of any inconsistency. The tribunal referenced the Supreme Court's landmark decision in CIT v. Monnet Ispat and Energy Ltd.[65], which confirmed the supremacy of the IBC over conflicting laws. Examining the specifics, the NCLT concluded

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[62] In re Hindustan Tankers Pvt. Ltd., C.P. (IB) No. 23/Chd/Pb/2021, National Company Law Tribunal, Chandigarh Bench (Feb. 25, 2021), https://ibccases.com/nclt/hindustan-tankers-pvt-ltd-23-2021-2/.

[63] M/s Bhanu Ram & Ors. v. M/s HBN Daries & Allied Ltd., NCLT Principal Bench, IBC Law, https://ibclaw.in/m-s-bhanu-ram-ors-vs-m-s-hbn-daries-allied-ltd-nclt-principal-bench/?print=print&print-posts=print

[64] Clash of the Authorities – SEBI v. IBC: Experts' Opinion, TAXMANN (Apr. 25, 2019), https://www.taxmann.com/research/company-and-sebi/top-story/105010000000017044/clash-of-the-authorities-%E2%80%93-sebi-v-ibc-experts-opinion.

[65] Comm'r of Income Tax v. Monnet Ispat & Energy Ltd., (2018) 5 SCC 577

that SEBI's recovery actions conflicted with sections 14, 15, 17, 18, and 25 of the IBC[66], and in particular the moratorium provisions which expressly forbid legal proceedings or asset transfers against the corporate debtor during the CIRP.

The dispute escalated to the National Company Law Appellate Tribunal (NCLAT) in the case of Bohar Singh Dhillon v. Rohit Sehgal[67]. The NCLAT focused on whether SEBI could impose penalties or recover assets using Section 28A of the SEBI Act during the moratorium. While referencing Anju Agarwal v. Bombay Stock Exchange[68], which stated that the Interim Resolution Professional (IRP) must ensure the corporate debtor complies with all laws (including SEBI regulations), the NCLAT made a critical distinction. It held that Section 28A of the SEBI Act could not override the IBC's moratorium provisions, reinforced by Section 238 of the IBC[69].

The NCLAT upheld the NCLT's decision. It emphasized that the IRP must manage the corporate debtor's assets strictly according to the IBC framework and with the approval of the Committee of Creditors (CoC). This ruling firmly established the supremacy of the IBC over other laws during the active insolvency resolution process.

This case vividly illustrates a conflict between regulatory authorities – specifically between SEBI's enforcement powers and the IBC's insolvency process. It also demonstrates how the NCLT and NCLAT skillfully interpreted the relevant legal sections to resolve this conflict. Their interpretations reflected a sophisticated grasp of the legal hierarchy, reinforcing the principle that the IBC takes precedence over other conflicting laws during insolvency proceedings[70]. This

[66] Insolvency and Bankruptcy Code, 2016, No. 31, Acts of Parliament, 2016

[67] Bohar Singh Dhillon v. Rohit Sehgal (Interim R.P.) & Ors., Company Appeal (AT) (Insolvency) No. 526 of 2019, National Company Law Appellate Tribunal (May 9, 2019)

[68] Ms. Anju Agarwal v. Bombay Stock Exchange, (2022) SCC OnLine Bom 1234.

[69] How the Moratorium and Overriding Effect Provisions Under the IBC Can Be Assessed to Dilute the Capacity of the SEBI to Recover the Penalty Amount or to Comply with Any Direction Under Section 28A of, IBC Law, https://ibclaw.in/how-the-moratorium-and-overriding-effect-provisions-under-the-ibc-can-be-assessed-to-dilute-the-capacity-of-the-sebi-to-recover-the-penalty-amount-or-to-comply-with-any-direction-under-section-28a-of/?print-posts=print&print=pdf

[70] Whether the Insolvency and Bankruptcy Code has Overriding Powers? An Analysis: Experts' Opinion, TAXMANN (Feb. 25, 2019), https://www.taxmann.com/research/ibc/top-story/105010000000016314/whether-

adjudication ensured that the core mechanisms of the IBC, especially the moratorium and the IRP's control over assets during the CIRP, were protected, thereby upholding the integrity and objectives of the insolvency resolution framework.

B. ALCHEMIST INFRA REALITY LIMITED

Alchemist Infra Realty was involved in operating an unauthorized collective investment scheme (CIS). The company raised over ₹1,900 crore from investors without securing the necessary regulatory approvals. In March 2017, SEBI took strong action, mandating the attachment of the company's bank accounts, Demat accounts, and mutual fund folios, as well as those of its directors. This move was aimed at recovering the illegally raised funds. It followed a 2013 directive from SEBI where, upon discovering the company was running a CIS disguised as a real estate business without regulatory consent, SEBI had ordered Alchemist Infra and its directors to refund the collected amount with interest[71].

In December 2018, the Calcutta High Court intervened, ordering the refreezing of Alchemist Infra Realty's demat account. Consequently, SEBI released the company's demat account in January 2019. SEBI maintained the attachment of the demat accounts belonging to directors Brij Mohan Mahajan and Narayan Madhav Kumar to continue its recovery efforts against them[72].

In a separate legal development, Technology Parks Limited, acting as the Financial Creditor (FC), filed an application under Section 7 of the IBC against Alchemist Infra Realty Limited (the Corporate Debtor, CD). The FC sought to initiate the Corporate Insolvency Resolution Process (CIRP) due to the CD defaulting on a loan. The FC had provided loans to the CD, formalized in an agreement dated August 1, 2016, with a three-year term starting June 30, 2016. A significant event occurred when the FC's Board of Directors resolved on June 25, 2016, to waive a call option

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the-insolvency-and-bankruptcy-code-has-overriding-powers-an-analysis-experts-opinion.

[71] SEBI Orders Release of Alchemist Infra's Demat Account in Rs 1,900 Crore Illegal Scheme Case, ET Realty, https://realty.economictimes.indiatimes.com/news/regulatory/sebi-orders-release-of-alchemist-infras-demat-account-in-rs-1900-crore-illegal-scheme-case/67665631

[72] Notice of Attachment of Bank Accounts and Demat Accounts 7778 and 7779 Dated December 13, 2021, Against Alchemist Infra Realty Limited, Mr. Brij Mohan Mahajan, Mr. Narayan Madhav Kumar, Mr. Balvir Singh, Sec. & Exch. Bd. of India, https://www.sebi.gov.in/enforcement/recovery-proceedings/dec-2021/notice-of-attachment-of-bank-accounts-and-demat-accounts-7778-and-7779-dated-december-13-2021-against-alchemist-infra-realty-limited-mr-brij-mohan-mahajan-mr-narayan-madhav-kumar-mr-balvir-singh-_54594.htm

and instead demand repayment of the loan with interest. This demand was formally communicated to the CD on June 25, 2018, which was within two years of the loan's commencement[73].

The CD was instructed to repay the principal loan amount of ₹3,290,500,000 before the original tenure ended on June 30, 2019. This repayment was also required to include any interest that had accrued from July 1, 2018, up to the date of repayment. A supplementary agreement was signed on December 31, 2018. This agreement specified that ₹3,156,800,000 would be due by June 30, 2019, and stipulated an additional interest rate of 12% per annum in case of any delay or default in payment[74].

After the CD failed to respond to a formal notice sent by the FC on July 26, 2019, a demand notice was issued on February 29, 2020. This notice demanded payment of ₹3,597,079,836. The CD eventually responded on November 24, 2021. In its response, the CD argued that initiating the CIRP was premature because settlement discussions were supposedly ongoing. The CD also contended that the loan agreement itself was unenforceable due to alleged improper stamping. It is essential to note that the CD did not dispute the underlying liability or the fact that a default had occurred[75]. As a result, the NCLT admitted the Section 7 application. It appointed Mr. Gaurav Misra as the Interim Resolution Professional (IRP). The IRP was directed to make a public announcement regarding the admission of the application. Crucially, a moratorium under Section 14(1) of the IBC was immediately imposed concerning the CD. The NCLT bench, satisfied that a default had occurred and the debt remained unpaid, ordered the applicant FC to deposit ₹200,000 with the IRP to cover the initial expenses of the CIRP. Therefore, the application under Section 7 of the IBC for initiating the CIRP by the Financial Creditor was formally admitted[76].

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[73] Corporate Insolvency Resolution Process of Alchemist Infra Realty Ltd., Alchemist Infra, https://www.alchemistinfra.com/court-orders-application

[74] Order Dated 10 August 2023 in the matter of Technology Park Ltd. vs Alchemist Infra Realty Ltd., Alchemist Infra, https://airl.netcdn.in/uploads/court-orders/Order-Dated-10.08.2023-AIRL.pdf

[75] Report under Regulation 13 and 17 for Updated CoC (V1), Alchemist Infra, https://airl.netcdn.in/uploads/court-orders/Report-13-17-V1.pd

[76] Report under Regulation 13 and 17 for Updated CoC (V1), Alchemist Infra, https://airl.netcdn.in/uploads/court-orders/Report-13-17-V1.pd

These case studies highlight the intricate complexities and significant legal hurdles involved in tackling Ponzi schemes within the Indian context. They demonstrate the pivotal roles played by regulatory bodies such as SEBI, RBI, and CBI, alongside the judiciary's continuous efforts to safeguard investor interests and deliver justice. The HBN Dairies case specifically showcases the potential for conflict between SEBI's regulatory mandate and the procedures outlined in the Insolvency and Bankruptcy Code (IBC). Conversely, the Alchemist Infra Realty case exemplifies more coordinated efforts between SEBI and the judicial system to recover funds defrauded from investors. Both these cases powerfully underscore the critical importance of strict regulatory compliance and highlight the robust legal mechanisms India has established to combat financial fraud and protect the interests of investors.

VI. WAY FORWARD

The core goals for addressing the fallout from Ponzi schemes must center on three key principles: ensuring consistent outcomes for all affected investors, distributing losses fairly among them, and minimizing overall resolution costs. India's current legal framework falls short in effectively achieving these objectives.

Firstly, the issue of fairness to investors remains a critical gap. Existing insolvency laws offer no guarantee of equitable treatment for victims of Ponzi schemes. These laws should instead enable the efficient liquidation of fraudulent operations and ensure that any recoverable funds are distributed justly, especially while prioritizing those who invested critical retirement savings. The collapse of a Ponzi scheme should not obstruct investors' recovery paths. Determining whether an investor provided legitimate value should not impede the liquidator's ability to claw back payments made using illicit funds[77].

Secondly, the current framework also generates arbitrary outcomes due to the lack of a statutory mechanism for recovering fraudulent payments in certain investment structures. Shortening the vulnerability period for voidable transactions from two years to six months is insufficient for tackling investment fraud. Consequently, recovery rates for investors vary widely based on external factors, such as whether funds can be reclaimed by a liquidator, statutory manager, or trustee, or the timing of an investor's withdrawal, none of which reflect the investor's culpability.

[77] Sanjay Kumar Trivedi, A Gap Analysis on Regulation of Collective Investment Schemes in India, 3 GJRA - GLOBAL J. FOR RES. ANALYSIS 1 (2014).

Finally, the uncertainty and complexity of the corporate insolvency regime drive up costs for liquidators. These expenses diminish the pool of funds available for distribution to victims[78]. Prolonged delays in resolving cases compound the harm suffered by defrauded investors, who endure extended waiting periods before receiving any compensation. Equally concerning is the absence of public enforcement mechanisms under current insolvency rules to assist Ponzi scheme victims[79]. Unlike trade creditors, fraud victims have no dedicated public recourse, forcing them to navigate recovery alone—a process often marked by high costs and frustrating delays.

One proposed solution is creating a Ponzi-specific insolvency regime modeled after New Zealand's Financial Markets Conduct Act, 2013 (FMCA)[80]. This approach offers distinct advantages: it aligns with the FMCA's core purpose of fostering market confidence and informed participation, and it leverages existing enforcement tools to support fraud victims. It is essential to note that embedding such a regime within the FMCA would be unprecedented. It could also prove ineffective if the scheme's assets are fully depleted and no recoveries can be made from investors[81].

An alternative is modifying the current insolvency regime. While this option builds on familiar legal infrastructure, it's fundamentally designed for ordinary business failures not only for investment fraud. Creating a parallel insolvency track might cause confusion, and it still lacks a public enforcement mechanism to aid victims. A third idea is a statutory compensation scheme for investors, which was considered but ultimately rejected due to risks like discouraging prudent investment decisions and imposing heavy transaction costs on financial markets[82].

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[78] Namrata Acharya, Ponzi Schemes Thrive on Loopholes, Apart from More Stringent Laws, Regulators Need to Come Together to Fight Saradha-Like Scams, BUS. STANDARD (May 3, 2013),

https://www.business-standard.com/article/companies/ponzi-schemes-thrive-on-loopholes-113050300032_1.html

[79] Restructuring and Liquidation, Ministry of Corp. Aff., Gov't of India,

https://www.mca.gov.in/content/mca/global/en/data-and-reports/reports/other-reports/report-company-law/restructuring-and-liquidation.html

[80] Financial Markets Conduct Act 2013, 2013 No 69 (N.Z.)

[81] Restructuring and Liquidation, Ministry of Corp. Aff., Gov't of India,

https://www.mca.gov.in/content/mca/global/en/data-and-reports/reports/other-reports/report-company-law/restructuring-and-liquidation.htm

[82] Kimberly D. Krawiec, Turning Winners into Losers: Ponzi Scheme Avoidance Law and the Inequity of

The most promising path forward is establishing a Ponzi-specific insolvency regime under the FMCA. This bespoke framework would better achieve our core objectives: delivering consistent outcomes for investors, distributing losses equitably, and minimizing unwinding costs. It should recognize all investors as fraud victims, apply uniformly across investment structures, enable collective fund recovery, and clarify repayment expectations[83]. It should be simple to administer and include hardship provisions for investors unable to repay clawback demands. This solution directly confronts the unique challenges of Ponzi schemes, ensuring fair and efficient liquidation while safeguarding investor interests.

VII. CONCLUSION

India's regulatory and legislative response to Ponzi schemes reflects a layered and evolving strategy to shield investors and uphold market integrity. Key regulations, including the Companies Act 2013, SEBI's oversight mechanisms, and the Insolvency and Bankruptcy Code (IBC provides robust tools to detect, investigate, and resolve fraudulent operations. These are powerfully reinforced by the Banning of Unregulated Deposit Schemes (BUDS) Act, which directly targets illegal deposit-taking at its source.

The proposal for a Ponzi-specific insolvency regime under New Zealand's Financial Markets Conduct Act (FMCA) stands out as a particularly innovative solution. This approach resonates with the FMCA's mission to promote confidence and informed engagement in financial markets. By treating all investors as fraud victims, applying consistent rules across structures, and streamlining fund recovery, the regime aims to deliver fairer outcomes, equitable loss-sharing, and lower resolution costs. Such a framework promises a more efficient and just process for unwinding fraudulent schemes.

Implementing this regime would break new ground and face significant hurdles, especially when schemes leave few recoverable assets. Continuous evaluation and refinement will be essential for its success. Merely adapting the existing insolvency framework, while leveraging familiar processes, risks inadequately addressing the nuances of investment fraud and still omits vital public

Clawbacks, 96 MINN. L. REV. 1179, 1188-1190 (2012).

[83] A New Regime for Unravelling Ponzi Schemes - Discussion Paper, N.Z. Ministry Bus. Innovation & Emp. (May 2018),

https://ppl-ai-file-upload.s3.amazonaws.com/web/direct-files/20785097/10ae1921-c01b-4a10-bc0e-6e689f28aba5/ponzi-discussion-paper.pdf

enforcement support for victims. Through comprehensive legislation, vigilant enforcement by bodies like SEBI and the RBI, and the potential adoption of a dedicated Ponzi resolution framework, India can significantly strengthen investor protection. These measures collectively foster a financial ecosystem that is more transparent, resilient, and trustworthy turning the lessons from past frauds into safeguards for the future.