SEBI INVESTMENT ADVISOR REGULATIONS – A STEP FORWARD

SEBI's Board Meeting dated August 16, 2012[1] approved the SEBI (Investment Advisors) Regulations, 2012 ('**Regulations**') providing a framework for the registration and regulation of investment advisors ('**Investment Advisors**'). The objective of the Investment Advisors Regulations is to regulate only the 'act of advising' to investors for consideration. In other words the act of 'selling' or mis-selling of products, if any, would be solely under the purview of the product regulators.

Prior to the approval of the Investment Advisors Regulations, SEBI had published the SEBI (Investment Advisors) Regulations, 2007 ("2007 Regulations") as well as a consultative paper on the 'Regulation of Investment Advisors' ("Concept Paper") and invited public comments on the same. Based on public comments received on the 2007 Regulations and the Concept Paper, a memorandum was placed before SEBI proposing a regulatory approach for registration of Investment Advisors.

INVESTMENT ADVISORS REGULATIONS

The key provisions of the draft Investment Advisors Regulations are broadly set out below:

1. *Who must Register*

- Persons providing investment advice: Any individual, body corporate, partnership firm and financial planners engaged in the business of providing investment advice for consideration.
- Any person who holds himself as an Investment Advisors.
- The representatives of Investment Advisors which is a body corporate.
- Fund Managers: The fund managers who are employees or advisors of Mutual Fund or Asset Management Company or Alternative Investment Fund.
- Banks: A Bank permitted by RBI to undertake investment advisory services through a subsidiary or a Separately Identifiable Department or Division ('**SIDD**') of a Bank.
- A body corporate which offers investment advisory services through a SIDD.

2. *Segregation of Advisory and Distribution business*

Any banks or corporate bodies offering distribution, execution or referral services can offer investment advisory services through a subsidiary or a SIDD. Such a SIDD offering advisory services should be clearly segregated from its other activities. Thus only the act of advising will be regulated under Investment Advisors Regulation, whereas the regulation of selling of products, if any would be solely under the purview of the product regulator.

3. *Exemptions from Registration*

- Good Faith Advice: Persons providing general advice, in good faith, on trends in the securities market or economic situation provided such comments do not specify any particular securities or investment products.
- Advice available to the public: Investment advice given without any consideration through newspaper, magazines, any electronic medium, or a broadcasting medium, which is widely available to the public.
- Advice on Insurance and pension products: Persons advising exclusively in areas like insurance and pension products provided they are regulated with sectoral regulator IRDA and PFRDA for such activity.
- Advice by Lawyers: Advocates, solicitors and law firms who provide any investment advice to their clients solely incidental to their legal practice.
- Advice by CA: Members of ICAI, ICSI, ICWAI, ICFA and Actuarial Society of India who provide investment advice to their clients solely incidental to their professional service.

[1] http://www.sebi.gov.in/sebiweb/home/list/4/23/0/0/Press-Releases, http://www.sebi.gov.in/cms/sebi_data/boardmeeting/1347620232173-a.pdf

- Advice by Market intermediaries: Stock-brokers, sub-brokers, portfolio managers and merchant bankers registered with SEBI providing investment advice incidental to their primary activity. However, such intermediaries are required to comply with obligations under the Investment Advisors Regulations such as acting in fiduciary responsibility, risk profiling etc.
- Distributors registered with Association of Mutual Funds of India who receive fees from investors under SEBI (Mutual Fund) Regulations 1996.

4. *Obligation of the Investment Advisors*

- Code of Conduct: Abide by prescribed code of conduct.
- Maintain records: relating to investment advisory services for a period of 5 years;
- Maintain system for redressing grievances of clients
- Fiduciary duty: Act in fiduciary capacity and in the interest of its clients;
- Risk assessment: Conduct risk profiling and risk assessment of the investor;
- Conduct yearly audit

5. *Conflict Resolution:*

To address the issue on conflict of interest, the Investment Advisors must ensure the following:

- Segregation of advisory and distribution services: Details set out in point 2 above;
- Disclosures: Make adequate disclosures to their clients in relation to any remuneration or compensation received by them and any of their associates from the distribution, referral or execution services if the client chooses the recommended investment advice.

6. *Other Provisions in the Investment Advisors Regulations*

- Registration: The Investment Advisors registered under the Investment Advisors Regulations shall use the words 'investment advisors' in their name. SEBI proposes to appoint a Self Regulatory Organisation for the purpose of regulating Investment Advisors, Representatives or Fund Managers. At present, SEBI will directly register and regulate Investment Advisors.
- Qualifications: Requirements relating to experience, qualification, certification, net worth/net assets and fit and proper person have been prescribed for a person to act as an Investment Advisors.
- SEBI's power to inspect book and accounts and documents of the Investment Advisors suo moto or on complain by the investor/client.

ANALYSIS:

Although the final notification of the Investment Advisors Regulations is awaited, SEBI's move to include the Investment Advisor within its regulatory ambit is a welcome move for the asset management business in India as it will deter the Investment Advisors from giving sham advice and instill investor confidence in the markets.

1. *Fund Managers for onshore and offshore fund must register:*

Offshore Funds: Presently, domestic Investment Advisors enter into Investment Advisory Agreements with the offshore fund managers, for giving investment advice to offshore funds investing in India. Post notification of Investment Advisors Regulations, such Investment Advisors would be able to render their advisory services to offshore managers only if they are registered as such with SEBI.

Domestic Funds: The 'Manager'[2] as defined under the SEBI (Alternative Investment Funds) Regulations, 2012 will have to be registered as Investment Advisor with SEBI.

2. *Greater degree of Responsibility and Accountability:*

The Investment Advisors Regulations once notified will certainly cast a greater degree of responsibility and accountability on the Investment Advisor. In accordance with the regulations, Investment Advisors are under an obligation to act in fiduciary capacity, carry out risk profiling and are required to follow a prescribed code of conduct while dealing with the clients. This will help to ensure that the investment advice given by Investment Advisors is client specific and based on client's risk appetite.

However, in India, a large set of retail investors rely on print and media reports and spokespersons to make investments in the stock markets. However, such category of persons giving investment advice does not fall within the purview of the Regulations as they have been exempted. Thus, SEBI needs to put in place some mechanism to regulate such Investment Advisors to ensure unsophisticated retail investors are protected from such unsolicited investment advice.

[2] Regulation 2(q) defines 'Manager' as '*any person or entity who is appointed by the Alternative Investment Fund to manage its investments by whatever name called and may also be same as the sponsor of the Fund.*'