SEBI (INVESTMENT ADVISERS) REGULATIONS, 2013

The SEBI (Investment Advisers) Regulations, 2013 ("**IA Regulations**") notified by SEBI on January 21, 2013 is an investor-friendly set of regulations which aims to create transparency in the provision of investment advisory services by establishing a pool of trustworthy, qualified and investor-friendly investment advisers. However, the implementation of the IA Regulations will determine if this intent has been achieved. The impact of the IA Regulations is manifold. However, in this article we have attempted to analyse a few aspects of the IA Regulations from an industry perspective.

- **EXEMPTIONS:** The IA Regulations have exempted many intermediaries from their scope with the intent of distinguishing between distributors and investment advisers and also exempting those already registered with SEBI under any other regulations. The exemptions as currently provided create ambiguity for some intermediaries already registered with SEBI. Given below are our observations in respect of a few of the exempt categories:

  1. Portfolio Managers registered with the SEBI:

     - Regulation 4(g) of the IA Regulations exempts from its scope any person "*who provides any investment advice to its clients incidental to their primary activity*". Several portfolio managers currently registered as such with SEBI also provide investment advisory services independent of their portfolio managerial services. The wordings of Regulation 4(g) are rather ambiguous as most portfolio managers provide investment advisory services in addition to the portfolio managerial services under a separate advisory agreement and these advisory services are not "incidental" to their primary activity as such. Thus, it is open to interpretation whether such portfolio managers are also required to obtain a separate registration under the IA Regulations.

     - Furthermore, portfolio managers have been brought under the purview of the IA Regulations as they are now required to comply with Chapter III of the IA Regulations which deals with 'General Obligations and Responsibilities'. This also means duplicity of compliance requirements as under Chapter III of the SEBI (Portfolio Managers) Regulations, 1993 ("**PM Regulations**") a portfolio manager is required to observe an exhaustive list of general obligations and responsibilities. It is also unclear whether a separate compliance officer is required to be appointed for each of the services. From an operational perspective, perhaps it would have been simpler if the PM Regulations were amended to remove advisory services from their scope of application.

  2. Regulation 4(i) of the IA Regulations exempts any person who provides investment advice exclusively to clients based out of India:

     - The implication of this is that advisers that provide investment advice exclusively to offshore funds/entities are exempt from registration under the IA Regulations. There are several cases of investment advisers who provide investment advice primarily to offshore clients with a very small percentage of domestic clients. Such advisers may have to terminate their arrangement with domestic clients to avoid registration under the IA Regulations.

- **CONFLICT OF INTEREST:** Regulation 18 (Disclosure to clients) of the IA Regulations, is very broadly worded and does not provide for an objective standard for disclosures. For example regulation 18(5) requires the investment adviser to disclose to the client any actual or potential conflicts of interest arising from any connection to or association with any issuer of products/ securities, including any

material information or facts that might compromise its objectivity or independence in the carrying on of investment advisory services. Further, the IA Regulations also require the investment adviser to draw the client's attention to the warnings, disclaimers in documents, advertising materials relating to an investment product which it is recommending to the client. While all the above requirements are investor friendly, the test to determine if the investment adviser has in fact complied with these obligations is unclear. The Investment Adviser is also required to act in a fiduciary capacity towards its clients and is required to disclose all conflicts of interest as and when they arise, which implies that the obligation to disclose conflict of interest is an ongoing one.

- **RISK PROFILING AND SUITABILITY:** Regulation 16 of the IA Regulations requires the Investment Adviser to undertake exhaustive risk profiling in respect of each of its clients and to also document that the advice provided to the client is appropriate in respect of the clients risk profile. However, no parameters have been defined for undertaking such risk profiling. Therefore, this may act as a deterrent for investment advisers who provide both distribution and investment advisory services to not obtain registration under the IA Regulations. Also, certain categories of advisers such as merchant bankers are exempt from obtaining registration under the IA Regulations but are required to comply with the general obligations under chapter III of the IA Regulations (which includes risk profiling). With most clients of merchant bankers being large corporate houses, undertaking risk profiling of such clients could be a very cumbersome exercise.

- **NO MINIMUM THRESHOLD:** Further, the IA Regulations do not provide for a minimum threshold to ease the compliance requirements on the part of smaller Investment Advisers.

From an investor perspective, the IA Regulations are a very positive step. However, this opportunity could have also been utilised by SEBI to overhaul the PM Regulations in view of the overlap between the PM Regulations and the IA Regulations to provide better clarity. Further, given the nature of the IA Regulations, it is the implementation of the same by SEBI and the manner in which the existing players in the market adopt the IA Regulations, which will determine if the object of the IA Regulations reaches the investors.