

# Update

## SEBI spreads its net to unregulated Investment Advisers: Regulations notified

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### *Introduction:*

With the tremendous growth of Indian asset management and financial advisory business over last few decades, a need for transparency in the conduct of dealing with market participants was felt. Accordingly, SEBI in the years 2007 and 2011 issued a consultative paper and a concept paper respectively on guidelines regulating investment advisors and approved a draft of SEBI (Investment Advisers), Regulations, 2012<sup>1</sup> at its meeting held on 16<sup>th</sup> August, 2012 which was placed on its site for public comments. SEBI has finally on 21<sup>st</sup> January, 2013 issued the SEBI (Investment Advisers) Regulations, 2013<sup>2</sup> (hereinafter referred to as the “**Regulations**”) vide its Notification No. LAD-NRO/GN/2012-13/31/1778 dated 21<sup>st</sup> January, 2013 which shall be coming into force on the ninetieth day from the date of their publication in the Official Gazette i.e. from 20<sup>th</sup> April, 2013.

### *Applicability:*

The Regulations shall apply to all individuals, bodies corporate, limited liability partnerships and firms engaged in or intending to engage in giving investment advice and accordingly such entities will be required to hold a valid registration certificate from SEBI in the manner prescribed under Regulation 3 of the Regulations. Entities offering investment advisory services prior to 20<sup>th</sup> April, 2013 will be given six months’ time to register themselves with SEBI.

It is pertinent to note that advisers advising their clients on or before 19<sup>th</sup> April, 2013 would not require registration. However, after the commencement of the Regulations, any person ‘acting’ or ‘holding itself out’ as an investment adviser will be required to compulsorily seek registration with SEBI.

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<sup>1</sup> Draft Guidelines are available at: [http://www.sebi.gov.in/cms/sebi\\_data/boardmeeting/1347620232173-a.pdf](http://www.sebi.gov.in/cms/sebi_data/boardmeeting/1347620232173-a.pdf)

<sup>2</sup> The notified regulations are available at: [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1358779330956.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1358779330956.pdf)



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### *Relevant Definitions:*

As per Regulation 2 (l) of the Regulations:

***“Investment advice”*** means advice relating to investing in, purchasing, selling or otherwise dealing in securities or investment products, and advice on investment portfolio containing securities or investment products, whether written, oral or through any other means of communication for the benefit of the client and shall include financial planning.

However, investment advice given through newspaper, magazines, any electronic or broadcasting or telecommunications medium, which is widely available to the public, will not be considered as investment advice for the purpose of these regulations. The definition is broad enough to include a wide range of financial products, advisory and planning actions rendered in any form of communication, but it is quite clear that it does not include non financial products like real estate. In the definition, the important terms used are ‘*securities*’ and ‘*investment products*’. The term ‘*securities*’ may have its meaning as defined in Securities Contracts (Regulation) Act, 1956 while phrase ‘*investment products*’ is undefined in the Regulations and is open for interpretation.

As per Regulation 2 (m) of the Regulations:

***“Investment adviser”*** means any person, who for consideration, is engaged in the business of providing investment advice to clients or other persons or group of persons and includes any person who holds out himself as an investment adviser, by whatever name called.

By the above definition every person engaged in providing investment advisory and planning services has been included within the ambit of the Regulations with exceptions to such persons or entities already regulated by SEBI or some other regulatory authority.

### *Exemption from Registration under the Regulation:*

Exemption were initially granted to

1. Stock and sub brokers,
2. Merchant bankers and portfolio managers already registered with SEBI providing investment advice incidental to their primary activity (*only with respect to registration requirement*),



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3. Distributors of mutual funds providing investment advice incidental to their primary activity,
4. Fund manager of mutual fund, alternative investment fund,
5. Professionals such as lawyers, chartered accountants, company secretaries, cost accountants providing advices incidental to their professional services,
  - a. *Considering the wide definition of investment advice, professionals who specialise in financial advice generally may have to consider whether they are covered.*
6. Persons providing advice exclusively in areas like insurance and pension products provided regulated by IRDA & PFRDA respectively;
7. Persons providing general comments in good faith about market trends and not restricted to a particular security or investment product.

In addition to the above-mentioned, following categories are also exempted from the requirement of registration:

1. Fund Manager of any Intermediary or entity registered with SEBI
2. Any representative and partner of a registered Investment adviser
3. Any person who provides investment advice exclusively to clients based out of India
4. Any other person as may be specified by SEBI

Thus investment advisers in India, or even outside India, engaged in providing investment advisory services to an offshore fund manager of an offshore fund need not get registered. However, whether persons providing investment advice to Non-Resident Indian (NRIs) or Person of Indian Origin (PIOs) will be required to obtain registration from SEBI or not is not clear. The exact interpretation of the term 'based out of India' cannot be gauged from the Regulations and needs further clarification.

Since the exclusions are specific, any other person who acts as investment adviser, whether full time or part time and whether gives advice generally even incidental to the financial products that he is distributing would be covered.



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### *Prerequisite for Registration Application:*

An exhaustive list of eligibility conditions for individuals, body corporate, firm or limited liability partnership for registering as an Investment adviser has been provided under Regulation 6. Besides, the applicant needs to possess qualification and certification as stated in Regulation 7. Fresh applicants need to comply with the Capital Adequacy requirement, stipulated in Regulation 8, at the time of making an application while existing investment advisers are required to comply with the same within one year from the existence of the Regulations.

In case the applicant is a bank or an NBFC, necessary permission shall be obtained from RBI and the application shall be made either through a subsidiary or a department or division which is separately identifiable for investment advisory and planning functions.

Further, where the applicant is an entity incorporated outside India or a foreign citizen, it will be required to set up a subsidiary or an office respectively in India for applying for registration. In case of a foreign citizen, his intention to operate through such office established in India needs to be disclosed.

One of the exemptions say that representatives and partners of registered investor advisers will not be required to get themselves registered with SEBI subject to compliance with Regulation 7 of the Regulations. However, it is pertinent to note here that the Regulation 7 prescribes the minimum qualifications and certifications from NISM. In other words, the only exemption is from the registration and the partners and representatives of a registered investment adviser will be required to have the prescribed qualification and certification.

### *What's in store for the Investors?*

The Investor may perceive the Investment Advice to be more appropriate and reliable as the same shall be given by the registered Investment Adviser only after suitable risk profiling of each of its client. The recommendation given to a client may be consistent with clients' experience, knowledge, investment objectives, risk appetite and capacity for absorbing loss. Investment Advisers shall always act in a fiduciary capacity towards their investor clients and shall disclose conflicts of interests as and when they arise in accordance with the Regulations.



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An Investment Adviser has been prohibited from receiving any consideration in any form, directly or indirectly, from any third person other than the client being advised, in respect of the underlying products or securities for which advice is provided. This minimizes the chances of getting a non-objective or biased advice by an Investor.

### *Onus on the Investment Advisers:*

- The Investment Advisers need to comply with the extensive disclosure and documentation requirements.
- The Investment Advisor needs to ensure KYC Compliance and adhere to the Code of Conduct.
- The Investment Advisers need to maintain the prescribed records duly signed and preserve the same for a minimum period of 5 years.
- Appoint a Compliance Officer in case of an Investment adviser being a body corporate or a partnership firm to ensure monitoring the compliance.
- The Investment Advisers need to conduct yearly audit in respect of compliance of these Regulations from a member of ICAI or ICSI.
- Segregation of distribution or execution services from investment advisory services in case of Investment Advisers which are banks, NBFCs and body corporate.
- The registration of the Investment Adviser shall be valid for a period of 5 years from the date of issue and renewal application shall be made three months before the expiry of registration.
- The Investment Adviser is required to obtain prior approval from SEBI in case of change in control<sup>3</sup> of the Investment Adviser.

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<sup>3</sup> Regulation 2(e) of the IA Regulations defines “change in control” in relation to a company or body corporate to mean – “(i) if its shares are listed on any recognized stock exchange, change in control within the meaning of clause (e) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011; and (ii) in any other case, change in the controlling interest or change in legal form.” It should be noted that the term “controlling interest” has been further elaborated to mean, “an interest, whether direct or indirect, to the extent of more than fifty percent of voting rights or interest.”



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### *Conclusion:*

The Investment Advisers were earlier governed by the Investment Advisory Agreement for the obligation cast upon them and any breach would therefore lead to breach of contract. But with the regulation coming in, the advisers are now statutorily governed, imposing a fiduciary obligation to act in the best interest of the investor. It is expected that this move will cast a greater degree of responsibility and accountability on the Investment Advisers.

The Regulations have been introduced by SEBI in order to regulate the unregulated section of investment and financial advisers in India, prevent fraud and protect investor's sentiments. The disclosure requirements and the requirement of risk profiling of clients have been mandated in order to enhance the quality of services offered by Investment Advisers and ensure transparency. Investors may now be assured of the genuineness of entity claiming to be Investment Advisers as well as rely upon their Investment Advice.

Several small to medium size investment advisers will now be governed by SEBI and are entrusted with added responsibility and accountability. However, compliance of the same on part of small advisers may prove cumbersome as well as costly.

Moreover, if unsatisfied, SEBI may reject the applications and on rejection, such person or entity shall cease to act as Investment Adviser. SEBI may reject the application by giving an opportunity to be heard to the applicant, no appeal can be made against decision of SEBI. However, in any case, such person shall not be relieved from any investor liability. A defaulting applicant or a registered Investment Adviser who acts in contravention to the Regulations shall be punishable and dealt in accordance with the SEBI (Intermediaries) Regulations, 2008.

Although SEBI is hoping to strike a right balance between imposing heavy regulations and protection of the investors in the securities market in India, the achievement of this aim will depend on the effective implementation of the Regulations and extent of willful compliance by the Investment Advisers.