

## Background

SEBI has released a consultative paper on the “Regulation of Investment Advisors” for public comments by 31<sup>st</sup> October 2011. Section 11(2)(b) of SEBI Act empowers SEBI to register and regulate working of Investment Advisors and such other intermediaries who may be associated with securities market in any other manner.

In this document India Juris has summarized the main features of the proposed regulations which intend to regulate the Investment Advisors.

## Structure of Proposed Regulations

The proposed regulatory framework intends to regulate the activity of providing investment advisory services in various forms by a wide range of entities including independent financial advisors, banks, distributors, fund managers etc. The investment advice may be provided for investments in various financial products including but not limited to securities, insurance products, pension funds, etc.

Persons desirous of registration as Investment Advisors shall obtain registration with the SRO (Self Regulatory Organization) established for the purpose. The SRO will be entitled to charge a fee for granting registration and an annual fee.

## Definitions

### Investment Advisor

Investment advisor for the purpose of the regulations shall be any person or entity that provides investment advice directly or indirectly for a consideration, which may be received directly from the investor or who holds himself out as an investment advisor.

### Investment Advice

Investment advice shall be an advice written, oral or through any other means of communication given regarding investment of funds in financial products or products that are traded and settled like financial products purportedly for the benefit of the investor. It shall include:

- (a) Financial advice; or
- (b) Financial planning service or
- (c) Actions which would influence an investment decision and are incidental to making an investment/investment decision.

## Coverage

### Individuals

The following set of individuals would need to get registered to be able to provide Investment Advisory Services:

- Independent Investment Advisor
- Representatives of investment advisors or intermediaries who on behalf of the investment advisor or intermediary provide investment advice to investors.

### Non Individuals

The following set of non-individuals (corporate entities) would need to get registered to be able to provide Investment Advisory Service:

- Banks providing investment advisory/ wealth management services:
- Any entity, other than an individual person - representing investment advisor, who on behalf of the investment advisor provides investment advice to investors.

## Persons Exempt from the regulations

A person shall be deemed not to be engaged in the business of providing investment advice, if the advice is solely incidental to some other business or profession and the advice is given only to clients of the person in the course of such other business or profession and the advice does not specify particular securities and is limited to general comments made in good faith in regard to trends in the securities market and the economic situation of the country.

The following shall be exempt from registration under these regulations:

- a. An advocate or a law firm
- b. Chartered accountants
- c. Any person who publishes magazine/newspaper,
- d. Any person who provides an information service through an electronic, or a broadcasting or telecommunications medium
- e. Any stock broker or sub-broker as registered with SEBI and not charging any consideration for such advice.
- f. Insurance broking services

## Registration Requirements

**Individuals:** who wish to get registered under these regulations should satisfy the following:

- Individuals should acquire a Professional Qualification from a recognized institute for e.g.

Chartered Accountancy from ICAI, MBA in Finance or similar qualification from a recognized university or should have at least 10 years of relevant experience; and

- Certification from NISM or such other organization approved by SEBI for this purpose
- The individuals should conform to the Fit and Proper Criteria as laid down in Schedule II of SEBI (Intermediaries) Regulations, 2008.

**Entities:** who wish to get registered under these regulations should satisfy the following:

- Capital Adequacy Requirement: Entities would need to maintain a minimum net worth which would be separate from the net worth required for other activities.
- Key personnel: Entities should have at least 2 key personnel having the relevant experience exclusively for such activity. Such key personnel should also acquire the certification from NISM or such other organization as approved by SEBI for this purpose and have minimum qualification as prescribed.
- The entity should conform to the Fit and Proper Criteria laid down in Schedule II of SEBI (Intermediaries) Regulations, 2008.
- The applicant must have adequate infrastructure to enable it to discharge its functions as an Investment Advisor.

## **Obligations of an Investment Advisor**

### **Fiduciary Responsibility to Investors**

All information received and provided by the investment advisor would be in fiduciary capacity. The investment advisor will be responsible to maintain confidentiality of the investment advice provided to the client and information provided by the client. Advice should be given by the advisor in the best interest of the investor.

### **Suitability and Risk Profiling**

The Investment Advisors or their representatives would be required to do adequate risk profiling of the client before any investment service is provided to them. Based upon the risk profiling performed by the investment advisor or their representative suitable investment advice should be provided. The records of such risk profiling and investment advice should be maintained by the Investment Advisor.

## **Advertising and Marketing Material**

Investment Advisors should not use any advertisement that contains any untrue statement of material fact or that is otherwise misleading. They should not use or refer to testimonials (which include any statement of a client's experience or endorsement).

Refer to past, specific recommendations made by the advisor that were profitable, unless the advertisement sets out a list of all recommendations made by the advisor within the preceding period of not less than one year and complies with other specified conditions.

## **Conflict of Interest**

No financial incentives/ consideration would be received from any person other than investors seeking advice. In case of advice regarding investment in entities related to the investment advisor, adequate disclosures shall be made to investor regarding the relationship.

## **Maintaining Records**

Records in support of every investment recommendation /transaction made which indicates the data, facts and opinion leading to that investment decision would be maintained by the Investment Advisor. Records should be retained for at least 5 years. Systematic record of all advises provided would be kept including audio recording of any oral advice given.

## **Fees and Charges**

The Investment Advisor would clearly indicate to its clients the fees and charges that are required to be paid by them. An investment advisor shall disclose to a prospective clients all material information about itself, its businesses, its disciplinary history, the terms and conditions on which it offers advisory services, its affiliations with other intermediaries and such other information as is necessary for him to take an informed decision whether to avail of its services.

## **Execution Services**

Investment advisors shall not accept funds / securities from investors, except the fee for investment advice. If Non-individual investment advisors (corporate entities) offer assistance in execution services such as broking, custody services, DP services, accounting etc., they must make appropriate disclosures, clarify that the investor is under no obligation to use their services and maintain arms length relationship through creation of Chinese walls. The choice of opting for execution services offered by investment advisor should be left to the investors. Fees and charges paid to service providers should be paid directly to them and not through investment advisors.

## **Outsourcing**

Other than sourcing of research reports, no other part of investment advisory activity can be outsourced.

## **Liability**

The investment advisors shall not be liable for civil or criminal liability in respect of advice given unless the advice is negligent or mala-fide in nature. Any dispute between the investment advisor and his client would be resolved through grievance redressal mechanism or arbitration created by SEBI

## **Entities registered as Portfolio Managers**

Portfolio Managers who provide only investment advice would need to be registered only as investment advisors after their present registration expires. Portfolio Manager Regulations would be amended in view of the proposed AIF Regulations as well as the Investment Advisor Regulations.

