INDIA NOTIFIES INVESTMENT ADVISERS REGULATIONS – ARE YOU REGULATED NOW?

(A Comparative Analysis With The Investment Advisers Act of 1940 of USA)

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Securities and Exchange Board of India ("**SEBI**"), the securities regulator in India, has recently notified the much awaited Investment Advisers Regulations, 2013 ("**Regulations**") in India, to regulate the hereto unregulated investment advisers in India. SEBI has introduced the Regulations after mooting two consultative papers in 2007 and 2011 seeking stakeholders' opinions on the substance and form of the regulations.

The Regulations will come into force on April 20, 2013 and a relaxation from registration under the Regulations has been provided for a period of six months thereafter for persons acting as investment advisers prior to April 20, 2013. However, any investment adviser who wishes to initiate investment advisory services after April 20, 2013 will compulsorily need to seek registration with SEBI under the Regulations.

The Regulations are likely to have a far reaching impact in regulating the unregulated investment advisers in India and in certain cases even offshore advisers providing investment advice in India. We present here an analysis of the Regulations to understand their impact across the financial industry in India.

I. Definition of Investment Adviser

The Regulations seem to have drawn an analogy from the US Investment Advisers Act of 1940 ("**US IA Act**"), wherein an investment adviser is defined to mean "*any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities…*".

Under the Regulations, an Investment Adviser means "*any person who is engaged in the business of providing investment advice to clients or other persons or group of persons, for a*

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consideration, and includes any person who holds out himself as an investment adviser by whatever name."

'Investment advice' has been defined under the Regulations to mean any 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.*" It, however, excludes any advice given through a newspaper or magazine or through any electronic, broadcasting or telecom medium as may be widely available to the public at large.

Also, 'consideration' is defined to mean any form of economic benefit, including non-cash benefit, under the Regulations. Similarly, under the US IA Act, 'compensation' received in the form of economic benefit is sufficient for a person or firm to qualify as an investment adviser and be regulated by the US IA Act in addition to the other components discussed further above.[9]

Further, the US IA Act covers advice only in relation to securities. However, under the Regulations, investment advice includes advice relating to securities and 'investment products'. However, under the SEBI Act, 1992, the role of SEBI is limited to "*protect the interests of investors in securities and to promote the development of, and to regulate the securities market…*"[10] and hence investment products may be interpreted contextually to be limited to securities market.

II. Exemptions from Registration Under the Regulations

The Regulations provide a comprehensive list of persons who shall be exempted from seeking registration under the Regulations. This exemption list extends to stock and sub brokers, merchant bankers, portfolio managers, distributors of mutual funds, fund manager of mutual fund, alternative investment fund, venture capital fund or any intermediary or entity that is registered with SEBI, professionals such as lawyers, chartered accountants providing advice incidental to their professional services; and person providing general comments in good faith about market trends.

Further, any person who provides investment advice exclusively to clients based out of India would be exempted from registering itself with SEBI; however, if clients happen to be non-resident Indians (NRIs) or person of Indian origin (PIOs), then they will fall within the net of the Regulations and would need to register with SEBI. This exclusion means that any person, whether in India or out of India, who provides investment advice exclusively to a person 'based outside India', other than to NRIs and PIOs, would be exempted from registering under the Regulations. This appears to have been aimed at, and is likely to provide relief to all the investment advisers in India, or even outside India, engaged in providing investment advisory services to an offshore fund manager (or General Partner) of an offshore fund, as long as their investment advice is restricted exclusively to such offshore clients. If in addition to the offshore clients, the investment adviser wishes to provide any advice to a client in India or to any NRIs or PIOs, it will be required to seek registration under the Regulations.

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[9] See the following link: http://www.sec.gov/divisions/investment/iaregulation/memoia.htm (last visited on February 15, 2013)

[10] Section 11 (1) of the SEBI Act, 1992.

It may however be noted that the exemption provision provides that the client should be 'based out of India', which may be ambiguous in its interpretation, i.e., whether an investment adviser giving investment advice to any Indian resident (not being a NRI or PIO) who, at the time when the advice was being given, was based outside India for a temporary period, would be caught under the exemption or not, may be ambiguous.

With regard to foreign entities that fall within the ambit of the Regulations and are required to get registration with SEBI under the Regulations, a vital determining factor that will be taken into consideration by SEBI would be whether the foreign entity has a subsidiary in India, and if yes, then whether such subsidiary has sought any registration under the Regulations. Similarly, if a foreign individual proposes to undertake investment advisory services and is required to register with SEBI under the Regulations, SEBI would take into consideration whether he/she has an office in India; and if yes, whether he/she proposes to undertake investment advice from such office or not.

III. Roles and Responsibilities of Investment Advisers

The Regulations hold investment advisers to the highest ethical and moral standards in order to protect clients' interests. SEBI seems to have taken into account the lessons learnt from the Global Settlement of Conflicts of Interest between Research and Investment Banking[11] and has sought to address the same issues through extensive rules (but not as far reaching as the rules prescribed by the US IA Act) to address conflict of interest, risk profiling and risk mitigation for persons availing the services of investment advisers.

The Regulations mandate that investment advisers shall always act in a fiduciary capacity towards their clients and sets an extremely high threshold on disclosures relating to conflict of interests which may arise during course of the investment adviser's activities being undertaken. Further, the Regulations prohibit an investment adviser from receiving any consideration by way of remuneration or compensation or in any other form from any person relating to underlying securities or investment products other than the client being advised by the investment adviser. On the contrary, under the US IA Act, fees need not be received directly from a client of the investment adviser.

The Regulations mandate an investment adviser to maintain arm's length relationship between its investment advisory activities and other activities. It is in furtherance of this that the Regulations mandate a 'Chinese wall' between the investment advisory arm and other activities of an investment adviser. The Regulations also devote special attention to the segregation of execution of investment advisory services, especially in cases of banks, non-banking financial companies and other body corporates which also provide distribution and execution services.

The Regulations also prohibit an investment adviser from purchasing or selling securities / investment products on its own account (knowingly) from / to a client.

The Regulations prescribes various other obligations on, and compliances to be fulfilled by, the investment adviser, including:

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[11] Information regarding the Global Settlement is available at http://www.finra.org/Industry/Enforcement/DisciplinaryActions/2003GlobalSettlement/ (last visited on January 23, 2013).

- Fulfilling KYC requirements,
- Following the prescribed Code of Conduct,
- Carrying out risk profiling for the clients,
- Maintenance of prescribed records,
- Appointment of a compliance officer,
- Setting up procedures to redress client grievances, and
- Making relevant disclosures such as material information pertaining to itself, its disciplinary history, etc. to enable the client to take an informed decision on procuring the services of the investment adviser.

IV. Conclusion

Regulations fill yet another void in the securities market regulation in India hitherto left largely unregulated. SEBI has done a fine job of plugging a gap in the Indian financial services regulation without overreaching provisions that could smother the financial industry and its intermediaries. There are, however, certain anomalies under the Regulations; hopefully, SEBI will clarify such ambiguities before the Regulations come into force.

Whether a balance is achieved or not will depend on the effective and reasonable implementation of the Regulations by SEBI, especially on SEBI taking a pragmatic view of the various organizational structures that financial intermediaries have adopted in India – indeed the taste of honey will be in the eating.

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