

Too many puzzles

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The Securities and Exchange Board of India (Sebi) had notified the Sebi (Investment Advisers) Regulations, 2013 (Investment Advisers Regulations) earlier this year on January 21, 2013. Initially, when the first declaration was made by Sebi in its board meeting in August 2012, the framework was expected to have a sweeping effect on the regulation and functioning of all investment advisers, which section was left unregulated till date. The Investment Advisers Regulations were issued subsequent to two consultative papers issued by Sebi in 2007 and 2011 seeking comments on the form and substance relating to the framework for regulating the investment advisers.

The Investment Advisers Regulations require all the investment advisers to mandatorily register, unless exempted, with Sebi within a specific window of time, including investment advisers outside India who render investment advice to Indian residents. All investment advisers that have been providing investment advisory services before the notification of the Investment Advisers Regulations have been provided a breather period of six months from April 20, 2013 (being the date on which the Investment Advisers Regulations came into force) to register with Sebi. However, any investment adviser who wishes to initiate investment advisory services after the commencement of the Investment Advisers Regulations will compulsorily need to seek registration with Sebi under the Investment Advisers Regulations before providing any such services.

The Investment Advisers Regulations casts several obligations on investment advisers and compliances to be followed by them inter alia including: a) covering responsibilities for risk mitigation, b) disclosures on conflicts of interest, c) compliance with the prescribed code of conduct, d) undertaking the 'know your client' formalities, e) carrying out risk profiling for clients, f) maintenance of prescribed records, g) appointment of a compliance officer, and h) setting up procedures to redress client grievances in a timely and prompt manner.

Although it has been close to two months since the window to register with Sebi had opened, the obvious question immediately facing the industry is how many applications have been actually made to Sebi and how many registrations have been approved by Sebi till date? The answer to this practical question lies in the more important question as to who all are required to register under the regulations and whether the right time has come to make the application to the financial regulator.

The term "investment adviser" has been defined under the Investment Advisers Regulations to mean any person who is engaged in the business of providing investment advice to clients or other persons or group of persons, for a consideration, and includes any person who holds himself out as an investment adviser by whatever name. Thus, it is extremely critical to understand what forms to be an 'investment advice'. 'Investment advice' has been defined 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.

Sebi has left the industry in a paradox by leaving the term 'investment product' undefined, and thus, leaving it open to interpretation. For example, does it mean that any person providing advisory services on realty products can also be a target of the Investment Advisers Regulations? Although this need not be the intention of Sebi, being a financial regulator, it still is essential that Sebi clarifies the extent of its reach

under the regulations.

The Investment Advisers Regulations provide a comprehensive list of persons who shall be exempted from registering under the Investment Advisers Regulations. The list is exhaustive and inter alia covers a regulated insurance agent, pension adviser, stockbroker, merchant banker or portfolio manager, an advocate or law firm, a chartered accountant, a fund manager of an alternative investment fund, any person who gives comments in good faith on trends in the financial or securities market or any other person specified by Sebi. Also, any person who provides investment advice exclusively to clients based out of India (other than to NRIs or PIOs) is also exempted from registering under the regulations. The term 'based out of India' may be ambiguous in its interpretation as it is not clear whether the criterion to be applied is relating to residency (under exchange control laws or tax laws), domicile or citizenship / incorporation.

Further, there is a requirement under the regulations for a person acting as an investment adviser to keep its investment advisory activities segregated from all the other activities (if any). Whilst this may be possible to achieve for body corporates and other forms of entities, it is unclear how an individual investment adviser can depart its investment advisory services from its other activities or maintain an arms-length relationship between the two.

Also, an investment adviser is forbidden from entering into transactions, on its own account, contrary to the advice provided by it to its client for a period of 15 days from the date of such advice. On one hand, Sebi has prescribed segregation of activities and on the other hand laid down the restriction on entering into transactions contrary to its own advice. If the investment adviser creates a dividing line in the form of a Chinese wall between the said activities, then entering into conflicting transactions between two separate departments internally may be a possibility, thus, falling foul of the regulations.

Imbued in its foundation to take care of the interest of the investors, Sebi has done a commendable job by coming out with this new set of regulations encompassing the section of unregulated investment advisers. However, having a possible impact on numerous small to medium sized boutique investment advisers, and burdening them with the responsibility and accountability towards their clients and Sebi, it is time that Sebi takes a pragmatic approach and comes out with some form of clarification on these anomalies or amend the regulations to bring more clarity on the far reaching impact of the Investment Advisers Regulations. With almost another four months of window available to stakeholders, it is likely that everyone would want to wait and watch at the moment and see the navigation strategy that will be adopted by Sebi for granting approvals / rejections under this new regulation.

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