

# Corpsec Hotline

March 23, 2021

## SEBI PROPOSES CONCEPT OF 'ACCREDITED INVESTORS'

### INTRODUCTION

The financial market regulators in many jurisdictions around the world, such as Canada, Singapore, China and the United State of America ("US") recognize and acknowledge the concept of a class of well-informed investors who not only have a relatively higher level of understanding when it comes to financial products and associated risks, but also have a higher risk appetite in terms of their ability to take financial decisions. Such investors are typically termed as 'Accredited Investors' ("Als") or 'Qualified Investors'. The industry understanding is that such Als have sufficient financial means to absorb any loss and do not require a wide regulatory protection, which means that certain relaxations can be accorded to such investors like easing off on disclosure requirements and filing of offer documents, flexibility in respect of investor reporting and other regulatory concessions.

The introduction of Als with uniform eligibility criteria accompanied with a flexible regulatory framework, may provide certain benefits to the Indian securities market such as, an increase in investment products due to lower entry barriers such as minimum investment size; better risk labeling and increased transparency; and better channelization of regulatory resources for protection of other investors.

### PROPOSED FRAMEWORK

On February 24, 2021 the Securities and Exchange Board of India ("SEBI") released a consultation paper introducing a framework on Als ("AI Framework")<sup>1</sup> to the Indian securities market. Some key provisions of the AI Framework are highlighted below:

1. **Eligibility criteria:** Factors such as annual income and net worth have been proposed as the basis upon which the eligibility of resident, non-resident Indians and foreign entities as an AI, would be determined. While the thresholds are different for resident Indians, the thresholds proposed for non-resident Indians and foreign entities is the same:

#### RESIDENT INDIANS

<i>Individuals, HUFs &amp; Family Trusts</i>	Annual income greater than or equal to INR 2 crores; or
	Net worth greater than or equal to INR 7.5 crores, with financial assets worth at least INR 3.75 crores; or
	Annual income greater than or equal to INR 1 crore along with a net worth greater than or equal to INR 5 crores; with financial assets worth at least INR 2.5 crores

<i>Other Trusts</i>	AUM greater than or equal to INR 50 crores
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<i>Body Corporate</i>	Net worth greater than or equal to INR 50 crores
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#### NON-RESIDENT INDIANS / FOREIGN ENTITIES

<i>Individuals &amp; Family Trusts</i>	Annual income greater than or equal to USD 300,000 (approx. INR 2.17 crores); or
	Net worth greater than or equal to USD 1 million (approx. INR 7.24 crores); or
	Annual income greater than or equal to USD 150,000 (approx. 1.08 crores) along with a net worth greater than or equal to USD 750,000 (approx. 5.43 crores); with assets worth at least USD 375,000 (approx. 2.71 crores)

<i>Other Trusts</i>	AUM greater than or equal to USD 7.5 million (INR 54 crores)
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<i>Body Corporate</i>	Net worth greater than or equal to USD 7.5 million (INR 54 crores)
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2. **Accreditation of investors:** The process of accreditation of the investors would be conducted through 'Accreditation Agencies' (proposed to be market infrastructure institutions), and once granted, it would be valid for a period of one year from the date of accreditation. Als would be required to submit the necessary data and documents to the accreditation agency for ascertaining eligibility, and receive a certificate to that effect. However, investors such as central and state government agencies, sovereign wealth funds and qualified institutional

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buyers ("QIB") do not need to comply with this certification requirement in order to avail the AI status.

3. **Procedure to avail AI status for financial products:** An AI would be required to furnish such accreditation certificate to the respective Issuer for validation, as well as a declaration attesting that they (i) understand the risk and profile of the investment, (ii) have the ability to bear the financial risk, and (iii) are aware that the Investment Products may have a relaxed and flexible regulatory framework..

The AI Framework has also accounted for two types of financial products in determining the applicability of the AI status, (i) for investors participating in a pooled investment, where one or more AIs are coming together, then the declaration submitted to the pooled investment vehicle to avail AI status would hold valid for the entire term of the pooled investment vehicle, (ii) if the product/ services availed by the AI is governed by bilaterally negotiated contractual terms, then the AI may at any point, withdraw his consent/ declaration, in which case all the AI would then be treated as a regular investor for the purpose of ensuring regulatory compliance in relation to that product/ service.

## PROSPECTIVE ADVANTAGES IN ADOPTING THE AI FRAMEWORK

The introduction of the concept of AIs may offer the following set of advantages:

1. **Flexibility in minimum investment amount:** Subject to the terms of the agreement with the product/ service provider, the AIs may participate in an existing financial product at a lower threshold as compared to the minimum amount required under law.
2. **Flexibility and relaxation in regulatory requirements:** the AI Framework offers a relatively relaxed regulatory environment in respect of regulations governing prudential norms, investment conditions, filings to be made with SEBI, frequency of reporting etc.
3. **Access to financial products offered exclusively to AIs:** In order to respond to the increasing demand in this regard, there is a proposal to introduce products/ services exclusive to AIs, which will be designed specifically to suit the AI's risk-return profile.

## GLOBAL OUTLOOK

SEBI seems to have drawn up the AI Framework after taking cue from the success and drawbacks of various jurisdictions, a few examples of which are provided below:

1. **US:** Under US securities laws, only persons who are AIs may participate in certain securities offerings. Such entities would have to meet certain qualifying criteria conditional upon their earned income, net worth and assets owned; also, any entity in which all of the equity owners are AIs would be treated as an AI. Companies and private funds engaging in such exempt offerings are not mandated to make prescribed disclosures to AIs, unlike with offerings registered with the US Securities and Exchange Commission.<sup>2</sup>
2. **Singapore:** Earlier, as per Singapore's Securities and Future's Act and Financial Adviser's Act, a person could be classified as an AI simply by virtue of that person meeting the income / asset criteria, and not by active application. Such format lacking informed consent had led to a large number of disputes arising, where the classified AIs would allege that they had been induced into entering transactions that were unsuitable for them or that they were not fully informed of. Therefore, from October, 2018 onwards, the regulatory framework was amended to require the individual / financial institution to give consent to be treated as an AI ("**Opt-In**") in certain scenarios, such as, in the case of offering of securities and units of collective investment scheme without a prospectus.<sup>3</sup> The new Opt-In process though widely welcomed, has further complicated an already complex client on-boarding mechanism.
3. **China:** The China Securities Regulatory Commission has established a Qualified Foreign Institutional Investor ("**QFII**") that enables certain foreign institutional investors ("**FI**") to directly trade in 'A-shares' stocks on Chinese stock exchanges (earlier FIs could only trade in 'B-shares' stocks listed on US stock exchanges). Such QFIIs would only be permitted to obtain a license upon meeting certain qualifying criteria, such as showing a certain level of assets under management ("**AUM**") or being in business for a certain number of years.<sup>4</sup> The QFII framework not only allows for a relaxation of regulatory restrictions but also offers a larger variety of securities for participation of QFIIs exclusively.

## CONCLUSION

With the proposed introduction of the concept of AI, India's securities market is on the precipice of meteoric growth and development, through the consequential increased participation of investors and increased number of market goods and services. Given that the Indian securities market does not readily provide for tailored investment products for specific class of investors, laying the foundation of an enabling framework may pave the way to introduction of better and innovative products thereby facilitating the growth and development of the securities market at large.

Alongside the direct benefits to the AI, the proposed AI framework will also ensure regulatory focus on less-informed investors, who are otherwise vulnerable to unfair practices such as mis-selling, and thereby requiring increased protection. Several industry experts have hailed the move by SEBI, having long argued against the 'one-size fits all' regulatory approach by SEBI and now exposing Indian markets to increased complex financial products, with the affirmation that only suitable investors would be allowed to participate in them. There are arguments against the AI Framework specifically in terms of the eligibility for AIs to the effect that net worth criteria cannot be a surrogate for financial acumen, noting that several high net worth individuals have crashed and burned while participating in complex securities.

An interesting point to look out for when the AI Framework is formalized would be the treatment of investments made by AIs (in a year in which they meet the qualifying criteria) in the following year, if they no longer meet the minimum net worth / annual income / AUM requirement; does the eligibility of the AIs to hold such investments continue, or will it fall away and will the AI be required to comply with disclosure requirements earlier exempted from? It is unclear from the consultation paper how this issue will be addressed, given the floating criteria and absence of an accreditation certificate renewal process. It is also yet to be seen how the AI framework will impact the regulatory environment surrounding the IPO process.

Another point to be noted is that in light of the already existing class of QIBs<sup>5</sup>, SEBI is now going to recognize another special class of investors. The AI framework has not addressed how two special classes of investors seeming to have benefits at par with each other will be regarded by SEBI, in terms of regulatory treatment, and how the two special classes will co-exist. Will AIs be recognized as retail investors for the purposes of an initial public offering (“IPO”)? Will AIs be permitted to invest in a qualified institutional placement? It will be interesting to see how SEBI answers these questions in the fine print of law.

SEBI has closed the window on receiving comments from stakeholders and other entities on the AI Framework on March 18, 2021.

– **Gazelle Pinto & Harshita Srivastava**

You can direct your queries or comments to the authors

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<sup>1</sup> *Consultation Paper on Introduction of concept of “Accredited Investors” in Indian securities market*, February 24, 2021, available at: [https://www.sebi.gov.in/reports-and-statistics/reports/feb-2021/consultation-paper-on-introduction-of-the-concept-of-accredited-investors\\_49269.html](https://www.sebi.gov.in/reports-and-statistics/reports/feb-2021/consultation-paper-on-introduction-of-the-concept-of-accredited-investors_49269.html)

<sup>2</sup> <https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins/updated-3>

<sup>3</sup> <https://www.legaleraonline.com/articles/singapores-new-accredited-investor-regime>

<sup>4</sup> <https://corporatefinanceinstitute.com/resources/knowledge/trading-investing/qualified-foreign-institutional-investor-qfi/>

<sup>5</sup> As per the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, qualified institutional buyer is defined as: (i) a mutual fund, venture capital fund, Alternative Investment Fund and foreign venture capital investor registered with the Board; (ii) a foreign portfolio investor other than Category III foreign portfolio investor, registered with the Board; (iii) a public financial institution as defined in section 4A of the Companies Act, 1956; (iv) a scheduled commercial bank; (v) a multilateral and bilateral development financial institution; (vi) a state industrial development corporation; (vii) an insurance company registered with the Insurance Regulatory and Development Authority; (viii) a provident fund with minimum corpus of twenty five crore rupees; (ix) a pension fund with minimum corpus of twenty five crore rupees; (x) National Investment Fund set up by resolution no. F. No. 2/3/2005-DDI dated November 23, 2005 of the Government of India published in the Gazette of India; (xi) insurance funds set up and managed by army, navy or air force of the Union of India; (xii) insurance funds set up and managed by the Department of Posts, India;

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