

# Regulatory Hotline

May 18, 2022

## SEBI SETTLEMENT ORDER – RESEARCH ANALYSTS NOT TO PROVIDE MODEL PORTFOLIO PRODUCTS

### INTRODUCTION

Recently, the Securities and Exchange Board of India (“SEBI”) in its settlement order<sup>1</sup> imposed monetary and non-monetary settlement terms against Mr. Amit Mohan Jeswani, the proprietor of Stallion Asset (“Applicant”), a SEBI registered research analyst, for provision of model portfolio products to the clients / investors, resulting in violation of provisions of the SEBI (Research Analysts) Regulations, 2014 (“RA Regulations”), SEBI (Investment Advisers) Regulations, 2013 (“IA Regulations”) and the SEBI Act, 1992 (“Act”).

### FACTS

Pursuant to an inspection conducted by SEBI on the Applicant, following two observations were made by SEBI under the Show Cause Notice, dated May 04, 2021 (“SCN”):<sup>2</sup>

1. the Applicant was offering two products, viz., ‘Multibagger’ and ‘Momentum’ as model portfolio products to its clients / investors. While ‘Multibagger’ had 10 - 20 stocks in the portfolio, ‘Momentum’ had 7 - 12 stocks, along with the allocation of weights. The clients / investors had to simply follow the above-named portfolios; and
2. from the call data records of the Applicant, wherein calls were made to clients by the employees of the Applicant, the Applicant was introduced to the clients as an entity providing ‘advisory services’.

### ALLEGED VIOLATIONS

Under the SCN, the Applicant was alleged to have contravened the following provisions of RA Regulations, IA Regulations and the Act:

1. the Applicant was selling model portfolio products to clients / prospective clients which was considered against the defined responsibility and professional standards of a research analyst, resulting in violation of provisions of Regulation 2(u)<sup>3</sup> read with Clause 1<sup>4</sup>, 2<sup>5</sup> and 8<sup>6</sup> of Schedule III of Code of Conduct prescribed under the RA Regulations (“Code of Conduct”); and
2. the employees misrepresenting to the clients that the Applicant provides ‘advisory services’ resulting in the Applicant not acting honestly and in good faith as well as not ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures; hence violating provisions of Regulation 24(2) of the RA Regulations<sup>7</sup> read with Clause 1, 2 and 8 of Schedule III of the Code of Conduct, and Regulation 3(1) of the IA Regulations<sup>8</sup> read with Section 12(1) of the Act<sup>9</sup>.

### SETTLEMENT ORDER

Pursuant to the settlement application filed by the Applicant, the High Powered Advisory Committee (“HPAC”) of SEBI<sup>10</sup>, on violation of the above-mentioned provisions by the Applicant, recommended imposition of settlement amount of INR 28,60,000, along with non-monetary settlement term of restraining the Applicant from obtaining any other registration with SEBI for a period of 3 years from the date of the settlement order.

Though nothing explicitly has been mentioned in the order, it seems to suggest that that the Applicant may continue to act as a research analyst, barring its activity of offering model portfolio products to the clients / prospective clients.

### ANALYSIS

#### Legal position of a Settlement Order

A settlement order is a non-speaking order for settlement of proceedings, without any admission or denial of the findings and conclusions of law<sup>11</sup>. By its very nature, it neither proposes to set a legal precedent nor operate as a law. A settlement order is also neither admissible as evidence in any other proceeding relating to an alleged default not covered under the settlement order nor does it affect the right of third parties arising out of the alleged default.<sup>12</sup>

More often than not, applications for settlements with SEBI are preferred to avoid long-drawn and expensive litigations (which at times may cost a lot more than the terms imposed by the settlement orders), without any acceptance of guilt. In fact, SEBI is not permitted to settle every settlement proposal it receives. Proceedings in which the alleged default (i) has a market wide impact, or (ii) caused losses to a large number of investors, or (iii) affected the integrity of the market, are not permitted to be settled by SEBI.<sup>13</sup>

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### Analysing SEBI's Consultation Paper

SEBI under its SCN stated that the activity of providing model portfolio products to clients / prospective clients should be considered to be like that of a 'portfolio manager' where the portfolio manager pursuant to a contract or arrangement with a client *advises the client about the management or administration of a portfolio of securities or* the funds of the clients.<sup>14</sup> One important aspect which should be kept in mind in such case is that the client / investor would be required to put in minimum INR fifty lakhs as funds or securities with the portfolio manager, as prescribed under the SEBI (Portfolio Managers) Regulations, 2020 ("PM Regulations"). Needless to say, the person, to act as a portfolio manager registered with SEBI, should comply with the eligibility criteria stipulated under the PM Regulations, including having a minimum net worth of INR five crores.

The SCN further said that the Applicant by advising his clients to simply follow model portfolio, was not giving option to the investors to invest in a specific security / scrip, as the recommendations made by him were portfolio based and not stock specific. As mentioned earlier, one of the activities in which a research analyst can be engaged in is 'making of buy /sell / hold recommendation'. It seems that the stand taken by SEBI in the settlement order is that a research analyst cannot provide model portfolio recommendations and should limit its activities to a stock specific recommendation. Interestingly, the RA Regulations define 'research report' to, *inter alia*, mean any *written or electronic communication that includes research analysis or research recommendation or an opinion concerning 'securities'* (as opposed to a specific stock / scrip), providing a basis for investment decision. In view of the definition of 'research report', it becomes difficult to differentiate between a typical research report on securities and a curated portfolio of stocks available on an online platform for the investors to elect and invest.

The IA Regulations define 'investment advice' to mean 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, including financial planning. Though neither the SCN nor the settlement order prescribes an investment adviser license procurement for sale of model portfolio products, the above definition suggests that an investment adviser should be permitted by SEBI to provide model portfolio products to investors for subscription, as against a portfolio manager.

While it has been clear from the above-mentioned regulations that a research analyst cannot render personalized investment advice to a client without procuring an investment advisor license under the IA Regulations, SEBI's stance on offering of model portfolios by a research analyst, has led to uncertainty in the market.

#### Mislabeling of services

With varied kinds of intermediaries active in the market, full disclosure and transparency to the investors in all respects becomes critical. Hence, it is always advisable that in all modes of communication, written or oral, the respective intermediary, its key persons and employees do not mislabel their services and are very cautious in apprising their clients about the license they are holding and the sort of services / products they are permitted to provide under the applicable regulations.

### CONCLUSION

Though a settlement order does not operate as law, in this case, it not only impacts online platforms offering model stock portfolios created by investment advisers and research analysts, but also the retail investors who have, especially in the recent times, shown increased interest in the stock market and have been utilizing such platforms for making investments.

If the market regulator aims to further regulate the activities of research analysts, it should be done only through proactive lawmaking, i.e., through circulars or publicly available market guidance, and not through a settlement order, as the latter fails to provide a full and clear picture of the situation, leading to ambiguity among the market participants, including the investors.

– Prakhar Dua & Kishore Joshi

You can direct your queries or comments to the authors

<sup>1</sup> Settlement Order No. SO/GR/BM/2022-23/6631, in respect of Mr. Amit Mohan Jeswani (Proprietor of Stallion Asset) – Research Analyst, dated May 06, 2022, available at: [https://www.sebi.gov.in/enforcement/orders/may-2022/settlement-order-in-respect-of-mr-amit-mohan-jeswani-proprietor-of-stallion-asset-research-analyst\\_58793.html](https://www.sebi.gov.in/enforcement/orders/may-2022/settlement-order-in-respect-of-mr-amit-mohan-jeswani-proprietor-of-stallion-asset-research-analyst_58793.html)

<sup>2</sup> SCN under Rule 4(1) of the SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995, available at [https://www.sebi.gov.in/enforcement/unserved-summons-notices/may-2021/unserved-scn-dated-may-4-2021-in-respect-of-mr-amit-mohan-jeswani\\_51375.html](https://www.sebi.gov.in/enforcement/unserved-summons-notices/may-2021/unserved-scn-dated-may-4-2021-in-respect-of-mr-amit-mohan-jeswani_51375.html)

<sup>3</sup> "Research analyst" means a person who is primarily responsible for (i) preparation or publication of the content of the research report; or (ii) providing research report; or (iii) making 'buy/sell/hold' recommendation; or (iv) giving price target; or (v) offering an opinion concerning public offer, with respect to securities that are listed or to be listed in a stock exchange, whether or not any such person has the job title of 'research analyst' and includes any other entities engaged in issuance of research report or research analysis.

<sup>4</sup> Research analyst or research entity shall act honestly and in good faith.

<sup>5</sup> Research analyst or research entity shall act with due skill, care and diligence and shall ensure that the research report is prepared after thorough analysis

<sup>6</sup> The senior management of research analyst or research entity shall bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures.

<sup>7</sup> Research analyst or research entity shall abide by Code of Conduct as specified in Schedule III of the RA Regulations.

<sup>8</sup> On and from the commencement of the IA Regulations, no person shall act as an investment adviser or hold itself out as an investment adviser unless he has obtained a certificate of registration from SEBI under the IA Regulations.

<sup>9</sup> No stock broker, sub-broker, share transfer agent, banker to an issue, trustee of trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and such other intermediary who may be associated with securities market shall buy, sell or deal in securities except under, and in accordance with, the conditions of a certificate of registration obtained from SEBI in accordance with the regulations made under the Act.

### Scope of judicial interference and inquiry in an application for appointment of arbitrator under the (Indian) Arbitration and Conciliation Act, 1996

<sup>10</sup> HPAC Members' details available at <https://www.sebi.gov.in/sebiweb/about/AboutAction.do?doMember=yes&committeesId=29>

<sup>11</sup> Paragraph 10 of Part C of Schedule I of the SEBI (Settlement Proceedings) Regulations, 2018 give the applicant an option to choose whether they wish to 'admit the findings of fact and conclusions of law' or 'neither admit nor deny the findings of fact and conclusions of law'.

<sup>12</sup> Regulation 27(1) of the SEBI (Settlement Proceedings) Regulations, 2018.

<sup>13</sup> Regulation 5(2) of SEBI (Settlement Proceedings) Regulations, 2018.

<sup>14</sup> 'Portfolio manager' is defined under Regulation 2(o) of the SEBI (Portfolio Managers) Regulations, 2020.

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