

Corpsec Hotline

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INVESTMENT ADVISERS: TIME TO REGISTER?

Till date, there has been an ambiguity as regards registration requirement in India for investment advisers and more specifically whether such advisers are required to be registered under Securities and Exchange Board of India (Portfolio Managers) Regulations, 1993 ("PMS Regulations"). The ambiguity existed on account of the broad definition of a 'portfolio manager' under the PMS Regulations as against the operative provisions of the said regulations which seem to cover only situations where the portfolio manager has a fiduciary over the clients' monies. Securities and Exchange Board of India ("SEBI") had in the recent past recognized this lacuna and had appointed a committee to examine the need and the proposed regulatory framework for regulating the investment advisers. It appears that SEBI is now in the process of getting rid of this ambiguity by issuing separate set of regulations for registration and regulation of investment advisers which are primarily engaged in rendering advice pertaining to investments in securities.

The draft of SEBI (Investment Advisers) Regulations, 2007 ("Regulations") has been published by SEBI for public comments and suggestions. The highlights of the Regulations are as follows:-

Investor Adviser Defined

An 'investment adviser' has been defined to mean any person (a) who for consideration is engaged in the business of providing investment advice to others, either directly or through publications or writings or electronic mails, or (b) who, for consideration and as part of regular business, issues or publishes reports or analyses containing investment advice and includes any person who holds himself out as an investment adviser (by whatever name called) to others.

The word 'consideration' referred to in the aforesaid definition, means cash or non cash consideration, whether received or receivable, directly or indirectly from any person.

Further, 'investment advice' has been defined to mean any advice with respect to value of securities or with respect to investing in, purchasing, selling or otherwise dealing in securities. However, an exclusion has been carved out for:-

1. any general advice rendered to clients which is incidental to one's business or profession and is not specific to particular securities;
2. any advice in a public media as long as the objective is not to provide investment advice nor to solicit or lead persons to deal in securities.

Registration process

Under the proposed Regulations, it has been made mandatory for every person rendering 'investment advice' to get a certificate of registration under these Regulations before rendering investment advice, with some transitional provisions for existing investment advisers.

Interestingly, SEBI has proposed a Self Regulatory Organization ("SRO") approach to regulating investment advisers, a model for some reason has not been effectively used in India thus far. Accordingly, it has been made mandatory for an applicant seeking registration with SEBI under these Regulations to also register themselves with a self-regulatory organization recognized under SEBI (Self Regulatory Organizations) Regulations, 2004. In fact the application for registration has to be channeled through the SRO. The idea seems to be to decentralize the monitoring of this segment of intermediaries which may help in more effective implementation of the Regulations. The form and nature of such SRO is yet to be formalized.

However, existing entities already registered with SEBI as an intermediary in any capacity are permitted to provide investment advice in their existing capacity, without obtaining a separate certificate under these Regulations.

Obligations and Responsibilities of Investment Advisers

The obligations are more generic and the emphasis seems to be on transparency and not necessarily regulating or controlling the relationship between a client and an investment adviser. Under the proposed Regulations, the obligations and duties of an investment adviser shall encompass the following:-

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- to act in a fiduciary capacity towards their clients;
- not to divulge any confidential information;
- to disclose to a prospective client, all material information about its business, disciplinary history, terms and conditions of its services, its affiliations with other intermediaries, etc.

No restrictions on fees or the nature of contract has been prescribed as such which gives flexibility to the parties to structure their relationship as may be mutually agreed.

Amendments to PMS Regulations

Consequential amendments to PMS Regulations have also been proposed wherein the function of advising has been carved out from the definition of portfolio manager thereby attempting to avoid the overlap between the PMS Regulations and the proposed Regulations.

Further, to avoid the need for appointing a custodian by a portfolio manager rendering only advisory services, a carve out has been made for all portfolio managers who have assets under management of less than rupees five billion.

Implications

1. It will provide an omnibus regulatory framework for yet unregulated activities involving investment advice thereby ensuring better accountability of such intermediaries to their clients. From an investor protection perspective, this will be a welcome move.
2. Hopefully, the SRO approach to regulating these entities would shift some regulatory burden from SEBI to such SRO. This though untested in India has been a successful model in countries like UK. How active a role those SROs will take up will still need to be seen.
3. In the USA, the publisher of any *bona fide* newspaper, magazine or business or financial publication of general and regular circulation is excluded from the definition of Investment Adviser. This exception reflects concern of the Congress that the Investment Advisers Act, 1940 of USA does not impinge on publishers First Amendment Rights. However, the Indian definition of Investment Adviser, though excluding print media and other forms of media to a particular extent, may fall harsh on business dailies or other financial publications which carry articles or advice on investing in particular securities.
4. The US Investment Advisers Act, 1940 till recently also provided for a safe harbor for certain kind of advisers (e.g. hedge fund managers) from being registered based on the number of investors and assets under management. While the recent trend in the US and other markets has been to cover all such advisers within the regulatory net, there has been a fair degree of resistance against such mandatory registration in those markets. One needs to consider in the Indian context as to whether any such carve out may be necessary.
5. Also one need to ascertain to what extent the proposed Regulations shall apply to foreign advisers. This issue has become more relevant in the recent times wherein the exchange controls have allowed Indian residents to invest in foreign securities and there are several foreign intermediaries marketing foreign investment products to Indian residents. From an investor protection perspective, SEBI may consider extending the applicability of these guidelines to such foreign advisers.
6. Finally, one needs to understand as to whether investment managers or advisers to venture capital funds ("VCFs") and other private equity funds which were hitherto not required to be registered may now require registration. While one can argue that in case of VCFs, the VCFs themselves are regulated and hence it may not be necessary to regulate the investment managers to such VCFs, but in absence of a specific carve out for such managers/advisers they may need registration. If so applicable, the conflict if any between the two sets of regulations may need to be carefully examined.

Sources:

1. SEBI (Investment Advisers) Regulations, 2007 issued by SEBI on October 10, 2007; and
2. Consultative Paper on Regulation of Investment Advisers issued by SEBI on March 31, 2007.

- Abha Shah & Siddharth Shah

You can direct your queries or comments to the authors

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