

Consultation Paper on Amendments/Clarifications to the SEBI  
(Investment Advisers) Regulations, 2013

**Background**

SEBI had issued a consultation paper on October 07, 2016 seeking public comments on the clarifications/amendments to SEBI (Investment Advisers) Regulations, 2013 ('IA Regulations'). Large number of comments have been received on the proposals enumerated in the consultation paper. Based on the feedback received and meetings held with market participants, the following proposals are stated below for public comments.

**1. Clear segregation between investment advisory and distribution/execution services:**

To prevent the conflict of interest that exists between “advising” of investment products and “selling” of investment products by the same entity/person, there should be clear segregation between these two activities. The investment adviser should act in the best interest of the client and should not receive commission from the product manufacturer. Further, the investment adviser shall act with due skill, care and diligence and shall ensure that its advice is offered after thorough analysis and taking into account the available investment alternatives and matching them with client’s suitability and needs. Thus, entities engaged solely in the business of “advising” on investment products shall not be permitted to sell any products to prevent conflict of interest.

**Existing Provision**

In terms of Regulation 22 of IA Regulations, banks, NBFCs and body corporates providing investment advisory services to their clients shall keep their investment advisory services segregated from distribution/execution services. Such entities are allowed to offer investment advisory services only through separately identifiable departments or divisions (SIDDs). The distribution or execution services can only be offered subject to the following:

- i. The client shall not be under any obligation to avail the distribution or execution services offered by the investment adviser.
- ii. The investment adviser shall maintain arms-length relationship between its activities as investment adviser and distribution or execution services.
- iii. All fees and charges paid to distribution or execution service providers by the client shall be paid directly to the service providers and not through the investment adviser.

**Proposal:**

Regulation 22 and other applicable provisions of IA Regulations are proposed to be amended as under:

- i. There shall be clear segregation between the investment advisory activities and distribution/execution services. An entity offering investment advisory services shall not be permitted to offer distribution/execution services.

- ii. The existing provision on offering execution/distribution services by banks, NBFCs and body corporates through separately identifiable departments or divisions (SIDDs) shall be omitted.
- iii. Banks, NBFCs and body corporates offering investment advisory services through separately identifiable departments or divisions (SIDDs) under the existing framework shall segregate the same within a period of six months through a separate subsidiary.
- iv. Investment advisers who provide holistic advice/financial planning on financial products across multiple categories, viz., securities, insurance, pension, deposits, etc. need to obtain permission from the specific regulator and comply with the regulations of the respective regulators, if any.
- v. Entities/persons who are providing advice solely on non-securities shall not come under the purview of the SEBI (Investment Advisers) Regulations, 2013.

## 2. **Distribution of Mutual Fund Schemes by Distributors:**

### **Existing Provision**

Regulation 4(d) of the IA Regulations, *inter alia*, provides exemption from registration as an investment adviser to any distributor of mutual funds, who is a member of a self-regulatory organisation recognised by SEBI or is registered with an association of asset management companies of mutual funds, providing any investment advice to its clients incidental to its primary activity.

**Proposal:**

In order to have clear segregation between advising on mutual fund products and selling/distribution of mutual fund products, it is proposed that Mutual Fund Distributors (MFDs) can only explain/describe the features of mutual fund schemes of which they are distributors and distribute them while ensuring suitability of the scheme to the investors. They can distribute suitable mutual fund schemes to the investors describing material facts of the scheme and the associated risk factors of the scheme, etc., subject to the following conditions:

- i. MFDs should not give any investment advice.
- ii. MFDs should offer suitable scheme to the investor considering all the available schemes distributed by them.
- iii. MFDs should not offer any financial planning services to the investor which requires risk profiling, financial goal setting, etc.
- iv. MFDs shall stop usage of nomenclature 'Independent Financial Adviser' or "Financial Adviser"; rather use the term "Mutual Fund Distributor" only;
- v. MFDs shall refrain from mis-selling of mutual fund schemes. There shall be strict enforcement action on mis-selling of mutual funds and constant supervision towards ensuring suitability of mutual funds sold to investors.
- vi. MFDs shall be required to clearly disclose the following in a form to the investors which would be signed off by the investors before making any investment in mutual fund scheme through such distributor:

- a. The list of mutual funds where he is acting as a distributor
  - b. the commission earned/ to be earned,
  - c. suitability of the product sold to the investor,
  - d. Disclaimer that he/she may not be acting in the best interest of investor.
- vii. MFDs who want to get registered as investment advisers shall be allowed to receive trail commission for the products already distributed subject to disclosure to the clients. They shall not be allowed to sell/distribute any investment product pursuant to grant of registration as investment adviser.

### **3. Incidental advice by recognised intermediaries:**

#### **Existing Framework**

Under the existing framework, exemptions from registration as an investment adviser have been granted to various persons under Regulation 4 of IA Regulations, such as stock brokers, portfolio managers giving investment advice to their clients incidental to their primary activity, etc.

#### **Proposal:**

- i. In order to have clear segregation between investment advisory services and other services, it is proposed that all the intermediaries as stated above who are receiving separate identifiable consideration for investment advisory services shall need to register with SEBI as an investment adviser. In case they get registered as investment advisers, they shall not provide any distribution/execution services.

- ii. All the persons who are engaged in providing holistic advice/financial planning services shall mandatorily be required to register themselves as an investment adviser.

#### 4. Relaxation in registration requirements

##### Existing Framework

Under the existing framework, there is no networth requirement and qualification requirement for acting as a mutual fund distributor. There is only the requirement of obtaining AMFI Registration Number (ARN) and NISM certification for becoming eligible to distribute mutual fund schemes. On the other hand, for getting registered as an investment adviser, the persons/representatives engaged in providing advisory services have to be a postgraduate or a graduate with 5 years of experience in the financial services industry. The networth requirement for body corporates and LLPs is Rs. 25 lakhs and the registration fees is Rs. 5 lakhs for a period of 5 years. The ARN fees is very low as compared to the registration fee for investment advisers. Investment advisers are also required to comply with higher requirements than that of mutual fund distributors such as fiduciary obligation, maintenance of records, etc.

In view of the above differences in eligibility requirements, the following is being proposed.

##### Proposal:

- i. It is proposed that the educational qualification shall be relaxed for representatives/employees of registered investment advisers. They shall be a

graduate in any discipline. In the case of individual investment advisers, there is no relaxation with respect to eligibility criteria and they shall need to fulfill eligibility and certification requirements as specified in the IA Regulations. However, in the case of partnership firms, atleast one of the partners, and in the case of body corporates, at least one of the representatives shall fulfill the eligibility and certification requirements as specified in the IA Regulations.

- ii. The net worth requirement for body corporates shall be reduced to Rs. 10 lakhs from the current requirement of Rs. 25 lakhs.
- iii. Application fees for corporate applicants, for initial 5 years, shall be reduced to Rs. 10,000 from the current requirement of Rs. 25,000 and the registration fees shall be reduced to Rs. 1,00,000 from the current requirement of Rs. 5,00,000. The subsequent fee to continue as investment adviser, after five years from the date of registration, shall remain as Rs. 5 lakhs. For individual applicants and partnership firms, the application fees of Rs. 5,000 and registration fees of Rs. 10,000 shall continue.

#### **5. Regulation of the activity of ranking of Mutual Fund schemes**

Ranking of Mutual Fund (MF) Schemes refers to relative ranking of mutual fund schemes within a peer group based on the past performance of the scheme. Ranking is not an opinion on the credit quality of the mutual fund scheme. It is simply a statistical sorting of similar peer group mutual fund schemes based on their past performances, risk and return analysis etc. and is not an opinion on the future performance of the scheme/ portfolio. Since ranking of Mutual Fund Schemes is an

objective statistical analysis of various parameters like risk and return, liquidity, performance ratio etc. for past years, it appears to be more of a research work that serves as the basis for investment decision by the investors.

Ranking agencies engaged in the activity of ranking of MF schemes play an important role in assisting investors, especially investors in the direct plan, while making investment decisions. However, learning from lessons of the past, wherein rate shopping had been observed and the methodology for ranking was not transparent, MFs were prohibited from advertising MF scheme ranking; it is therefore important to bring the activity of ranking of MF schemes under the regulatory ambit prior to allowing publishing of ranking of MF schemes in advertisements issued by MFs.

Internationally also, MF scheme advertisements are allowed to be accompanied with the respective ranking of the scheme. In the ongoing Financial sector assessment program (FSAP) exercise for India, the assessment team, in their draft report has also stated that *“over time, it may be appropriate to relax strict limitations on advertising that prohibit the use of third party non-compensated fund rankings or other information that is not false or misleading”*.

In the SEBI Board meeting dated January 14, 2017, it was decided that, prior to allowing publishing of ratings of MF schemes, the activity of rankings of MF schemes needs to be brought under the regulatory ambit.

### **Proposal**

Considering the activity of Ranking of Mutual Fund Schemes as research report to the public that serves as a basis for their investment decision, it is proposed that the



activity of ranking of MF schemes shall be brought under the regulatory ambit of SEBI (Research Analysts) Regulations, 2014. Accordingly, the definition of research analyst shall be appropriately broadened so as to cover such entities in the definition of research analyst. A separate chapter shall be made in the RA regulations on ranking of mutual fund schemes prescribing methodology, disclosure and other requirements, etc. as under:

- i. Agencies/entities providing ranking of mutual fund schemes shall be required to register under SEBI (Research Analysts) Regulations, 2014.
- ii. Agencies/entities providing ranking of mutual fund schemes on public media such as newspaper, website, etc., need not obtain registration from SEBI subject to compliance with the requirements specified such as disclosure of financial interest, holdings, methodology, etc. The proposed guidelines on ranking of mutual fund schemes shall cover the following:
  - a. A Mutual Fund ranking entity shall be defined as any entity that ranks performance of MFs for general information of the common investors.
  - b. A MF ranking entity shall rank the performance of mutual fund schemes through an objective methodology that is based on quantitative performance measurements and applied consistently to all mutual funds.
  - c. A MF ranking entity should prominently disclose the criteria, name of category, number of funds in category and the data used for ranking different schemes. Also, the disclosure should be in a manner that is easily understandable by common investors.

- d. If all/certain schemes of certain MFs are not ranked, the same as well as the reason for non-inclusion should be disclosed prominently.
- e. Ranking must at a minimum be current to the most recent calendar quarter.
- f. A MF ranking entity shall disclose the holding of MF schemes' by its Board of directors and promoters.
- g. A MF ranking entity should act independently of the AMC/MF and its affiliates in assessing the MF schemes' performance and should not accept any consideration, monetary or otherwise and whose services are not procured by the AMC/MF or any of its affiliates to assign the AMC/MF or its schemes a ranking.
- h. The rankings should be accompanied by the disclaimer that past performance is no guarantee of future returns. Also, it should be accompanied with the standard disclaimer that 'Mutual Fund investments are subject to market risks, read all scheme related documents carefully.' This would be applicable for the ranking entity as well as the MF using this ranking.



## 6. Public Comments

In light of the above, public comments are invited on the proposals contained in the consultation paper. Comments/suggestions may be provided in the format given below:

Name of entity / person / intermediary/ Organization*			
Sr. No.	Pertains to Point No	Suggestions	Rationale

*\* In order to have a consolidated view, mutual fund distributors are requested to send their suggestions on the proposals only through their association/ representative body.*

The comments may either be forwarded by email to [sebiria@sebi.gov.in](mailto:sebiria@sebi.gov.in) or may be sent by post to the following address latest by July 14, 2017.

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