

Memorandum to the Board
Amendments to the SEBI (Investment Advisers) Regulations, 2013

1. Objective

This Board Memorandum seeks the approval for public consultation for amendments to the SEBI (Investment Advisers) Regulations, 2013.

2. Background

2.1. SEBI (Investment Advisers) Regulations, 2013 (“IA Regulations”), were notified on January 21, 2013 to lay the framework for independent financial advisers and to address the conflict of interest arising due to the dual role played by distributors of financial products as an agent of investors as well as of the manufacturers.

2.2. The existing IA Regulations provided for exemptions to certain entities who were providing advice as an incidental activity to their primary activity.

2.3. During internal deliberations, it was suggested to re-visit the SEBI (Investment Advisers) Regulations, 2013, particularly with respect to the following issues:

- Exemptions provided to the entities providing investment advice incidental to their main business
- Maintenance of Chinese Wall and Segregation of Investment Advisory services with other activities
- Change in the nomenclature of Independent Financial Advisers.

2.4. RBI, vide circular dated April 21, 2016, issued guidelines on Investment Advisory Services (IAS) stating that the Banks cannot undertake IAS departmentally. Accordingly, banks desirous of offering investment advisory services may do so either

through a separate subsidiary set up for the purpose or one of the existing subsidiaries and ensuring that there is an arm's length relationship between the bank and the subsidiary. Banks which are presently offering IAS may reorganize their operations in accordance with these guidelines within a period of three years from the date of the circular.

First consultation paper dated October 07, 2016

2.5. SEBI had issued a Consultation Paper on Amendments/ Clarifications to the IA Regulations on October 07, 2016 with the objective of further enhancing the investor confidence by protecting their interests and to make Indian securities market more efficient. The major issues discussed in the Consultation Paper were as under:

- i. Mutual Fund distributors shall not be allowed to provide incidental or basic investment advice in respect of mutual fund products except describing the product specification without recommending any particular product. If they want to engage themselves in providing incidental or basic investment advisory services on mutual fund products, they need to register themselves as an investment adviser under IA Regulations and period of three years shall be provided to the distributors for migrating to investment advisory model.
- ii. The registration under IA Regulations shall be mandatory for all the persons who, for consideration, are engaged in the business of providing investment advice in respect of securities or investment products, irrespective of whether such activity is ancillary to their primary activity or not. However, exemption shall be given to those persons carrying out investment advisory activities which are permitted under any other regulations specified by SEBI such as merchant bankers providing corporate advisory, as well as persons providing

advice only on insurance products regulated by IRDA, pension products regulated by PFRDA, etc.

- iii. The investment advisory services shall be allowed only through separate subsidiary in place of separately identifiable department or division (SIDD). The existing entities were proposed to set up a separate subsidiary within three years.

2.6. In response to the Consultation Paper, around 2000 comments were received from the public. Comments were received from various stakeholders such as AMFI, distributors, Mutual Fund Distributor associations, investors, ANMI, brokers, legal firms, registered investment advisers, etc. It was stated in comments that investors may not be willing to pay from their pocket for the advice and thus may remain unserved. Further, investor needs to avail services of different entities for advisory and distribution /execution resulting into increased cost to the investor.

2.7. While proposing amendments to IA Regulations based on the aforesaid consultation, it was suggested that there is a need for clearer road map for migration from commission based model to fee based model and views of International advisory Board (IAB) may be taken before proceeding further. The seventh meeting of IAB was held on January 13 & 14, 2017. The matter with respect to the migration from commission based model to fee-based advisory model was discussed in IAB wherein following recommendations were made :

- 'Fee for advice' is the journey which needs to be completed. However, the proposed migration needs to be calibrated.
- Commission based as well as fee based approach to investment advisory can co-exist for the time being. The transition from commission to a fee based approach has to be gradual. Such transition has to happen in tandem across regulatory segments to

have uniformity in regulatory stringency across competing segments like securities market, insurance and pension businesses.

- Regulators need to keep in mind the financial viability and the business model of the advisory business. Proper due diligence before transition in regulatory regime is essential.
- Distinction between retail and sophisticated investors should be clear. There is a felt need for greater awareness among investors on cost of commission versus fees based advisory.
- More transparency is required on distributors' commission in all financial products.
- Before undertaking any effective steps, SEBI may consider undertaking a study of migration to fee-based advisory model under RDR, FOFA and robo-advisory models.

2.8. Taking into consideration the recommendations of IAB, SEBI studied the fee based advisory model under FoFA, Australia and RDR, United Kingdom during April – May 2017. The learnings from these fee based advisory models are as under:

a. Future of Financial Advice (FoFA) – Australia

The ASIC (Australia Securities and Investment Commission) proposed the Future of Financial Advice (FoFA) reforms to improve the quality of advice, measures that will improve the standard of adviser conduct, remove conflicts of interest, and improve engagement by retail clients with advisers. The FoFA reforms were introduced on 1 July 2012 and successfully implemented from 1 July 2013. The FoFA reforms are designed to improve trust and confidence in the financial planning sector, as well as access to quality financial advice. The FoFA reforms include the following:

- Ban on Conflicted remuneration
- The introduction of a statutory best interest or fiduciary duty so that financial advisers must act in the best interests of their clients.

- Advisers need to provide fee disclosure statements to its clients annually stating on-going fees and services provided
- Renewal of ongoing fees arrangement every two years
- Strengthening the powers of ASIC to act against unscrupulous entities.

Till date no impact study/analysis is conducted. As per ASIC, improvements have been observed in the quality of personal advice, records are kept by advisers and statement of advice given to clients. However, the advice is not available to the small investors due to increase in cost for investment advice thus advisory gap is observed among the investors.

b. Retail Distribution Review (RDR)- UK

- Financial Conduct Authority (FCA) [formerly known as FSA] decided that financial advisers will charge upfront fee to the customers rather than receiving commission from companies issuing financial products from December 31, 2012. The key features of RDR are as under:
 - i. Commission payment was banned across all investment products sold to retail investors and it was replaced by advisory fees, directly paid by investors to such advisors.
 - ii. Advisers are required to mandatorily disclose services provided by them under two categories, namely, independent advice and restricted advice.
 - iii. Minimum qualification of investment advisers was increased.
 - iv. Product providers will not be permitted to make payments to the financial platform that offer their products to retail investors.
 - v. Increase in the minimum capital requirement for advisors.
- The positive and negative impacts pursuant to implementation of the RDR legislation are as below:

Positive Impacts

- Better quality advice received due to high qualification
- Ban on third party commission has reduced product bias and widened the investor's choice
- Appropriate documenting suitability saves an advisor who is not guilty of wrongdoing from future allegation/litigation

Negative Impacts

- Increase cost of advisory on small investors
 - Advisory services could be availed by medium to high net worth clients
 - Minimum qualification increase for advisors led to decrease in number of advisors and upfront payment of advisory fee has led to 'advisory gap'
 - There is difficulty in convincing investors to pay for advice
-
- The government and the regulator have conducted various studies to assess the impact of the RDR. The studies inter alia revealed that RDR norms have brought about positive changes to the investors who are availing the advisory services. However, UK advice market is not working well for small investors and, due to advisory gap, decisions are being taken by investors without consultation with advisers.

Second consultation paper dated June 22, 2017

2.9. Based on internal discussion on issues dealt in consultation paper and comments received thereon, it was decided to place a revised consultation paper seeking public comments and the same was issued on June 22, 2017. The major issues discussed in the Consultation Paper are as under:

- An entity offering investment advisory services shall not be permitted to offer distribution/execution services.
- Mutual Fund Distributors (MFDs) should not give any investment advice. However, they can explain the feature of mutual fund schemes distributed by them. They shall be required to clearly disclose the following in a form to the investors which would be signed off by the investors:
 - 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.
- 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.
- The intermediaries such as stock brokers, portfolio managers etc. who are receiving separate identifiable consideration for investment advisory services shall need to register with SEBI as an investment adviser. After registration, they shall not provide any distribution/execution services.
- Agencies/entities providing ranking of mutual fund schemes shall be required to register under SEBI (Research Analysts) Regulations, 2014. However, such entities providing ranking on public media such as newspapers, website etc. need not obtain registration from SEBI.

2.10. In response to the Consultation Paper, around 850 comments have been received from the public. Comments were received from various

stakeholders such as AMFI, Banks, distributors, Mutual Fund Distributor associations, investors, brokers, legal firms, registered investment advisers, etc. It is stated in the comments that the fee based advisory module may work well with the informed, educated and seasoned investor willing to pay separately for advisory services. However, for the retail and uninformed investor a distributor can offer better services by providing incidental advice and is paid by the Mutual Fund. MFD should be allowed to continue giving advice incidental to their function of selling MF to enable them to provide a suitable scheme to the investor in the best interest of the investor. The existing mechanism of execution through SIDD should continue as subsidiary will unnecessary add manpower, legal and compliance cost to the entity. Intermediaries such as stock brokers, portfolio managers, giving investment advice to the clients incidental to their primary activity, may not be registered under IA Regulations.

2.11. Based on the feedback received from the consultation process, meetings with various stakeholders and internal deliberations, it was felt that there is a need to prevent the conflict of interest existing between advising for investing in financial products and selling of financial products. Considering the above and the vision about migration from commission based model to fee based model, it is proposed that consultation on specific issue may be undertaken, after due approval of the Board. The proposals in the consultation paper for the consideration of the Board are as under:

- i. There should be clear segregation between the two activities of the entity i.e. providing investment advice and distribution of the investment products/ execution of investment transactions.
- ii. Individuals who are willing to get registered as investment advisers shall not provide any distribution services in financial products, either directly or through any of their immediate relatives. Similarly, individuals providing distribution services shall not provide advice for investing in financial product either directly or through their immediate relatives.

“Immediate relative” means a spouse of a person, and includes parent, brother, sister or child of such person or of the spouse as defined under SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011.

- iii. Banks, NBFCs, Body Corporates, LLPs and firms who are willing to get registered as investment advisers, shall not provide any distribution services in financial products, either directly or through their holding company or associate company or subsidiary company. Similarly, banks, NBFCs, body corporates, LLPs and firms providing distribution services shall not provide investment advice in financial products either directly or through their holding company or Associates Company or subsidiary company. “Associate company” of an entity means a body corporate in which the entity or its director or partner holds, either individually or collectively, more than fifteen percent of its paid-up equity share capital or partnership interest, as the case may be.
- iv. Existing registered investment advisers who are offering distribution services through immediate relatives or through separately identifiable division or department or through holding / subsidiary /associate company shall choose among providing investment advice or the distribution services before March 31, 2019. Similarly, distributors who are offering advisory services through aforesaid modes shall also choose between distribution services and advisory services. From April 01, 2019, any person, including their immediate relatives or holding/subsidiary/associate entity, shall offer either investment advice or distribution services.
- v. Mutual Fund Distributors (MFDs), while distributing their mutual fund products can explain the features of products to client, and shall ensure the principle of ‘appropriateness’ of products to the client. As per the extant SEBI circulars, appropriateness is defined as selling only that product categorization that is identified as best suited for the client. As part of disclosures to clients, MFDs shall disclose the list of mutual funds

they are affiliated with and that the information provided is restricted to the mutual fund products being distributed by them. However, the client may also consider other alternate products, which are not being offered by them before making investment decision.

The revised consultation paper is placed at **Annexure-A**

3. Proposal

The proposal requires amendments to SEBI (Investment Advisers) Regulations, 2013.

3.1. The Board is requested to consider the revised consultation paper and approve the proposal for initiation of public consultation process for the purpose of making amendments to the IA Regulations. The Board is also requested to authorize the Chairman to make necessary changes in this regard.

**Consultation Paper on Amendments 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'). A revised consultation paper was issued on June 22, 2017 clarifying certain issues raised by the market participants. Based on the feedback received and to prevent the conflict of interest between "advising" of investment products and "selling" of investment products by the same entity/person, the proposals are revised as under.

Proposals

- i. There should be clear segregation between the two activities of the entity i.e. providing investment advice and distribution of the investment products/ execution of investment transactions.
- ii. Individuals who are willing to get registered as investment advisers shall not provide any distribution services in financial products, either directly or through any of their immediate relatives. Similarly, individuals providing distribution services shall not provide advice for investing in financial product either directly or through their immediate relatives. "Immediate relative" means a spouse of a person, and includes parent, brother, sister or child of such person or of the spouse as defined under SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011.
- iii. Banks, NBFCs, Body Corporates, LLPs and firms who are willing to get registered as investment advisers, shall not provide any distribution

services in financial products, either directly or through their holding company or associate company or subsidiary company. Similarly, banks, NBFCs, body corporates, LLPs and firms providing distribution services shall not provide investment advice in financial products either directly or through their holding company or Associates Company or subsidiary company. "Associate company" of an entity means a body corporate in which the entity or its director or partner holds, either individually or collectively, more than fifteen percent of its paid-up equity share capital or partnership interest, as the case may be.

- iv. Existing registered investment advisers who are offering distribution services through immediate relatives or through separately identifiable division or department or through holding / subsidiary /associate company shall choose among providing investment advice or the distribution services before March 31, 2019. Similarly, distributors who are offering advisory services through aforesaid modes shall also choose between distribution services and advisory services. From April 01, 2019, any person, including their immediate relatives or holding/subsidiary/associate entity, shall offer either investment advice or distribution services.
- v. Mutual Fund Distributors (MFDs), while distributing their mutual fund products can explain the features of products to client, and shall ensure the principle of 'appropriateness' of products to the client. As per the extant SEBI circulars, appropriateness is defined as selling only that product categorization that is identified as best suited for the client. As part of disclosures to clients, MFDs shall disclose the list of mutual funds they are affiliated with and that the information provided is restricted to the mutual fund products being distributed by them. However, the client may also consider other alternate products, which are not being offered by them before making investment decision.

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 or may be sent by post to the following address latest by *****, 2018.

Deputy General Manager
Investment Management Department, Division of Funds 1
Securities and Exchange Board of India
SEBI Bhavan, Plot No. C4-A, "G" Block,
Bandra Kurla Complex, Bandra (East), Mumbai - 400 051.

Issued On: *****, 2018