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Navigating the updated regulatory framework for Investment Advisers and Research Analysts

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Introduction

The Securities and Exchange Board of India (SEBI) has recently introduced amendments to the SEBI (Investment Advisers) Regulations, 2013 and SEBI (Research Analysts) Regulations, 2014 dated 16 December 2024 (Amendments) and has significantly modified the regulatory framework governing Investment Advisers and Research Analysts in India. Subsequently, on 8 January 2025, SEBI issued two circulars in furtherance of the Amendments titled '*Guidelines for Investment Advisers*' and '*Guidelines for Research Analysts*' (Circulars), providing detailed guidelines on the updated regulatory framework for Investment Advisers and Research Analysts. The Amendments and Circulars are introduced pursuant to the SEBI Consultation Paper on Review of Regulatory Framework for Investment Advisers and Research Analysts dated 6 August 2024 (Consultation Paper).

Key Highlights

The Amendments and the Circulars mark a significant deviation from the previous regulatory framework governing various aspects such as the eligibility criteria for registration of Investment Advisers and Research Analysts, scope of investment advice and research services, net worth requirements, fees etc. In addition to the above, the Amendments and Circulars have also provided detailed guidelines in relation to certain new concepts such as part-time registration as Investment Adviser / Research Analyst, appointment of independent professionals as compliance officers, use of Artificial Intelligence (AI), etc. We have outlined below a few key aspects of the updated regulatory framework.

(a) <u>Relaxation in the eligibility criteria for obtaining registration</u>

i. The minimum qualification requirement for an individual Investment Adviser / Research Analyst or a principal officer of a non-individual Investment Adviser / Research Analyst has been reduced from a post graduate degree to a graduate degree in any of the specified fields. For persons associated with investment advice / research services, the minimum qualification requirement has been reduced to a graduate degree in any discipline.

ii. Further, the experience requirement of five years in activities relating to advice in financial products or securities or fund or asset or portfolio management for an individual Investment Adviser / Research Analyst or a principal officer of a non-individual Investment Adviser / Research Analyst has been removed as well.

<u>Comment</u>

The relaxation in the qualification requirements for Investment Advisers and Research Analysts is a welcome move, as it lowers the entry barrier and provides an opportunity for a broader pool of individuals and entities to participate in the regulated advisory space. However, the complete removal of the experience requirement in the securities market may be viewed as an aggressive change since such experience is crucial in ensuring that individuals possess the necessary expertise to provide sound advice or research. While the five-year threshold may have been stringent, a reduced experience requirement, rather than an outright elimination, could have struck a better balance.

(b) Scope of investment advice

i. Investment Advisers have been allowed to provide comprehensive financial planning services to their clients which may now include products or services outside the regulatory purview of SEBI, i.e., investment products other than 'securities'. However, Investment Advisers must (i) make appropriate disclosure to its clients that such services are outside the purview of SEBI and no recourse is available to them with SEBI for their grievances related to such products / services; and (ii) obtain relevant declarations and undertakings from its clients acknowledging the above limitation.

ii. It may be noted that this position is a departure from what was earlier proposed in the Consultation Paper. The Consultation Paper had suggested that Investment Advisers could provide investment advice in respect of a specific instruments / products if they belonged to an asset class (i) related to securities under the purview of SEBI or (ii) regulated by any other financial sector regulator (such as PFRDA, RBI, IRDAI). If a non-individual Investment Adviser wanted to offer advisory services in relation to products / services other than the above, it would have been required to do so through a separate legal entity having a different legal and brand name.

Comment

SEBI has now specifically enabled Investment Advisers to offer holistic financial planning services to clients, providing advisory services in relation to products such as NPS, fixed deposits, provident funds, insurance, etc. However, this expanded scope also opens avenues for Investment Advisers to provide advisory services on unregulated products and global securities, including cryptocurrencies and digital gold which may raise concerns about investor protection in relation to such advisory services.

(c) Scope of research services

i. In line with the regulatory framework applicable to Investment Advisers, the definition of Research Analyst has been modified to include the provision of research services 'for consideration'. Further, the scope of research services has also been modified to include (i) recommendation of model portfolio; (ii) giving stop loss targets; and (iii) providing trading calls.

ii. Detailed guidelines have been prescribed in relation to recommendation of model portfolios by a Research Analyst which *inter alia* provides that every model portfolio must have a corresponding research report that should include the disclosures, rationale, methodology, launch date, update date and type of model portfolio contained therein. Further, each model portfolio must have its performance validated by a duly validated agency / body, *i.e.*, the Past Risk and Return Verification Agency (**PaRRVA**) prescribed by SEBI.

Comment

Similar to Investment Advisers, individuals or research entities providing research services will now be required to obtain registration as a Research Analyst only if they are engaged in providing these services for consideration. This essentially enables individuals or entities to offer research services without obtaining registration as a Research Analyst, provided that these services are offered without any direct or indirect consideration.

Further, the recognition of model portfolios as a specific research service resolves a long-standing ambiguity surrounding such services by Research Analysts, particularly in light of the Settlement Order in respect of Mr. Amit Mohan Jeswani dated 6 May 2022 wherein the noticee opted to settle the matter arising from a show cause notice issued to him for offering model portfolios as a Research Analyst. Additionally, the requirement of validating the performance of every model portfolio may entail a significant financial burden on the Research Analyst assuming PaRRVA will charge a certain fee for its services.

(d) Part-time registration

i. Individuals and partnership firms engaged in other business activities and employment (not related to securities) may seek registration as a part-time Investment Adviser / Research Analyst provided they (i) obtain a no-objection certificate from its employer; and (ii) provide a declaration that they will maintain an arms-length relationship between their business activity as an Investment Adviser / Research Analyst and other activities. Clear disclosures must be made that their other business activities and employment are not under the regulatory purview of SEBI and no complaint can be raised to SEBI for the services rendered therein.

ii. It has been expressly clarified that individuals offering investment advice or making any claim of returns about securities without SEBI's approval (Finfluencers), as well as those offering advice / recommendations on assets such as gold, real estate, cryptocurrency, etc. will not be considered eligible for registration as a part-time Investment Adviser / Research Analyst.

Comment

While the proposal to introduce registration as a part-time Investment Adviser / Research Analyst is a welcome move and will indeed increase the number of registered players in the advisory and research services space, further clarity may be required from SEBI in relation to the eligibility criteria for individuals seeking part-time registration as an Investment Adviser / Research Analyst. While on one hand, SEBI has allowed Investment Advisers to offer investment advice in relation to products / services outside the regulatory purview of SEBI (i.e. investment products other than securities), but on the other hand, it has refused to allow part-time registration for applicants providing investment advice in relation to assets such as gold, real estate and cryptocurrencies which fall outside its regulatory purview.

(e) Client level segregation

i. With the intent of bringing the regulatory framework of Research Analysts in line with Investment Advisers, Research Analysts have now been mandated to ensure client level segregation of its research services from its distribution activities at their group/family level. Thus, if a Research Analyst provides research services in respect of a particular security, it cannot earn distribution income (at a group/family level) from distributing that security to the same client to whom the research services have been provided.

ii. It has also been clarified that client-level segregation of advisory and distribution services will not apply if the Investment Adviser/Research Analyst provides services exclusively to institutional clients and accredited investors, provided the client signs a waiver acknowledging this arrangement. In such cases, Investment Advisers/Research Analysts are permitted to offer both investment advisory and distribution services to the same client.

Comment

The requirement to align Research Analysts with Investment Advisers with respect to client level segregation may be misplaced. The rationale for this segregation in the case of Investment Advisers stems from the fact that Investment Advisers provide personalized, client-specific advice designed to cater to the individual interests of investors. Such advice inherently carries the potential to influence client actions. For instance, the segregation requirement ensures that an Investment Adviser does not recommend particular securities to clients with the intention of also earning distribution income from those securities if the client decides to purchase them.

In contrast, Research Analysts do not offer client-specific advice or recommendations. Their services are inherently security-specific and client-agnostic, as Research Analysts typically issue research reports or general recommendations without direct interaction with clients. As such, the potential for influencing client actions in the manner seen with Investment Advisers is absent.

A more appropriate approach for Research Analysts could have been to impose a product-level segregation requirement under which a Research Analyst could be restricted from earning distribution income from a security on which it has issued a recommendation or research report. However, Research Analysts could still be permitted to provide both research and distribution services to the same client, as long as the product-level restriction is adhered to. For example, a Research Analyst issuing a research report on a specific mutual fund must not earn distribution income from selling that specific mutual fund but must be allowed to earn distribution income from distributing another mutual fund to the same client.

(f) Fee

i. To ensure a level playing field between Investment Advisers and Research Analysts in terms of the maximum fee that can be charged, a cap of INR 1.51 lakhs (US$ 1750) per annum per family has been prescribed for Research Analysts in case of individual or HUF clients, aligning with the limits applicable to Investment Advisers.

ii. With respect to Investment Advisers, fees can be charged under two models: (i) the Assets under Advice (**AUA**) model, subject to a cap of 2.5% of AUA per annum per client family across all services offered by the Investment Adviser, and (ii) the fixed fee model, now subject to the same limit of INR 1.51 lakhs per annum per client family. Previously, Investment Advisers were restricted to charging fees under either the AUA model or the fixed fee model, with changes permitted only after a 12-month waiting period. To enhance flexibility, Investment Advisers can now switch between fee models for clients at any time without adhering to a minimum waiting period. However, the maximum fee remains capped at the higher of the fixed fee limit or 2.5% of AUA per annum per client family.

iii. The maximum fee limit for Investment Advisers and Research Analysts will not apply to non-individual clients and accredited investors. The fee structure for such clients shall be governed by bilaterally negotiated contractual terms.

Comment

While the revision aims to create a level playing field, it inadvertently creates a disparity between the two intermediaries. To elucidate, Investment Advisers, under the AUA mode, are permitted to charge up to 2.5% of the client's AUA. Thus, if the AUA of a particular client is INR 100 crores, the Investment Adviser could charge a fee of up to INR 2.5 crores for its services. In contrast, Research Analysts, which do not manage any AUA and provide security-specific recommendations, are restricted to a fixed fee limit of INR 1.51 lakhs per annum, with no flexibility for charging a variable fee.

Additionally, further clarity may be required on the fee structure for Investment Advisers when they earn commissions or advisory fees in relation to products other than 'securities' that fall outside the regulatory purview of SEBI.

(g) KYC by Research Analysts

The Amendments now specifically provide for Research Analysts to conduct KYC of their fee-paying clients and maintain such KYC records with them. Further, Research Analysts have also been mandated to maintain records of interactions with clients and prospective clients in the form of physical records, telephone recordings, emails, SMS, etc for a minimum period of five years.

Comment

The requirement to conduct KYC and maintain communication records may be unnecessary for Research Analysts, as they are not technically required to be aware of the details of their client as part of their normal business operations. Unlike Investment Advisers, Research Analysts do not have any AUA or provide implementation/execution services to their clients. The role of a Research Analyst is limited to analysing specific securities and issuing research reports or recommendations pertaining to those securities. These services are inherently client-agnostic, with no personalised interaction or advice tailored to individual clients. Therefore, imposing an obligation to conduct KYC of their clients and maintain communication records may be misplaced and could impose an undue burden on Research Analysts without any clear benefit.

Concluding Remarks

The Amendments and Circulars are a welcome measure that provide much needed relaxations and clarity in the regulatory framework applicable to Investment Advisers and Research Analysts. The updated regulatory framework not only reduces compliance burden but also open the doors for more professionals to enter the field with the objective of ensuring quality research and advisory services for investors. This is likely to improve access to investment advice and research services for retail investors while ensuring that such services are aligned with regulatory expectations.

While many of the changes in the regulatory framework for Research Analysts address the regulatory arbitrage that previously existed (where Research Analysts operated under a less stringent regulatory regime with fewer compliance obligations compared to Investment Advisers), some of the new requirements on Research Analysts may be misplaced. Given the distinct nature of their services which are security-specific, client-agnostic and lack the personalized interaction characteristic of Investment Advisers, such requirements could impose unnecessary burden and may require reconsideration in the future.

- *Sanjay Khan Nagra (Partner); Prashanth Ramdas (Partner); Smita Jha (Partner) and Shivaang Maheshwari (Associate)*

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