

INVESTMENT ADVISORY AND BANKS - THE FUTURE

Traditionally banking function in India is considered as taking deposits and providing loans. This is substantially enhanced and banks today provide various products and services such as selling of insurance products, mutual funds, acting as financial consultants etc. These activities are generally monitored by a bank internally by implementing stringent policies to avoid conflict of interest inter alia by maintaining Chinese walls, entering into service level agreements and/or by adopting a methodology where entities are set up to undertake visibly distinct types of business / activity.

This is also done to insulate the banking systems from risks that can be attached to it from other sectors. After all, and specifically post the global financial crisis, it is a constant endeavor to repose faith of public at large in the banking and financial system. Towards this objective, on 21st April 2016, the Reserve Bank of India (“**RBI**”) has issued the ‘*Guidelines on Investment Advisory Services offered by Banks*’ (“**IA Guidelines**”). Investment advisory services in the context of banks has seen significant development specifically since 2013. The snapshot of the developments are as under:

1) Back in 2013:

(a) The stage of SEBI:

Investment advisory services in India from a regulatory perspective, were formally recognized in a distinct manner in January 2013, when the Securities and Exchange Board of India (“**SEBI**”) released the SEBI (Investment Advisers) Regulations, 2013 (“**SEBI IA Regulations**”). Prior to the SEBI IA Regulations, investment advisory services were regulated under the SEBI (Portfolio Managers) Rules and Regulations, 1993.

The definition of “*investment adviser*” under the SEBI IA Regulations includes activities undertaken by a banking entity. For the purpose of being certified as an investment adviser, the banking entity had to comply with certain key conditions like (a) the banking entity seeking permission from the RBI, and (b) providing the services of ‘***an investment adviser through a subsidiary or separately identifiable department or division.***’

(b) The stage of RBI:

Given that the picture involved banks as a type of eligible applicant, RBI released the ‘*Draft Guidelines on Wealth Management and Marketing / Distribution Services offered by Banks*’ on 28th June 2013 (“**RBI WM Guidelines**”).

The RBI WM Guidelines acknowledged the fact that the investment advisory services are governed by the SEBI IA Regulations. They also set out a set of requirements that banks as applicants need to comply with in order to be eligible to be an investment adviser. These include:

- (i) Banks offering investment advisory services could do so only ‘***through a separately identifiable department or division***’; and
- (ii) The banks offering investment advisory services should be registered under the SEBI IA Guidelines and shall adhere to all SEBI prescribed regulations in this regard.

Additionally, bank sponsored subsidiaries were also permitted under the RBI WM Guidelines to provide the services of an investment adviser. Such subsidiary, just like

the conditions for bank itself, also had to be registered under the SEBI IA Guidelines and had to adhere to all SEBI prescribed regulations in this regard.

(c) Interpreting SEBI & RBI norms

Basis the SEBI IA Regulations and the RBI WM Guidelines, banking entities could act as an investment advisor, either:

- (i) through a subsidiary; or
- (ii) separately identifiable department or division.

2) 2016:

Over the years, as has been the case globally, India has also witnessed a major shift in the nature of business undertaken by a bank. The IA Guidelines bring about a significant change in the manner of conducting the activity of investment advisor by banks in general.

Acknowledging the SEBI IA Regulations and the RBI WM Guidelines, it has now been stipulated that going forward, banks cannot undertake investment advisory services departmentally. Banks can provide such services only through a separately set up subsidiary for this purpose or an existing subsidiary.

Banks have been provided a window of three years from April 2016 to make this distinction in its activity indeed a reality.

3) What next:

By creating the requirement of separate entities, a demarcation between the nature of businesses over which RBI would have a regulatory control and businesses over which SEBI would have a regulatory control has been spelt out.

While defining and regulating products is simpler, defining and regulating activities isn't. The main reason for this is the involvement of human nature in the activity per se. The nature of the activity is typically the determining factor for evaluating whether it can be housed within the banking entity (and therefore the financing industry) or whether it needs to be housed in a separate entity from a prudential risk management perspective. This also needs to be considered from the perspective of the recently introduced SEBI Investment Advisor Regulations.

Market participants may remember that towards achieving the objective of giving a boost to the government securities market in India, 'Primary Dealers' for their activity were allowed to be housed within the banking entity itself. The condition is that the activity should be undertaken departmentally. Last few years have seen that the same banking entity in addition to playing the traditional role of a lender, also plays a related role of a facility agent, a not so related role (specifically for consortiums) of a security trustee / agent, and in some cases also goes on to act as an adviser / arranger. Informal structures of soft underwriting also exists, though not widely spoken about or discussed.

From this perspective, the IA Guidelines, the true impact of which would be felt three years from now, seems as a step in the right direction provided that a banking entity is not in any manner stopped from undertaking related activities (i.e. closely and intricately linked to what is "banking business"). The IA Guidelines also reflect the positive synergy between the regulators, which is the need of the hour for any growing economy.

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