

Financial Literacy vs. Investor Protection: SEBI's Dilemma in the Age of Finfluencers

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Introduction

In recent years, there has been a significant rise in the number of unregistered financial influencers, popularly known as "Finfluencers", who provide financial advice and information on various financial topics such as investing in securities, personal finance, banking products, insurance, real estate investment, etc. on their social/digital media platforms/channels (Instagram, Facebook, YouTube, LinkedIn, Twitter etc.) through reels, stories, messages, videos, posts and links. Such Finfluencers have the ability to influence the financial decisions of their followers. While some Finfluencers are genuine and provide accurate and helpful information, others may be operating as unregistered investment advisers or research analysts.

Investment advisers and research analysts that offer investment advising or provide research reports, as the case may be required to register with the Securities and Exchange Board of India ("SEBI") before providing such services to the general public. However, one exception with respect to registering as an investment advice is where the investment advice is given through newspapers, magazines, or any other electronic, broadcasting, or telecommunications medium, which is widely available to the public. Similarly, comments on general trends in the securities market, discussions on broad based indices, commentaries on economic, political and market conditions, statistical summaries of financial data of the companies etc. shall not be considered as communications for a research report.

SEBI has time and again passed orders and come down heavily on entities offering various packages for investment advisory services through their websites and other social media platforms without registering themselves with SEBI. In many cases, SEBI has prohibited such entities from acting or holding themselves as investment advisors

and also asked the entities to refund or disgorge all the illegal gains which has been collected from their clients after providing such investment advisory services. In other cases, SEBI has also refrained such unregistered entities from buying, selling or otherwise dealing in the securities market for a specified period. Providing such investment advice without proper registration is illegal and can mislead investors, leading to financial losses.

In this background, SEBI is concerned about the role played by Finfluencers and the potential for Finfluencers to mislead or misinform investors, and to create conflicts of interest due to the wide base of their followers and ability to influence common man without being registered with SEBI as an investment adviser or research analyst. In order to protect investors, SEBI on 25th August 2023 released two consultation papers: (i) on the association of SEBI Registered Intermediaries/Regulated Entities (“SEBI RI/RE(s)”) with Unregistered Entities (including Finfluencers)ⁱⁱⁱ (“Consultation Paper 1”) and (ii) on mechanism for fee collection by SEBI registered Investment Advisers and Research Analysts (“SEBI IA/RA(s)”)^{iv} (“Consultation Paper 2”).

Consultation Paper 1

1. Unregistered entities or Finfluencers have been effectively enticing their followers to purchase products, services or securities in return for undisclosed compensation from platforms or producers in the form of referral fees, non-cash benefits, profit sharing with the underlying product, channel, platform or services or compensation received directly from the social media or other platforms where they share their content. SEBI has also come across instances where SEBI RI/REs may be relying on such Finfluencers to promote their product or services. In view of the above, the Consultation Paper 1 introduced by SEBI proposes to (i) limit the association of SEBI RI/REs with unregistered entities, including Finfluencers and to (ii) disrupt the revenue model of the Finfluencers by introducing the following measures:
 - Disassociation by SEBI RI/REs or their agents/representatives, in all forms, i.e., monetary or non-monetary and directly or indirectly with unregistered entities (including Finfluencers) for any promotion or advertisement of their services/products.
 - Restriction on SEBI RI/REs or entities regulated by stock exchanges or Association of Mutual Funds in India (“AMFI”) from sharing any confidential information of their clients with any unregistered entities.
 - Finfluencers registered with SEBI or stock exchanges or AMFI in any capacity shall be required to display their registration number, contact details, investor grievance redressal helpline and make appropriate disclosure and disclaimer on any posts.
 - Such entities shall comply with the advertisement guidelines issued by SEBI, stock exchanges and SEBI recognised supervisory bodies.
 - SEBI RI/REs shall not pay any trailing commission based on the number of referrals as referral fee to the Finfluencers.
 - Limited referrals from retail clients, and payment of fees for such limited referrals by stockbrokers shall be allowed.
 - All SEBI registered intermediaries shall take active measures to separate themselves from any unregistered entity using their name, product or service and

shall take necessary action to the notice of enforcement agencies for impersonation and fraud, as may be applicable.

Consultation Paper 2

1. Regulation 15 of the Securities Exchange Board of India (Investment Advisers) Regulations, 2013 provides that SEBI registered IAs shall be entitled to charge fees for providing investment advice to their clients. In a similar vein, SEBI registered RAs bill their fee-paying clients for the services they provide. Numerous unregistered entities have deceived investors throughout the years in violation of SEBI IA and RA requirements. The SEBI Consultation Paper 2 suggests introducing a mechanism for fee collection by SEBI IA/RAs to make sure that they are recognized as registered intermediaries and to set them apart from unregistered entities. The proposed mechanism for fee collection by SEBI IA/RAs is as follows:
 - They will be required to open a designated bank account for the purpose of collecting fees.
 - Fees will be paid by clients to the designated bank account through a designated platform(s) to be specified / administered by a SEBI recognised supervisory body. Such bank accounts shall be solely used for collection of fee from investment advisory / research activity.
 - Disclosure of mechanism of collection of fees by SEBI IA/RAs to their clients and shall form part of their client agreement, if any.
 - Disclosures to be made by SEBI IA/RAs to their clients in respect of the risk of payment of fees outside of the proposed mechanism.

Conclusion

The Consultation Papers are important measures taken by SEBI to safeguard investors against the risk that unregistered Finfluencers pose. Finfluencers have emerged as a powerful force in the Indian financial sector, democratizing financial literacy and making investment advice more accessible to the masses. Their rise poses a new challenge for regulators who must strike a balance between fostering innovation and protecting investors from any material risks and losses. In this regard, the Consultation Papers released by SEBI represent a significant development in greater regulation of the financial sector in India, particularly in the context of social media influencers or “Finfluencers”. It also has to be observed how SEBI construes the exceptions to such investment advising and research reports with respect to Finfluencers, given the Consultation Papers remain silent on the matter.