

Consultation paper
on
Draft Circular to provide clarity on provisions related to
association of persons regulated by the Board, MIIs and their
agents with persons carrying on prohibited activities

1. Objective

1.1. The objective of this paper is to seek public comments on the provisions of the draft circular providing details/clarifications on various provisions related to association of persons regulated by the Board, MIIs (stock exchanges, clearing corporations, depositories), and their agents with certain persons carrying on prohibited activities as specified under SEBI (Intermediaries) Regulations, 2008, Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 and SEBI (Depositories and Participants) Regulations, 2018.

2. Background

2.1. In order to address concerns related to unregistered entities giving investment advice and research calls, and entities making claims which are not permitted by SEBI, SEBI (Intermediaries) (Amendment) Regulations, 2024, Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) (Fourth Amendment) Regulations, 2024 and SEBI (Depositories and Participants) (Second Amendment) Regulations, 2024 have been published by SEBI on August 29, 2024.

2.2. In terms of these regulations, the persons regulated by the Board (as defined in these regulations), MIIs, and their agents shall not have any direct or indirect association with another person who-

- i. provides advice or any recommendation, directly or indirectly, in respect of or related to a security or securities, unless the person is registered with or otherwise permitted by the Board to provide such advice or recommendation; or

ii. makes any claim, of returns or performance expressly or impliedly, in respect of or related to a security or securities, unless the person has been permitted by the Board to make such a claim.

2.3. Given the above, it is proposed to issue a circular to provide details/clarifications in respect of the same.

3. Public Comments

3.1. The draft circular to provide details/clarity on provisions related to association of persons regulated by the Board, MIIs and their agents with certain persons is placed at Annexure A. Comments are invited on the proposals mentioned in the Draft Circular. The comments/ suggestions should be submitted latest by December 27, 2024, through the following link:

<https://www.sebi.gov.in/sebiweb/publiccommentv2/PublicCommentAction.do?doPublicComments=yes>

3.2. In case of any technical issue in submitting your comment through web based public comments form, you may write to consultationMIRSD@sebi.gov.in with the subject: "Comments on Draft Circular to provide clarity on provisions related to association of persons regulated by the Board, MIIs, and their agents with persons carrying on prohibited activities"

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Encl: Annexure A

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DRAFT CIRCULAR

SEBI/HO/MIRSD/ MIRSD-PoD-1/P/CIR/2024/ XX

December XX, 2024

To,

All registered Intermediaries

All recognized Stock Exchanges

All recognized Clearing Corporations

All registered Depositories

BSE Limited (Administration and supervisory body for Investment Advisers and Research Analysts- IAASB/RAASB)

Sir / Madam,

Sub: Details/clarifications on provisions related to association of persons regulated by the Board, MIIs, and their agents with persons carrying on prohibited activities

1. Securities and Exchange Board of India (Intermediaries) (Amendment) Regulations, 2024, Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) (Fourth Amendment) Regulations, 2024 and Securities and Exchange Board of India (Depositories and Participants) (Second Amendment) Regulations, 2024 have been published on August 29, 2024.
2. These regulations inter alia provide that persons regulated by the Board, MIIs (stock exchanges, clearing corporations, depositories), and agents of such persons/MIIs shall not have any direct or indirect association with another person who-

Consultation paper on draft circular to provide clarity on provisions related to association of persons regulated by the Board, MIIs, and their agents with persons carrying on prohibited activities

- (i) provides advice or any recommendation, directly or indirectly, in respect of or related to a security or securities, unless the person is registered with or otherwise permitted by the Board to provide such advice or recommendation; or
- (ii) makes any claim, of returns or performance expressly or impliedly, in respect of or related to a security or securities, unless the person has been permitted by the Board to make such a claim.

The person regulated by the Board (including recognised stock exchanges, clearing corporations and depositories) is required to ensure that any person associated with it or its agent does not engage in the activities mentioned in clauses (i) or (ii) above.

It has been clarified that the term “another person” shall not include a person who is engaged solely in investor education, provided that such a person does not, directly or indirectly, indulge in any activity as referred to in clauses (i) or (ii) above.

3. In this regard, the details/clarifications on the provisions are provided in the form of frequently asked questions at **Annexure A-1**. This is intended to provide guidance for compliance to persons regulated by the Board, MIIs, and their agents on their association with another person.
4. This circular is issued in exercise of powers conferred under section 11(1) of the Securities and Exchange Board of India Act, 1992 read with Regulation 36 of Securities and Exchange Board of India (Intermediaries) Regulations, 2008, Regulations 50 of Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 and Regulation 96 of Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018, to protect the interests of investors in securities market and to promote the development of, and to regulate the securities market.
5. This circular is available on the SEBI website at www.sebi.gov.in under the category "Legal →Circulars".

1. Which regulations provide provisions for association of persons regulated by the Board, MIIs, and their agents with another person carrying on prohibited activities?

Regulation 16A of Securities and Exchange Board of India (Intermediaries) Regulations, 2008 ('Intermediaries Regulations'), Regulation 44B of Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 ('SECC Regulations') and Regulation 82B of Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018 ('DP Regulations') provide the provisions on association of persons regulated by the Board, MIIs, and their agents with another person carrying on prohibited activities (hereinafter referred to as "regulations" in this circular).

2. Who is a 'person regulated by the Board' for these regulations?

The term 'Person regulated by the Board' is defined in Intermediaries Regulations as -

- (a) a person registered with the Board under section 12 of the Act;
- (b) an asset management company of a mutual fund registered with the Board;
- (c) investment manager of an alternative investment fund or infrastructure investment trust registered with the Board;
- (d) manager of a real estate investment trust registered with the Board;

In addition, SECC Regulations and DP Regulations have similar provisions for recognised stock exchanges, clearing corporations and registered depositories respectively.

In this circular, hereinafter all these persons are collectively referred to as "persons regulated by the Board".

3. Who is an agent of a person regulated by the Board?

Anyone who acts on behalf of a person regulated by the Board including inter alia employees, distributors, authorised persons (APs), channel partners etc. is an agent of a person regulated by the Board.

4. What are the restrictions on persons regulated by the Board and their agents on their association with another person?

As per law, no regulated entity can do indirectly, what it cannot do directly. Thus, the prohibited activities which it cannot do directly [(i) and (ii) mentioned below], it cannot do indirectly i.e. by indirectly associating with another person who is carrying on such activity.

Thus, persons regulated by the Board and their agents shall not have any direct or indirect association with another person who is engaged in any of the two activities not permitted by the Board. These two prohibited activities are:

- (i) providing advice or any recommendation, directly or indirectly, in respect of or related to a security or securities, without being registered with or otherwise permitted by the Board to provide such advice or recommendation; and
- (ii) making any claim, of returns or performance expressly or impliedly, in respect of or related to a security or securities, without being permitted by the Board to make such a claim.

5. What constitutes an association between persons regulated by the Board and their agents with another person?

The “association” for the purposes of these regulations shall mean the association in the nature of transaction involving money or money’s worth or referral of a client or interaction of information technology systems or any other association of similar nature or character, by any name called.

6. Whether persons regulated by the Board are responsible to ensure that the persons with whom they associate do not engage in abovementioned two prohibited activities?

Yes. It is the responsibility of the person regulated by the Board to ensure that any person associated with it or its agent, directly or indirectly, does not engage in any of the abovementioned two prohibited activities, directly or indirectly.

7. Are there any restrictions on persons regulated by the Board and their agents to associate with another person who is engaged in investor education?

Investor education is not one of the two prohibited activities under these regulations. However, before associating with such a person, it must be ensured that such a person does not engage in any of the abovementioned two prohibited activities, directly or indirectly.

8. What distinguishes education and advice/recommendation?

A person engaged solely in education shall mean that such person is not engaged in any of the two prohibited activities, such person should not be using the market price data of the preceding three months to speak/talk/display the name of any security including using any code name of the security in his/her talk/speech, video, ticker, screen share etc. indicating the price, opinion, advice or recommendations related to security or securities. If the name of any security or the market price data is used for the purpose of education, such market price data may be used with a lag of at least three months.

9. Whether the personal services provided by the person regulated by the Board to another person (e.g. an unregistered IA), like opening of his personal demat account or trading account, amount to association of such person with such another person?

There is no restriction on any person in availing the services from person regulated by the Board, or their agents such as opening of a demat account or trading account in their personal capacity provided that such services/accounts are not used for any of the abovementioned two prohibited activities, directly or indirectly.

10. Whether stock brokers can avail services of another person who is engaged in any of the abovementioned two prohibited activities?

Persons regulated by the Board including stock brokers can not avail services of another person who is engaged in any of the abovementioned two prohibited activities, directly or indirectly.

11. Whether the Mutual Fund Distributors (MFDs) and Authorised Persons (APs) are required to comply with these regulations for their association with another person?

Yes, MFDs and APs are agents of Asset Management Companies (AMCs) and stock brokers respectively who are covered under the definition of “person regulated by the Board”. Hence, they are required to comply with these regulations. AMCs and stock brokers being persons regulated by the Board are responsible to ensure compliance of their agents with these regulations.

12. What are the consequences of violation of these regulations for persons regulated by the Board and their agents?

As per Regulation 16B of Intermediaries Regulations and Regulation 82C of DP Regulations, SEBI may, in case of violation of any of the provisions of Regulation 16A of Intermediaries Regulations and Regulation 82B of DP Regulations respectively, take such action as it may deem fit including action under Chapter V of Intermediaries Regulations. Such action may include the enquiry, adjudication or an order under Section 11B of SEBI Act, 1992.

Further, in terms of Regulations 44C of SECC Regulations, SEBI may, in case of violation of any of the provisions of Regulation 44B of SECC Regulations, take such action as it may deem fit including action as provided under regulation 49 of SECC Regulations. Such action may include adjudication or an order under Section 11B of SEBI Act, 1992.

Potential actions could include penalty, suspension/cancellation of registration, debarment etc.

13. Can SEBI registered intermediaries make any payment or receive payment or share any client information from or with another person engaged in any of the abovementioned two prohibited activities, directly or indirectly?

For the purposes of these regulations, “association” means-

- (a) a transaction involving money or money’s worth;
- (b) referral of a client;
- (c) interaction of information technology systems;
- (d) any other association of a similar nature or character.

Sharing client information is of similar nature as of “referral of a client”. Hence, making any payment or receiving payment or sharing any client information from or with any person shall amount to “association” under these regulations, and is not permitted.

Thus, such intermediaries are prohibited to make any payment or receive payment or share any client information from or with another person engaged in any of the abovementioned two prohibited activities, directly or indirectly.

14. Whether persons regulated by the Board and their agents are allowed to associate for their branding/marketing/promotional activities with another person?

The persons regulated by the Board and their agents are allowed to associate for their branding/marketing/promotional activities with another person provided that such another

person is not engaged in any of the abovementioned two prohibited activities, directly or indirectly.

15. Can SEBI regulated entities and their agents associate with another person who is promoting consumer products from the sectors such as banking, financial services, and insurance, which are not regulated by SEBI?

Some of products which are not under the purview of SEBI may come under the jurisdiction of some other regulatory authority. Hence, regulatory provisions of such other regulatory authority shall be applicable. However, persons regulated by the Board shall ensure that they and their agents shall not associate, directly or indirectly, with another person for any promotional activities if such another person is engaged in any of the abovementioned two prohibited activities, directly or indirectly.

e.g. if a broker associates with a person (who is promoting insurance product) engaged in carrying on any of the two prohibited activities, it would be violation of the SEBI regulations since the Intermediaries regulations prohibit any association, directly or indirectly, with another person engaged in any of the two prohibited activities.

16. Do the following amount to violation under the regulations?

a) Advertising/branding/lead generation through a marketing agency by any name.

The same shall amount to violation of the regulations if the person regulated by the Board or its agent indirectly ends up in getting associated with an entity carrying on any of the two prohibited activities.

b) Digital platforms where person regulated by Board or its agent has control on where any advertisement/content appear.

No, if person regulated by Board or its agent does not, directly or indirectly, end up in getting associated with an entity engaged in any of the two prohibited activities. Since the person or its agent has control, it can ensure that there is no such association.

c) Platforms where person regulated by Board or its agent has no control over the content/entity with whom it gets associated.

The same shall amount to violation of the regulations if the person regulated by Board or its agent indirectly ends up in getting associated with an entity carrying on any of the two prohibited activities.

17. When will these regulations come into effect?

These regulations have come into force with effect from August 29, 2024. Persons regulated by the Board and their agents have been advised through a circular dated October 22, 2024 to terminate their existing contracts, if any, with persons engaged in any of the abovementioned two prohibited activities, directly or indirectly, within three months from the date of issuance of the circular i.e. by January 21, 2025.
