



Consultation Paper
Self Regulatory Organizations in Securities Market

1. Objective

- 1.1. The objective of the Consultation Paper is to seek comments from the public on the proposal to amend the Securities and Exchange Board of India (Self Regulatory Organizations) Regulations, 2004 (SRO Regulations) for the purposes of defining Self Regulatory Organization, simplifying the process of recognition and strengthening the role of Self Regulatory Organizations (SROs) in the securities market.

2. Background

- 2.1. SEBI had notified the SRO Regulations on February 19, 2004. As on date, the said Regulations are in force only in relation to distributors engaged by Asset Management Companies of Mutual Funds and distributors engaged by Portfolio Managers.
- 2.2. SEBI had initiated the process of selection of SRO for distributors of Mutual Fund (MF) products in 2013. The in-principle approval granted to one of the applicants was challenged before the Hon'ble Securities Appellate Tribunal (SAT) and a further appeal was made before the Hon'ble Supreme Court.
- 2.3. In October 2017, pursuant to an application filed by SEBI, the Hon'ble Supreme Court allowed SEBI to start afresh the selection process for SRO of distributors of MF products.
- 2.4. Pursuant to the same and after a detailed internal deliberation in the matter, SEBI had filed an application before the Hon'ble Supreme Court to seek leave to make necessary amendments to the SRO Regulations including that of recognizing a company as an SRO, after considering its experience and capability, without calling for applications.
- 2.5. The Hon'ble Supreme Court in its order dated November 12, 2018 while allowing SEBI's application observed the following:
"Prayer to amend the Self Regulatory Organization (SRO) Regulations and to consider the pending cases in the light of the amended Regulations is allowed. We make it clear that we have expressed no opinion on the validity of the amendment(s) proposed."



3. SROs for Different Segments of Securities Market

3.1. Concept of SRO

3.1.1. The distributors of MF products and Investment Advisers (IAs) are becoming important players in the market and growing in numbers. There are approx. 1.24 Lakh distributors of MF products as on February 28, 2019 and 1,136 IAs registered with SEBI as on March 19, 2019. Therefore, their direct supervision by SEBI would be challenging. Hence, some form of a first level regulator is required to have an oversight on them. In view of the above, it is proposed to have SRO(s) to regulate the Distributors of MF products and Investment Advisers (IAs). Further, the same may be extended to such other intermediaries / other market participants as may be notified by SEBI from time to time.

3.2. Role of SRO

3.2.1. An SRO for a segment of intermediaries in the securities market would be entrusted with the role of being the first level regulator for such intermediaries, who are its members. The SRO would perform several crucial roles including some or all of the following:

3.2.1.1. Developmental Role

- 3.2.1.1.1. Providing Training and Education to its members
- 3.2.1.1.2. Creating Investor awareness
- 3.2.1.1.3. Providing policy inputs inter alia by participating in SEBI committees

3.2.1.2. Regulatory Role

- 3.2.1.2.1. Granting of membership in SRO/ Recommending to SEBI for grant of certificate of registration / renewal of certificate of registration of its members
- 3.2.1.2.2. Setting down a Code of Conduct and conducting examination for certification / admission of members
- 3.2.1.2.3. Supervision and Inspection (offsite and onsite) of its members

3.2.1.3. Grievance Redressal & Dispute Resolution Role

- 3.2.1.3.1. Resolution of grievances against the members
- 3.2.1.3.2. Resolution of disputes between an investor and member
- 3.2.1.3.3. Resolution of disputes between members

3.2.1.4. Disciplinary Role

- 3.2.1.4.1. Taking action in the event of violation of code of conduct
- 3.2.1.4.2. Taking action in the event of violation of regulations



3.3. Powers of SRO

3.3.1. Being the first level regulator of its segment, SRO is authorized to discharge the roles as provided in Para 3.2 and for an effective execution of these roles, the SRO Regulations provide for, inter alia, the following actions which may be taken by an SRO:

- 3.3.1.1. Expulsion from membership
- 3.3.1.2. Suspension from membership
- 3.3.1.3. Any other penalty of a like nature not involving the payment of money

3.4. Eligibility Criteria to become SRO

3.4.1. While SRO is required to have adequate experience (direct or indirect) in regulation, supervision, dispute resolution and investor protection, the SRO Regulations provide certain eligibility criteria which, inter alia, include the following:

- 3.4.1.1. Incorporation under Section 8 of Companies Act, 2013
- 3.4.1.2. MoA has discharging the functions of SRO as one of its main objects
- 3.4.1.3. Minimum net worth of one crore rupees
- 3.4.1.4. Adequate infrastructure
- 3.4.1.5. Professional competence, financial soundness and general reputation of fairness and integrity

3.5. SRO for Distributors of Mutual Fund Products

3.5.1. In recent years, the securities market in general and the Mutual Funds industry in particular has grown manifold. AUM increased from INR 1.4 Lakh Crores in 2004 to INR 5.87 Lakh Crores in 2012, and thereafter to INR 21.36 Lakh Crore as on March 31, 2018. The number of folios has grown from 1.46 Crores in 2004 to 4.65 Crores in 2012, and thereafter to 7.13 Crores as on March 31, 2018. The number of distributors of the Mutual Fund products has also increased from 18,285 in 2004 to 47,845 in 2012 and thereafter to 1,07,302 as on March 31, 2018.

3.5.2. As on February 28, 2019, the AUM of the Mutual Funds industry has grown to INR 23.16 Lakh Crores, number of folios has increased to 8.18 Crores and number of distributors of MF products has risen to approx. 1.24 Lakhs.

3.5.3. To sustain this growth and to ensure deeper penetration of Mutual Fund products into all areas of the country, the distributors are expected to play an important role.



3.5.4. At present, distributors of Mutual Fund products are registered with the Association of Mutual Funds in India (AMFI) which assigns an AMFI Registration Number (ARN) to them. They are paid commissions by the Asset management Companies (AMCs) for their services in bringing investments. The distributors are empanelled, by way of agreements, with single / multiple AMCs, for marketing their products. Hence, Mutual Funds / AMCs have the primary responsibility for the conduct of the distributors empanelled by it.

3.5.5. However, it is observed that there are diverse practices in the industry regarding the relationships between the AMC and the distributor. Further, a distributor is empanelled with multiple AMCs. Thus, there is a need to bring a certain level of consistency in the practices of the distributors. Hence, there is a need to have an SRO for the distributors of Mutual Fund products to ensure consistency in the practices, enforcement of code of conduct and to take disciplinary action, if required, particularly in respect of alleged malpractices like mis-selling of products, churning of portfolio etc. and to deal with investor grievances, in order to safeguard the interests of the investors.

3.6. SRO for Investment Advisers

3.6.1. Section 11(2)(b) of SEBI Act inter alia empowers SEBI to register and regulate the working of Investment Advisers. For the said mandate, SEBI issued a Concept Paper on Regulation of Investment Advisers on September 26, 2011 to seek public comments.

3.6.2. The Concept Paper, inter alia, stated that SEBI (Investment Advisers) Regulations would be implemented through an SRO. Post receipt of public comments, draft regulations on Investment Advisers were put up to the Board for consideration and approval of the same. The memorandum to the Board with regard to the draft regulations, inter alia, proposed as follows:

10.1. At the initial stages till recognition of a SRO, SEBI will directly register and regulate Investment Advisers.

10.2. SEBI may appoint an SRO for the purpose of regulating Investment Advisers, representatives or fund managers.

10.3. SEBI may specify that no person shall act as an investment advisor unless he is a member of a recognized SRO.

The Board, in its meeting held on August 16, 2012 approved the draft SEBI (Investment Advisers) Regulations.

3.6.3. SEBI (Investment Advisers) Regulations, 2013 (IA Regulations) were notified on January 21, 2013 and came into effect from April 21, 2013.



Regulation 14(1) of IA regulations, inter alia, state that the Board may recognize any body or body corporate for the purpose of delegating administration and supervision of Investment Advisers to such a body on such terms and conditions as may be specified by the Board.

- 3.6.4. As on March 19, 2019, a total of 1136 investment advisers are registered with SEBI. The category wise details of SEBI registered investment advisers are as follows:

Category	No. of Investment Advisers
Body Corporates	290
Limited Liability Partnership	46
Individuals and Partnership Firms	800
Total	1,136

- 3.6.5. SEBI has been registering and regulating Investment Advisers since 2013 by providing necessary criterion for registration and seeking compliances in terms of risk profiling, suitability, maintenance of records etc. Further, the complaints received against registered investment advisers are also taken up for redressal.
- 3.6.6. Since the last five years, the number of registered investment advisers has shown an increase, particularly individuals, and there has been a corresponding increase in number of complaints against them.
- 3.6.7. SEBI is in receipt of a large number of complaints alleging charging of exorbitant fees, assurance of returns, misconduct etc. by Investment Advisers.
- 3.6.8. Given the growth in this segment of the market, it is felt that the time is appropriate to initiate the formation of an SRO. Thus it is proposed that in line with the earlier Board memorandum, an SRO may be formed and recognized to regulate Investment Advisers.

4. Salient Features of proposed amendments to the SRO Regulations

- 4.1. Globally it is observed that SROs have played an important role in the development of the securities market in several jurisdictions and effectively assisted the regulator in discharging its regulatory duties.
- 4.2. Broadly speaking and conceptually, SRO is an organization representing a particular segment of entities, which, as a first level regulator, regulates the



members of that segment. The proposed SRO(s) as per Para 3.1 above, would be entrusted with several important tasks, inter alia including registration / grant of membership, supervision, training and education of its members, and redressal of investors' grievances. SEBI would be assisted in its regulatory functions by such an SRO. Therefore, it is of utmost importance as to which body / institution is allowed to be recognized as an SRO by SEBI.

- 4.3. In view of the above, SEBI is proposing to amend the SRO Regulations with respect to the manner of recognizing an SRO, subject to the compliance/satisfaction with criteria specified by the Board. As per the proposed process, instead of inviting applications, SEBI would recognize an entity as an SRO on nomination basis, after conducting due diligence. The proposed salient changes are highlighted below:

4.3.1. Definition of Self Regulatory Organization

- 4.3.1.1. The definition of Self Regulatory Organization under regulation 2(1)(k) may be amended as follows:

“Self Regulatory Organization” means, an organization of intermediaries or an entity promoted by a stock exchange, as may be recognized by the Board.”

4.3.2. Nomination Process

- 4.3.2.1. As described in Para 4.2, an SRO is the first level regulator that performs the crucial task of regulating intermediaries representing a particular segment of securities market on behalf of the regulator. An SRO would be seen as an extension of the regulatory authority of SEBI and would perform the tasks delegated to it by SEBI. The role of an SRO is developmental, regulatory, related to grievance redressal and dispute resolution as well as taking disciplinary actions. Therefore, it is crucial that SEBI, after due diligence, recognizes such entity/entities which is/are capable of carrying out responsibilities of an SRO.

4.3.2.2. Nomination Committee

- 4.3.2.2.1. It is proposed to constitute a Nomination Committee comprising of external experts, preferably headed by a retired Judge of a High Court or Supreme Court, to consider and give its recommendation(s) to SEBI regarding the suitability of an organization or entity to be recognized as an SRO.



4.3.2.2.2. The said Committee may also consider the pending cases, as directed by the Hon'ble Supreme Court in its Order dated November 12, 2018, as stated in Para 2.5.

4.3.2.2.3. SEBI, after considering the recommendation of the Nomination Committee and experience and capability of an entity and/or its promoter(s) or promoting entity/entities may grant recognition to the entity as an SRO subject to such conditions as may be deemed appropriate.

4.3.3. Governing Board and Committees.

4.3.3.1. The Governing Board may consist of elected representatives of members of SRO (i.e. regulatees e.g. Distributors of Mutual Fund products and Investment Advisers), SEBI nominated Public Interest Directors (PIDs) and shareholder directors (i.e. representatives of the promoters or promoting entities).

4.3.3.2. The Chairman of the Governing Board shall have the casting vote.

4.3.3.3. The Chairman of the Governing Board shall be elected by the Governing Board from amongst the PIDs.

4.3.3.4. The general superintendence, direction and management of the affairs of the SRO shall vest in the Governing Board, which may exercise all powers and do all acts which may be exercised or done by the SRO.

4.3.3.5. The Governing Board may appoint a CEO / Managing Director who shall be responsible for the day-to-day administration of the SRO and for implementing the decisions of the Governing Board. The CEO / Managing Director will be deemed to be a shareholder director.

4.3.3.6. The functioning and composition of the Governing Board shall be as specified by SEBI from time to time. The Governing Board shall constitute such committees, as may be necessary, including but not limited to Disciplinary Committee, Arbitration Committee etc. The creation, composition and functions of such committees shall be specified by SEBI from time to time. Further, the majority of members of such committees shall be independent persons including PIDs and market experts.

4.3.3.7. For the SRO(s) of distributors of MF products and Investment Advisers, it is proposed that the Governing Board shall



comprise of not more than 25% Shareholder Directors, not more than 25% Elected Representatives and not less than 50% PIDs.

4.3.3.8. The appointment and removal of all directors including CEO/Managing Director shall be with prior approval of SEBI.

4.3.4. Arbitration & Dispute Resolution.

4.3.4.1. The SRO shall provide for a dispute resolution mechanism including arbitration to settle disputes between investors and its members and disputes between its members.

4.3.4.2. The SRO of distributors of MF products shall not handle disputes between the distributors and the Mutual Funds and the same shall continue to be governed under their contractual arrangements.

4.3.5. Tenure of Recognition of SRO.

4.3.5.1. SRO may be granted recognition on a permanent basis subject to it satisfactorily carrying out its role in compliance with regulations etc. to the satisfaction of SEBI and effectively carrying out such other related mandate as specified by SEBI from time to time.

5. Matters for consideration

5.1. Whether there should be a single or different SROs for different classes of regulatees?

5.2. Whether the role of SRO, as mentioned in Para 3.2 of the Consultation Paper, is adequate?

5.3. Is there any need for enhancing the net worth of SRO from INR 1 Crore as per the extant SRO Regulations notified in 2004? If so, what could be the capital requirement for setting up an SRO?

5.4. Any other comments/suggestions regarding the aforesaid proposal.

5.5. Any other comments/suggestions regarding other provisions of [SRO Regulations](#).



6. Public Comments

6.1. Comments from public are invited on the proposal contained in this paper. The comments should reach SEBI latest by April 21, 2019.

The comments may be sent by email to sro@sebi.gov.in or by post to:

Ms. Jyoti Sharma

General Manager

Investment Management Department

Securities and Exchange Board of India

SEBI Bhavan, C4-A, "G" Block, Bandra Kurla Complex,

Bandra (East), Mumbai – 400 051.

6.2. Comments/ suggestions may kindly be provided in the format given below:

Name of the Entity/ Person:				
Sl. No.	Reference Consultation provisions Regulations	Para of the Paper or other of the SRO	Suggestions	Rationale