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High Court upholds SEBI's powers to regulate Investment Advisers' fees

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Introduction: Professional fees charged by Investment Advisers (IAs) to its clients has been a matter of debate and discussion from the time when SEBI (IA) Regulations, 2013 were rolled out. In 2020, SEBI amended the IA Regulations with regard to qualification and certification requirement, networth, fees, client level segregation of advisory and distribution activities, implementation of advice or execution. SEBI issued a Circular[1] titled 'Guidelines for Investment Advisers'. Additionally, SEBI also provided for qualification and certification requirement, registration as non-individual IA, maintenance of record, audit, risk profiling and suitability for non-individual clients, display of details on website and in other communication channels, etc. In a case[2], the Petitioner (SEBI – registered IA) filed a writ petition with the Bombay High Court challenging constitutional validity of the amendments to SEBI (IA) Regulations and above-mentioned SEBI Circular.

Extant Regulations : Regulation 15A of SEBI (IA) Regulations relates to 'Fees' and it states the Investment Adviser shall be entitled to charge fees for providing investment advice from a client in the manner as specified by SEBI. The SEBI Circular provided for 'fees', which stated that IAs shall charge fees from the clients in either of the two modes:(A) Assets under Advice ('AUA') or (B) Fixed fee mode. Under the AUA mode, SEBI provided that IA can charge maximum fees not exceeding 2.5% of AUA p.a. per client across all services offered by IA. Under the fixed fee mode, SEBI stated that maximum fees that may be charged shall not exceed INR 1,25,000 per annum per client across all services offered by IA. The general conditions under both modes are: (i) In case 'family of client' is reckoned as a single client, the fee as referred above shall be charged per 'family of client'. IA shall charge fees from a client under any one mode on an annual basis. The change of mode shall be effected only after 12 months of on boarding/last change of mode. If agreed by the client, IA may charge fees in advance. However, such advance shall not exceed fees for 2 quarters. In the event of pre-mature termination of the IA services in terms of agreement, the client shall be refunded the fees for unexpired period. However, IA may retain a maximum breakage fee of not greater than one quarter fee.

Summary of Petitioner's key arguments : The Petitioner submitted that amendments to SEBI (IA) Regulations and the subsequent Circular are ultra vires the SEBI Act. It was submitted that there is no power under SEBI Act to make Regulations in respect of prescribing fees which can be charged by IAs from their clients. It was also submitted that in the event there is a power to cap the professional fees charges by IAs, the same is violative of the Petitioner's fundamental rights guaranteed under Article 14, 19(1)(g) and 21 of Constitution. Petitioner further submitted that prescribing rate of fee to be charged by private

professionals is an essential legislative function and there are no guidelines in that regard and therefore the amendment to SEBI (IA) Regulations suffers from vice of excessive delegation. The Petitioner contended that the amendment and subsequent Circular are arbitrary and unreasonable and cap on fee is imposed without any rational criteria or rational basis or study.

Summary of High Court's observations : The Bombay High Court observed that SEBI (IA) Regulations are framed in exercise of powers conferred by section 30(1)read with section 11(2)(b) of the SEBI Act. High Court noted that SEBI was receiving numerous complaints from investors against IAs, inter alia of assured returns by IAs, charging exorbitant fees from clients with false promises of handsome returns, mis-selling by the IAs without adhering to the risk profile of the clients, non-disclosure of complete service fees/charges, extracting money in the name of various charges, etc. Taking into consideration such malpractices, SEBI constituted a Working Group. Based on Working Group's deliberations and recommendations, SEBI floated a Public Consultation Paper[3] proposing limit on maximum fees that an IA can charge from its clients at Rs.75,000/- or 2.5% of AUA p.a. After considering the public comments, the said matter was placed before the SEBI board its meeting[4]. Accordingly, SEBI amended IA Regulations with the points mentioned above.

The High Court perused the provisions of section 11 and section 30 of SEBI Act, and observed that there are sufficient powers conferred on SEBI in issuing the SEBI (IA) 2020 Amendment Regulations and the consequential Circular. While interpreting section 30 of SEBI Act, the High Court observed that "*Section 30(1) is an overarching provision which gives a general power to the SEBI to make Regulations which are consistent with the SEBI Act and to carry out the purposes of SEBI Act. Section 30(2)(d), inter alia, provides for the conditions subject to which certificate of registration is to be issued to the intermediaries including Investment Advisers. Section30(2)(db) empowers SEBI to make regulations in respect of 'any other matter'. The term 'any other matter', in our view, is of wide amplitude. Under section 11(1) a duty is cast upon SEBI to protect the interest of the investors and to regulate the securities market by such measures as it thinks fit. Under section11(b) SEBI may take measure to provide for registering and regulating the working of Investment Advisers and such other intermediaries who may be associated with securities market in any manner. The impugned IA 2020 Amendment Regulations are thus issued by SEBI in exercise of powers conferred by section 30 and section 11(2)(b)of the SEBI Act which empowers SEBI to make Regulation in respect of working of Investment Advisers. The impugned IA 2020 Amendment Regulation is intra-vires the SEBI Act.*"

The High Court observed that SEBI is a statutory authority and an expert body established under SEBI Act with an object to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market and for matters connected there with or incidental thereto.

Scope of judicial review of delegated legislation: The High Court observed that the scope of judicial review of delegated legislation is limited. The High Court stated that "*There is always a presumption of validity of legislation/delegated legislation. In terms of Article 19(6) of the Constitution, reasonable restrictions in public interest can be imposed on the fundamental rights guaranteed under Article 19(1)(g).*"The High Court noted important observations made by Supreme Court in Internet and Mobile Association of India v/s. RBI[5]. The Supreme Court had prescribed 5 tests to examine the validity of a legislative action, be it a statute or a delegated legislation, as under:(i) Direct and immediate impact of legislation upon fundamental rights of the citizens affected thereby;(ii) Larger public interest sought to be ensured in the light of the object sought to be achieved;(iii) Necessity to restrict the citizens' freedom;(iv) Inherent pernicious nature of the act prohibited or its capacity or tendency to be harmful to the general public; and(v) Possibility of achieving the same object by imposing a less drastic restraint. The High Court relied in the said Supreme Court judgment and stated that SEBI (IA) Amendment Regulations, 2020 and the subsequent Circular satisfies the above-mentioned tests. The High Court observed that said amendments to IA Regulations and SEBI Circular carries out the objects of SEBI Act which provides for protection of interest of investors. High Court stated that "...*IA 2020 Amendment Regulation is a beneficial*

piece of legislation. The restrictions imposed in our view cannot be said to be unreasonable." The High Court stated that SEBI is an expert body which plays the role of a watchdog. It was further observed that the amendments to IA Regulations are not violative of Articles 19(1)(g) and 21 of the Constitution. It was observed that the said amendments are not arbitrary and violative of Article 14 of the Constitution. Noting that SEBI is an expert regulatory body established under the SEBI Act, High Court observed that "*.... Court, therefore, would have to exercise judicial restraint and the scope of interference would be extremely narrow. The Court cannot substitute own views in place of views of the expert body. Moreover, it is well settled that the Court should be very slow in staying a law by way of interim relief when the constitutional validity of the law is challenged.*"

Observation & Conclusion : Generally, the amount of professional fees for any work or services by any professional in any field depends upon primarily on three factors: (i) Nature of work, (ii) Time and efforts involved in completing the work and (iii) Involvement of resources. The same is applicable to an architect, interior designer, management consultant, advocate, company secretary, chartered accountant, etc. Due to the cap of fees, such criteria have become irrelevant IAs for the purposes of charging professional fees. Though the work is unique for IAs, SEBI has stated that under the AUA mode, IAs can charge maximum fees not exceeding 2.5% of AUA p.a. per client across all services offered. Under the fixed fee mode, SEBI stated that maximum fees that may be charged shall not exceed INR 1,25,000 per annum per client across all services offered by IA. At a macro-level, the proposed structure would not be in the interest of IAs. However, SEBI has even micro-managed the amount of advance and pre-mature termination of IA services. The overall provisions relating to fees by IAs would be within the regulatory powers of SEBI, however, some contractual terms are also mandated by SEBI which has made the working of IAs a bit difficult.

The preamble of SEBI Act states that "*An Act to provide for the establishment of a Board to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market and for matters connected therewith or incidental thereto"* Here for SEBI, it had to balance: (i) Protection of interests of investors in securities market and (ii) Regulation of the securities market. In quite a few cases, protection of interest of investors in securities market takes priority over the other two objectives – regulation of securities market and development of securities market.

The amendments introduced by SEBI to the IA Regulations with regard to qualification and certification requirement, net worth, fees, client level segregation of advisory and distribution activities, implementation of advice or execution – has changed the entire business model of investment advisors and mutual fund distributors. And such change has been introduced in Covid-19 situation wherein the business environment is changing on day-to-day basis.

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1. SEBI Circular No. SEBI/HO/IMD/DF1/CIR/P/2020/182, dated September 23, 2020.
2. Purnartha Investment Advisers Pvt. Ltd. vs. SEBI (Writ Petition (L) No. 638 of 2021, judgement dated April 5, 2021).
3. SEBI's Consultation Paper on review of Regulatory Framework for IAs (dated January 15, 2020).
4. SEBI Press Release No.: 7/2020, dated February 17, 2020.
5. 2020 SCC OnLine SC 275.