Our Views

New Merchant Banking Regulations - sincere request to SEBI for a relook

In my article of September 17, 2024, "SEBI's proposed merchant banking regulations – will it make the big, bigger?", I had dealt at length with the unintended and potentially adverse impact of the proposed changes. SEBI has now notified the amended Merchant Banking Regulations, followed by a detailed circular setting out how the new framework will be implemented from January 3, 2026.

Taken together, these represent the most far-reaching rework of India's merchant banking regulations since 1992. With the consultation process now concluded and the framework formally in place, the discussion inevitably shifts from regulatory intent to how these changes are likely to reshape the industry in practice. Even so, I make one more attempt to sincerely urge a re-review of these changes.

Merchant banking regulations in India were framed in a very different market context. The merchant banker of the 1990s was closer to a balance-sheet underwriter, absorbing risk in relatively shallow capital markets. Today's merchant banker, by contrast, operates more like a transaction architect, where judgement, execution capability and credibility matter far more than deployable capital.

At present, there are 238 registered merchant bankers operating in a far more institutionalised ecosystem. Their role has evolved towards advisory-led activities across the transaction lifecycle, spanning IPOs, pre-IPO and private capital raises, mergers and acquisitions, buybacks, delistings and other complex capital market transactions.

While SEBI has attempted to introduce some flexibility compared to the original proposals, the broader concerns remain largely unaddressed. I am perplexed by the rationale for these changes, particularly at a time when the country is moving towards a low-touch regulatory regime. Further, there have been no major market disruptions, failures or systemic risks that would warrant such sweeping regulatory intervention.

Apart from several operational challenges, there are two substantive issues that merit serious reconsideration. The most consequential change is the sharp increase in net worth and liquid net worth requirements, coupled with minimum revenue thresholds. These requirements have their roots in the 1992 era of hard underwriting, when liquid net worth directly underpinned market risk. While it may be reasonable to revisit net worth norms after more than three decades, it is important to recognise that the underlying context today is fundamentally different. The merchant banker's role has shifted from that of a hard underwriter to one centred on judgement relating to execution, pricing and structuring, which does not require balance-sheet capital.

High capital thresholds, therefore, do not necessarily translate into proportionately higher investor protection. Instead, they risk concentrating the business in the hands of a few large entities. Just as liquidity in financial markets depends on multiple buyers and sellers, depth in advisory markets depends on a broad base of credible intermediaries rather than a handful of dominant players. Merchant banking is inherently a service-led business, not a risk-led one. The complexity of an IPO, an M&A transaction or a restructuring exercise does not scale with the net worth of the intermediary. Differentiation based on expertise, track record and execution quality would therefore be far more appropriate.

Similarly, the introduction of minimum revenue requirements may deter high-calibre professionals from coming together to build merchant banking businesses. At a time when the market should be encouraging more well-trained and highly experienced professionals to enter the industry, these changes risk achieving precisely the opposite outcome.

Closely linked to this is the introduction of a new categorisation framework for merchant bankers. Categorisation can work well in segments where it reflects genuine differences in risk profiles, such as alternative investment funds or lending institutions. In merchant banking, however, such distinctions are far less clear.

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The second major area of concern relates to the mandated segregation of merchant banking activities. Under the circular, merchant bankers are required to segregate any non-SEBI-regulated activities into separate business units within six months, with identification of such activities to be undertaken immediately and disclosed on their websites.

In practice, a merchant banker is expected to provide a wide range of capital market-related services, including mergers and acquisitions, private and public capital raising, REITs, InvITs, corporate restructuring, and advisory services to AIFs and other SEBI-registered entities. If one were to map these activities across different transaction types and client categories, it becomes evident that they are deeply overlapping and intertwined. In such a setting, the practicality of segregating these activities into distinct business units is questionable.

The skills required for effective merchant banking, including sector understanding, valuation judgement, transaction structuring and regulatory interpretation, are developed across both listed and unlisted segments. A senior banker advising an unlisted M&A transaction often draws on the same expertise when a transaction transitions to the public markets. In practice, merchant banking transactions rarely move in straight lines. Listed and unlisted elements are often two sides of the same transaction rather than distinct businesses that can be neatly ring-fenced.

Consider a common scenario where an unlisted subsidiary of a listed company embarks on a strategic sale. Potential buyers could include an AIF, a listed company, an unlisted company or management itself. The ultimate structure of the transaction may remain uncertain for a considerable period, sometimes spanning several years. In such circumstances, it would be extremely difficult for an advisor to classify the activity under one regulatory category or another. To add to this complexity, advisors representing different bidders may view and categorise the same transaction in entirely different ways.

SEBI's intent to professionalise merchant banking in an increasingly complex capital market environment is well founded. However, the current framework risks making the big, bigger by creating capital and revenue moats and enforcing artificial activity silos. A growing economy requires a diverse pool of specialist merchant bankers to enable efficient capital allocation, not an oligopolistic market structure.

Given the growth and increasing sophistication of India's capital markets, the objective should be to encourage more high-quality merchant bankers rather than introduce measures that are inherently restrictive.

In my view, a more balanced regulatory approach would have focused on entity-level regulation, supported by stronger disclosure, inspection and enforcement mechanisms, instead of prescribing rigid structural separations and elevated capital thresholds. Robust governance standards, effective Chinese walls and clear accountability frameworks can adequately address conflict-of-interest concerns without diluting the expertise that underpins effective merchant banking.

While it may be late in the process, I sincerely urge a thorough review of these changes.

Sunil Sanghai
Founder & CEO
NovaaOne Capital Pvt. Ltd