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FPIs from high-risk countries may face greater regulatory scrutiny

Sebi may impose stricter due diligence, KYC norms on investors based on risk profile

Last Published: Mon, Jul 09 2018. 11 48 PM IST

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Low-risk jurisdictions include US, UK, Hong Kong and Singapore. Photo: Reuters

Mumbai: The Securities and Exchange Board of India or Sebi is considering implementing foreign fund or investor segregation based on the risk profile of the countries where the funds come from, said two people with direct knowledge of the matter.

“This segregation would be for monitoring and scrutiny purposes rather than entry barriers. The countries in high risk jurisdiction will face more due diligence, more scrutiny on ultimate beneficiary ownership (UBO), frequent KYC (know your clients) documentation by custodians. Low-risk jurisdictions will face minimal scrutiny as

these flows are coming from highly regulated countries," said the first of the two people.

Higher scrutiny would include six-monthly KYC, monthly or three monthly UBO reporting. Lower scrutiny would include KYC every 3-5 years, yearly UBO reporting, he explained.

Currently, for registration purposes, foreign portfolio investors or FPIs are categorized as Category I, II and III. Category I FPIs typically include foreign central banks, sovereign wealth funds and government agencies and abide by a limited number of compliance requirements. Category II FPIs are broad- based funds such as mutual funds and Category III FPIs are typically hedge funds.

"Sebi had asked custodians to come out with a list of high-risk jurisdictions. A list of 25 countries was ironed out by custodians such as HSBC Bank, Deustche Bank, Citi, JPMorgan and Standard Chartered in first week of July. Some of them are your typical tax havens," said the second of the two people quoted above, who too declined to be named.

According to the two people, the high-risk countries as recognized by custodians include Mauritius, Cayman Islands, British Virgin Islands, UAE, Cyprus, Russia and Turkey. Switzerland is not on this list. *The Economic Times* had first reported the custodians list on 5 July.

Low-risk jurisdictions include US, UK, Hong Kong and Singapore.

"India gets FPI flows from 56 countries, so if regulators consider 25 of those as high risk, it is bit much. The list is under examination custodians reasoning will be corroborated by Sebi's data to finalise the high risk countries. The list will be leaner and may include 15 countries," said the first of the two people quoted above.

"Some countries have already raised objections on being called high risk countries," he added.

The bulk of flows to India come via the US and Singapore. Overseas investors have been net sellers since January to June, having pulled out ₹48,000 crore from Indian markets—₹41,433 crore from the debt markets and ₹6,430 crore from equities. This was a 10-year high.

"It is recommended that the list should be one that is uniformly followed and issued by the government and it should ideally be benchmarked to some inter-governmental body so that it enjoys a global consensus," said Richie Sancheti, Head, Investment Funds, Nishith Desai Associates.

“The Sebi norm imposes FPIs to apply lower materiality threshold of 10% for identification of BO (beneficial ownership) if the FPI is set up in ‘high risk jurisdictions’. This requires FPIs that are institutional or broad based funds to undertake full KYC which FPIs set up in other jurisdictions will not be subject to,” he explained.

As a way out, beneficial ownership as a concept should be used only for carrying out KYC checks. Material economic ownership on the other hand could be used as a parameter to restrict or impose ceilings on investments, said Sancheti.

First Published: Mon, Jul 09 2018. 10 30 PM IST