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India may tighten disclosure rules for FPIs from Mauritius

BY SUGATA GHOSH & REENA ZACHARIAH, ET BUREAU | SEP 03, 2018, 07.18 AM IST

Sebi panel is in favour of stepping up scrutiny of non-FATF members to prevent money laundering.

Mumbai: The Mauritius story has taken a new turn as the government and the capital market regulator discuss fresh criteria to stop 'dubious' money flowing into the country — particularly, in the run up to the 2019 elections.

According to new yardstick, foreign portfolio investors (FPIs) coming from countries which are not members of the Financial Action Task Force (FATF) will have to meet stricter disclosure standards, and face greater scrutiny and regulatory hurdles.

The proposal, unlikely to go down well with Mauritius, would place FPIs based in the Indian Ocean tax havens and jurisdictions such as Cyprus, British Virgin Islands and Cayman — none of which belong to 37-member FATF club — at a disadvantage to the funds located in FATF-compliant countries like Singapore, Hong Kong, Luxembourg, The Netherlands, US, Canada, UK and others. FATF is an inter-governmental policy-making body that was established in the 1989 Paris summit of G7 amid mounting concerns over money laundering. India became its in 2010.

The proposal (to make FATF a benchmark) was submitted to Sebi a week ago by a high-profile committee, three persons aware of the development told ET.

PLAN WAS DROPPED EARLIER

The committee headed by former RBI deputy governor HR Khan was constituted by the Securities Exchange Board of India (Sebi) to look into FPI related issues. Significantly, it comes a month after Sebi assured a delegation from Mauritius that there would be no new list of 'high-risk countries'.

Over several meetings in the month preceding that, Sebi officials had verbally directed banks and institutions acting as custodians (of FPIs) to draw a list of high-risk jurisdictions. The plan, however, was dropped amid custodians failing to arrive at a consensus on high-risk countries and FPIs and Mauritius authorities asking Sebi to review the decision.

HARSH MOVE

But the unwritten resolution to put stringent anti-money laundering rules for certain countries in place has not been dropped. In fact, it's now being pursued in another way — plausibly at the instance of New Delhi. Instead of leaving it to the discretion of custodians and grappling with multiple lists prepared by different MNC banks in accordance with their respective risk perceptions, the market regulator will now consider Khan panel's recommendation to treat FATF and non-FATF members differently. Though neater and less arbitrary, some think it's a harsher move.

"If this happens, stringent beneficial ownership (BO) and KYC norms would become applicable to FPIs registered in such non-FATF member jurisdictions which can impact FPI inflows and new registrations. This could also result in a spurt in P-note issuance which over the years has declined due to Sebi's efforts to increase the direct FPI registrations," said Tejesh Chitlangi, senior partner at IC Universal Legal.

RATIONALISING RULES

Some of the other recommendations of the Khan committee are toward rationalising certain regulations.

According to Sebi's April circular — which triggered the debate over high-risk countries — NRIs, PIOs (persons of Indian origin) and

OCIs (overseas citizens of India) cannot be ‘beneficial owners’ (BO) of FPIs.

BO was defined as 25% ownership in a company or 15% in a trust or partnership — depending on how an FPI is structured abroad. The entry barrier is stiffer as the threshold (for establishing NRI control or dominance in the fund pool) is 10% if an FPI is based in a high-risk jurisdiction.

The rule is aimed at curbing round-tripping of funds by residents with the help of NRI relatives and associates. The Khan committee is understood to have recommended an exemption for PIOs and allowed NRI fund managers to own management shares in the fund up to a certain limit. Sebi, which has given FPIs time till December in identifying their beneficial owners, may also consider representations to relax the rule on clubbing two or more FPIs with common beneficial owner as single FPI (a norm that could force many FPIs to sell stocks).

However, a stricter regime for Mauritius and non-FATF countries could emerge as the new bone of contention. “High-risk jurisdictions are largely those with less than effective money laundering controls. A general point of reference is the FATF’s list of countries having AML deficiencies. It does not mean that a country has to be a member of FATF to be considered appropriate jurisdiction,” said Richie Sancheti of Nishith Desai Associates, a law firm with many FPIs clients and which has been an adviser to Mauritius authorities.