ET Markets

Mauritius in FATF 'grey list'; worried banks, fund advisors knock SEBI's doors

Sources said Mauritius is tapping diplomatic channels to preserve its position as a tax haven.

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MUMBAI: Mauritius, the tax haven used by for foreign investors for the past three decades to bet on Indian stocks, is now in the 'grey list' of Financial Action Task Force (FATF) -- an inter-governmental policy making body setting anti-money laundering standards.

As the jurisdiction comes under the strict monitoring of FATF, there is a question mark on whether foreign portfolio investors (FPIs) from Mauritius will receive registration from Indian authorities and to what extent they can trade in Indian securities.

As soon as they grasped the implications of the development, custodian banks and advisors to foreign portfolio investors (FPIs) rushed to Indian capital market regulator Sebi on Monday morning to figure out the future course of action and enquire whether stocks purchased by FPIs on Monday can be settled seamlessly.

"'Grey List' is meant to list each such jurisdiction that has committed to resolve identified strategic deficiencies within agreed timeframes and is subject to increased monitoring. From an FPI regime perspective, if the concerned jurisdiction of FPI is listed in FATF public statement as "high risk" and "noncooperative" jurisdiction, then such FPIs are barred from making fresh purchases till the time the jurisdiction is compliant. However, the FPI shall be allowed to sell the securities or continue to hold the securities already purchased by it. Accordingly, in our preliminary analysis, Mauritius may not be construed as "high risk" and "noncooperative" jurisdiction from the perspective of existing FPIs. But, it remains to seen whether the going would be easy for new FPIs," said Nishith Desai, founder of Nishith Desai Associates (NDA) which had advised the Barclays-sponsored Bombay Fund Ltd – the first foreign institutional investors (FII) to invest in India from Mauritius in the early '90s.

According to Richie Sancheti, partner, NDA, "In respect of Foreign Direct Investments and investments into Alternative investment funds (AIFs) further analysis will have to be done to find out any immediate impact. Having said that, it's our observation that global institutional investors typically see a governance red flag in investing in structures based out of 'Grey List' jurisdictions."

Amid mounting concerns over money-laundering, FATF was established in the 1989 Paris summit of G7. In 2012 FATF further tightened its standards.

Mauritius, which has been improving its compliance and AML regulations since last few years, is expected to make a media statement soon. About 15% of FPIs invest in India via Mauritius while it is estimated 25% or more of the total inflow is through structures set up in the Indian Ocean island.

"Over the past 2 days, the media focus on FATF was on Pakistan languishing in the grey list. It was a long weekend and most market participants missed the action on Mauritius," said a market intermediary dealing with FPIs.

The development comes at a time when Sebi rules and the government's tax policy to attract kosher overseas money have placed FPIs and other foreign investors from non-FATF member countries (like Mauritius and Cayman) at a serious disadvantage. For instance, no Category-I FPIs -- which alone are allowed to issue participatory notes, or offshore derivative instruments to trade on Indian stocks as underlier -- can be based in Mauritius. Secondly, many FPIs in Mauritius may be asked by India to pay tax on profits from `indirect transfers' as overseas investors move in and out of a fund.

While these moves may not impact inflows into India – as FPIs may gradually relocate to jurisdictions like Singapore which (like Mauritius) shares a similar tax treaty with India – Mauritius could lose its significance as a tax haven in the medium term.

Sources said Mauritius is tapping diplomatic channels -- using whatever leverage it has or thinks it has with India -- to preserve its position as a tax haven. Over the past four months, chairman of FSC Mauritius has had multiple meetings with Sebi top officials followed by visits by senior leaders from Mauritius.

"For years India has sold Mauritius to foreign funds as a stable jurisdiction due to the diplomatic relations it shares with the country. But now, Sebi's policies and recent Budget amendments are hurting Mauritius.. One of the conspiracy theories is India may have changed its stance on Mauritius to promote GIFT City which is yet to take off," said.