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New threshold limit a challenge to many FPIs

By Sugata Ghosh, ET Bureau • Last Updated: Mar 11, 2023, 03:04 PM IST

Synopsis
The lower threshold can be a challenge for ultimate beneficiaries as lowering ownership below 10 per cent in a fund could mean losing control over the entity. Bankers think investors who want to hide their identities may add a few more layers to dilute the eventual ownership below 10 per cent.

Bad actors and overseas investors who fiercely guard their privacy will have to change tack while bankers servicing thousands of offshore funds will have to scan a mountain of investor data with India tightening its anti-money laundering rules this week to figure out the faces behind the foreign portfolio investors (FPIs) trading on stock exchanges here.

The threshold for identifying 'beneficial owners' (BO) - or the 'last natural persons' - in an FPI now stands at 10% as against the earlier levels of 25% (for funds structured as companies) and 15% (for funds under a trust). With this, an FPI will have to reveal the identities of all ultimate investors owning or having a share of 10% or more in the fund to their custodian banks who, in turn, will periodically share the information with the Securities & Exchange Board of India (Sebi).

So far, the 10% threshold for determining BO was applicable only for funds incorporated in 'high-risk' jurisdictions or in countries in the watchlist of international organisations.

"The amendment to the PMLA (Prevention of Money Laundering Act) rules will enable the government to collect more information about the indirect ownership and real purpose behind creation of entities and fund structures. The reduction in BO limit to 10% will make it easier to track the BO in situations where BOs might be splitting their legal ownership to fall below the 25% limit. To ensure there is no hardship to legitimate structures, the government could consider exempting entities from FATF member countries from this additional requirement," said Rajesh Gandhi, partner, Deloitte India. (FATF or Financial Action Task Force, is the global money laundering and terror financing watchdog).

The new rules would also require FPI names of persons holding senior management positions in the fund, along with the registered office and the principal place of its business, if it is different. Some entities, said Gandhi, might be uncomfortable in disclosing their principal place of business to avoid consequent tax challenges. "Also, funds and other entities which carry out activities in different countries may sometimes be unable to decide the principal place of their business," he said.

The lower threshold can be a challenge for ultimate beneficiaries as lowering ownership below 10% in a fund could mean losing control over the entity. Bankers think investors who want to hide their identities may add a few more layers to dilute the eventual ownership below 10%.

"I am sure they will try out different structures. We don't know what exactly triggered the amendments - while it could be Hindenburg's allegations against foreign holdings in Adani companies, I also remember Sebi's clampdown on NRI-controlled FPIs in the run-up to the 2019 elections. The government wants to keep tabs on the nature and quality of inflows," said a senior banker. There are more than 11,000 FPIs registered with Sebi, and custodian banks (which hold the money and stocks of FPIs and conduct their KYC formalities) are inundated with questions from overseas clients who want to know: How soon one must share the BO and other information? Will the rules apply to all funds or only new funds? Since names of senior officials are already mentioned in the 'common application form', what more needs to be shared? Many global custodians dealing with MNC **bank** branches (which act as local custodians) in India do not have BO data at 10% level.

"Considering that the amended rules are applicable prospectively; existing FPIs should not be required to assess their BO structures and identify ultimate BOs (UBOs) based on the new thresholds. However, since Sebi seems to have asked custodians to share the UBOs of FPI clients by September, they would now have to reassess the UBOs as per the 10% threshold," said Prakhar Dua, leader, financial services and regulatory practice, Nishith Desai Associates.

Several foreign portfolio investors (FPIs) are reluctant to name key persons in their ultimate parent organisations as 'senior management officers' (SMOs) to Sebi. FPIs have to be cautious because in many situations employees of the fund administrators are named as senior managers even though they may not have any decision-making powers, said Dhaval Jariwala, partner at PNDJ & Associates LLP. SMOs assume importance in FPIs where BOs are not readily identifiable. Sebi wants FPIs to name the persons who take actual stock-trading decisions as well as the entities which are managers to the funds.