Investments via UAE to face more scrutiny after FATF grey list inclusion

FATF grey list inclusion hurts its attractiveness for investors

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By Ashley Coutinho | Mumbai | Last Updated at March 07 2022 02:25 IST

The United Arab Emirates (UAE) has become the latest addition to the grey list put out by the Financial Action Task Force, a global financial crime watchdog. The country's inclusion may reduce its attractiveness as an investment hub for foreign inflows into India and raise the level of scrutiny by India's financial regulators.

The UAE has become a popular destination for companies and wealthy individuals seeking tax avoidance and is facing greater scrutiny amid global efforts to counter Russia's invasion of Ukraine, according to reports.

"The announcement will dampen the attractiveness of the UAE for foreign portfolio investors (FPIs), who may look at alternative jurisdictions, such as Cyprus, Mauritius, and Singapore, for investments in India. The development also increases the level of scrutiny by regulatory bodies in India for investors coming from the UAE," said Viraj Kulkarni, founder, Pivot Management Consulting.

India has seen a sharp increase in foreign direct investment (FDI) via the UAE in the past two years, especially from Emirates-based sovereign wealth funds. FDI from the country stood at Rs 2,393 crore in 2019-20 and rose to Rs 31,242 crore in 2020-21. But despite changes to Mauritius and Singapore tax treaties, the UAE is not a popular jurisdiction for setting up India-dedicated funds and is not part of the top 10 FPI regions investing in India.

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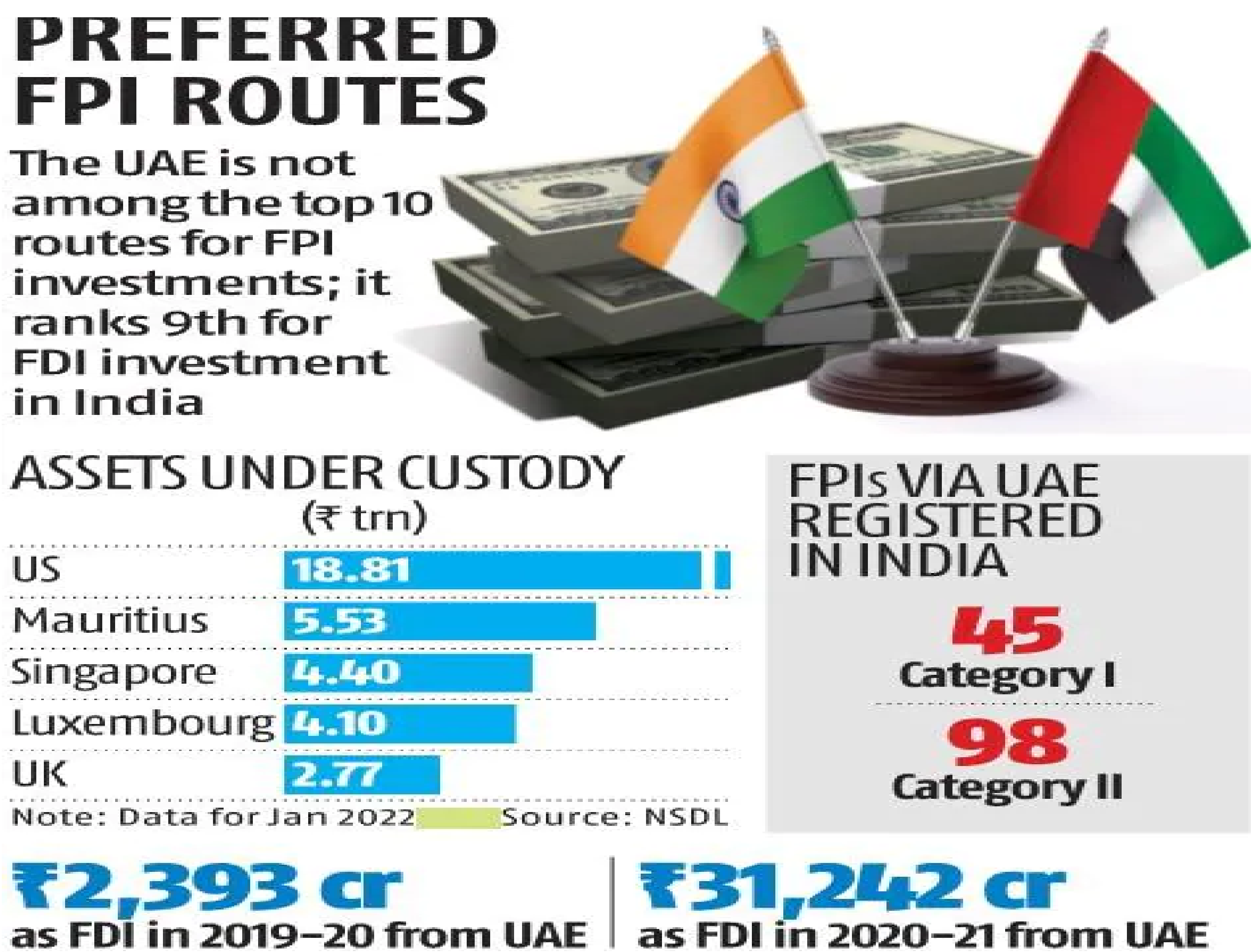
"Given its addition to the grey list, investments through the UAE may face a further lack of confidence from investors domiciled in the US and Europe," said Parul Jain, head of international tax and fund formation practice at Nishith Desai Associates, a law firm.

Last year, the Indian government had classified FPIs from the UAE as eligible for taking up Category-I licence, making it the second non-FATF jurisdiction after Mauritius to get the exemption. The UAE has 45 Category I and 98 Category II FPIs registered in India. Being part of Category I implies lower compliance burden and fewer investment restrictions.

"Investments from the UAE may face additional challenges while seeking to acquire significant influence in NBFCs in India, besides lowering the materiality threshold to 10 per cent (from 25 per cent for low-risk jurisdictions) for determination of beneficial ownership of the UAE-based FPIs," said Jain.



The materiality threshold for identification of beneficial owners of FPIs from high-risk jurisdictions is 10 per cent, according to the Securities and Exchange Board of India.

A Reserve Bank of India (RBI) circular in February last year stated that investments in NBFCs from FATF non-compliant jurisdictions would not be treated at par with that from compliant jurisdictions. New investors from or through non-compliant FATF jurisdictions, whether in existing NBFCs or in companies seeking Certification of Registration (COR), will not be allowed to directly or indirectly acquire 'significant influence' in the investee company. Accordingly, fresh investors, either directly or indirectly, from such jurisdictions in aggregate should be less than the threshold of 20 per cent of the voting power (including potential voting power) of the NBFC.

In 2020, the RBI had rejected several applications for greenfield investments or acquisitions in NBFCs routed through private equity and venture capital funds domiciled in Mauritius after the latter was put on the FATF's grey list.

"It's a reputational risk for the UAE but the financial impact will not be that large," said a person who does business with international jurisdictions. "The region's aspiration to build Dubai International Financial Centre as a financial hub will take a hit, especially given the competition in West Asia with Saudi Arabia opening up its economy. Having said that, the country's AML guidelines are improving and Emirati authorities are committed to improving the regulatory framework."

Jurisdictions under increased monitoring are actively working with the FATF to address strategic deficiencies in their regimes to counter money laundering, terrorist financing, and proliferation financing. When the FATF places a jurisdiction under increased monitoring, it means the country has committed to swiftly resolving the identified strategic deficiencies within agreed timeframes and is subject to extra checks.

According to Kulkarni, the UAE has historically invested in developing FATF compliant practices and the region will aspire to resolve the current situation at the earliest. Last month, India and the UAE signed a comprehensive free-trade agreement with an aim to bolster bilateral trade to $100 billion in over five years and create several hundred thousands of jobs in both countries.

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