

Regulatory Hotline

March 11, 2023

AMENDMENT TO ANTI-MONEY LAUNDERING LAWS: A RELATIVE CONUNDRUM

INTRODUCTION:

The Department of Revenue, Ministry of Finance, Government of India amended the Prevention of Money-laundering (Maintenance of Records) Rules, 2005 ("PML Rules") on March 7, 2023 by notifying the Prevention of Money-laundering (Maintenance of Records) Amendment Rules, 2023¹(the "Amendment Rules").

The Amendment Rules, inter alia, have introduced and defined the terms 'group'² and 'politically exposed person'³, defining the latter to mean 'individuals who have been entrusted with prominent public functions by a foreign country, including the heads of States or Governments, senior politicians, senior government or judicial or military officers, senior executives of state-owned corporations and important political party officials'.

CHANGES TO THE THRESHOLD FOR THE IDENTIFICATION OF BENEFICIAL OWNERSHIP:

Rule 9 of the PML Rules, inter alia, provides the threshold and process for the identification of beneficial owners ("BO") of clients of reporting entities.

For Companies

Prior to the amendment, the BOs for companies were identified as natural persons, acting alone or together, through one or more juridical person having controlling interest or exercising control through other means on the company. In this regard, controlling interest was defined to mean ownership or entitlement to more than twenty-five percent of the shares or capital or profits of the company, and control included the right to appoint majority of the directors or to control the management or policy decisions including by virtue of the shareholding or management rights or shareholders agreements or voting agreements.

The Amendment Rules, while retaining the criteria for control, have reduced the threshold for controlling interest to ten percent.

For Trusts

Prior to the amendment, the author of the trust, the trustee, the beneficiaries with fifteen per cent or more interest in the trust and any other natural person exercising ultimate effective control over the trust through a chain of control or ownership were identified as BOs of a trust.

The above threshold has now been reduced to ten percent as well.

ADDITIONAL INFORMATION / DOCUMENTATION REQUIREMENTS:

The Amendment Rules prescribe additional information and documentation requirements, to be provided by the entities for the purposes of due diligence..

Additionally, companies and partnership firms have to provide the names of the senior management person/s and partners, respectively, along with the registered office address and the principal place of its business.

Trusts, on the other hand, have been mandated to disclose the names of their beneficiary/ies, trustee/s, settlor and author/s. Moreover, Amendment Rules also stipulate the requirement of submission of the list of trustees, along with the documents for those individuals discharging the role as trustee and authorised to transact on behalf of the trustee⁴. Further, the address of the registered office of the trust is also required to be disclosed.

It has also been prescribed that in case of any change in the already furnished data, such change would be required to be intimated by the client to the reporting entity within 30 days of such change.

OUR VIEWS:

The Master Circular of the Securities and Exchange Board of India ("SEBI") for FPIs, DDPs and EFIs⁵ requires an FPI to identify and declare its ultimate beneficial owner ("UBO") in accordance with Rule 9 of the PML Rules. Pursuant to the foregoing, in case of its fresh or renewal application, now, an FPI applicant set up in the form of a company or a trust, will have to apply the new threshold of 10% (which historically, has been the threshold of determination of the UBO of an FPI situated in a high-risk jurisdiction as determined by a DDP / custodian) for the identification of its UBO, instead of the earlier 25% and 15%, respectively.

Interestingly, this change will not affect FPI applicants who are in the form of partnership firms, unincorporated associations or body of individuals, as the threshold for the identification of BOs of such entities remains unchanged

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at 15% of the property or capital or profits of the partnership, unincorporated association or body of individuals, as the case may be.

Vide reduction of the threshold for the identification of BOs and increasing the documentation requirements for entities, the Amendment Rules have made it stricter and more cumbersome for the FPIs to register and operate in the Indian market. These rules though seem to be a right step towards increasing transparency, are in contrast to Government of India and SEBI's overall vision of facilitating ease of doing business by foreign investors, including FPIs in India, and encouraging FPI participation in the public market⁶.

It is important to mention that this is the second attempt, after SEBI's directive to DDPs to provide details of the senior managing officials of the ultimate parent entity of all existing FPIs, who have earlier declared no UBO from an ownership or control basis, to pierce the corporate veil and identify the UBOs of the FPIs.

We believe that though from an Indian regulatory perspective and at the backdrop of the recent capital market events, the reduction of the identification threshold should be seen as the requisite step, however, for many large global hedge funds, it seems to be of slight concern since the individuals merely having economic participation of 10% or more in an FPI entity, directly or indirectly, may not be comfortable with identification as a UBO of the FPI. Moreover, it needs to be seen whether there would be any impact on the existing FPIs, though we hope not, since the Amendment Rules are applicable prospectively.

– Ritul Sarraf, Prakhar Dua & Kishore Joshi

You can direct your queries or comments to the authors

¹Available at: <https://egazette.nic.in/WriteReadData/2023/244194.pdf>

²Rule 2 (1) (cba)

³Rule 2 (1) (da)

⁴Documents as required for individuals under Rule 9(4).

⁵https://www.sebi.gov.in/legal/master-circulars/dec-2022/master-circular-for-foreign-portfolio-investors-designated-depository-participants-and-eligible-foreign-investors_66356.html

⁶SEBI constitutes FPI Advisory Committee, available at: https://www.sebi.gov.in/media/press-releases/aug-2022/sebi-constitutes-fpi-advisory-committee-fac_61783.html

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