

# Regulatory Hotline

May 23, 2023

## SEBI DIRECTS DESIGNATED DEPOSITORY PARTICIPANTS TO IDENTIFY 'LEGAL ENTITIES' FOR FOREIGN PORTFOLIO INVESTORS

### INTRODUCTION

The Indian securities market regulator, Securities and Exchange Board of India ("SEBI") has lately been taking numerous steps to regulate and monitor the activities of Foreign Portfolio Investors ("FPIs") registered with SEBI under the SEBI (Foreign Portfolio Investors) Regulations, 2019 ("FPI Regulations"), including their beneficial ownership.

In the most recent of such developments, SEBI, vide an e-mail to the Designated Depository Participants ("DDPs"), has communicated certain client identification, know your customer ("KYC") and beneficial ownership requirements for the FPIs. Interestingly, no circular / guideline / direction has been released by SEBI in this regard in the public domain.

### THE SEBI DIRECTIVE

#### Identification of clients

SEBI has mandated that only a legal entity should become client of a DDP (i.e., in its capacity of a reporting entity under the Prevention of Money-Laundering Act, 2002). Thus, a bank and not its branch which may be registered as an FPI with SEBI, or an entity and not its sub-funds investing in India as FPIs, should be the client of the DDPs. However, such legal entities should be able to obtain multiple FPI registrations in the name of their funds / sub-funds.

The Prevention of Money-Laundering Act, 2002 ("PMLA") defines the term 'client' as 'a person who is engaged in a financial transaction or activity with a reporting entity and *includes a person on whose behalf the person who engaged in the transaction or activity, is acting*<sup>1</sup>'. Thus, the requirement of identification of the legal entity as the client of the DDP seems to stem from the above definition.

Moreover, such legal entity shall also be required to furnish the requisitioned KYC information and supporting documents to the DDP.

#### Identification of Senior Management Official as the BO of FPI

The rules for the identification and verification of a beneficial owner ("BO")<sup>2</sup> of a client are laid down in the Prevention of Money-laundering (Maintenance of Records) Rules, 2005 ("PML Rules"), which mandate a reporting entity to, inter alia, identify its client and verify its identity.

Rule 9(3)(d) of the PML Rules provides that if no BO (through ownership or control) can be identified in case of a client set up as a company, partnership firm or an unincorporated association or body of individuals, then the BO is the relevant natural person who holds the position of senior managing official ("SMO").

SEBI, in this regard, has directed the DDPs to identify and declare the SMO of the legal entity at the end of the chain of the legal arrangement, as the BO of the FPI.

#### Identification of BO as per new threshold

On March 07, 2023, the Department of Revenue, Ministry of Finance, Government of India amended the PML Rules and notified the Prevention of Money-laundering (Maintenance of Records) Amendment Rules, 2023 (the "Amendment Rules"). The Amendment Rules inter alia amended the ownership threshold for the identification of BO under the PML Rules to (i) 10% for companies and trusts; and (b) 15% for partnership firms and unincorporated association or body of individuals. Please see our hotline "Amendment to Anti-Money Laundering Laws: A Relative Conundrum" for an analysis of the Amendment Rules and their effect on FPIs.

SEBI, in its email communication, has asked all the existing FPIs to re-identify and disclose the BO(s) to their DDPs as per the new thresholds.

#### Prescribed Timeline

The DDPs have been asked to complete the KYC at the legal entity level and update BO data, as per reduced threshold, if required, in their records as well as on the KYC Registration Agency portal by September 30, 2023.

In case the FPI fails to make the requisite disclosures within the above-mentioned timeline, then such FPI shall not be permitted to make fresh purchases and shall be required to liquidate its holdings and surrender the registration by March 31, 2024.

## Research Papers

### Handbook on New Labour Codes

April 29, 2024

### Compendium of Research Papers

April 11, 2024

### Third-Party Funding for Dispute Resolution in India

April 02, 2024

## Research Articles

### Private Client Insights - Sustainable Success: How Family Constitutions can Shape Corporate Governance, Business Succession and Familial Legacy

January 25, 2024

### Private Equity and M&A in India: What to Expect in 2024?

January 23, 2024

### Emerging Legal Issues with use of Generative AI

October 27, 2023

## Audio

### Third-Party Funding: India & the World

April 27, 2024

### IBC allows automatic release of ED attachments: Bombay HC reaffirms

April 15, 2024

### The Midnight Clause

February 29, 2024

## NDA Connect

Connect with us at events, conferences and seminars.

## NDA Hotline

Click here to view Hotline archives.

## Video

### Q&A 2024 Protocol to the Mauritius India Tax Treaty

April 22, 2024

### Boost to India's Space Potential: India Liberalizes Foreign Direct

This informal directive of SEBI seems to be another step towards filling the lacunae in the identification and verification process of FPIs. While on one hand, this regulator activism needs to be appreciated since it should ultimately increase transparency in the entire ecosystem and help the Indian securities market to further flourish, on the other hand, such frequent legal changes and email communications may end up hampering the peace of the genuine investors and may prove to be counterproductive.

We believe that SEBI's objective towards identifying the legal entity as the client of the DDP aims at ensuring that the actual entity duly regulated by the appropriate regulator of the home jurisdiction is disclosed to the DDP.

Further, while it is helpful to finally receive clarity on which FPIs are required to re-identify the BOs basis new thresholds, disclosure of the SMO of the end entity seems irrational and not-well-thought-of.

Lastly, this method of communication by SEBI is also not well appreciated. Considering that these are crucial directives for the FPI players, a circular / guideline by SEBI issued in the public domain in this regard, along with any standard declaration template(s) would have been much preferable.

– Prakhar Dua & Kishore Joshi

You can direct your queries or comments to the authors

<sup>1</sup>Section 2 (1) (ha) of PMLA.

<sup>2</sup>The term 'beneficial owner' is defined under section 2(1)(fa) of the PMLA as 'an individual who ultimately owns or controls a client of a reporting entity or the person on whose behalf a transaction is being conducted and includes a person who exercises ultimate effective control over a juridical person'.

DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.