

Investment Funds: Monthly Digest

February 27, 2020

MAURITIUS' INCLUSION IN THE FATF 'GREY LIST': IS 'GREY' THE NEW 'BLACK'?

BACKGROUND

The foreign portfolio investment regime in India was overhauled last year by introduction of a new set of regulations, replacing the erstwhile 2014 regulations. The Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2019 ("2019 Regulations") places an increased focus on classification of countries or jurisdictions by the Financial Action Task Force ("FATF"), when prescribing eligibility criteria for registration as a foreign portfolio investor ("FPI"), both generally and specifically for eligibility as a Category I FPI.

On February 21, 2020, the FATF released a publication titled "Jurisdictions under Increased Monitoring" ("FATF Release"),¹ whereby Mauritius was added to such list, often referred to as the 'grey list'. This led to significant confusion and speculation as to the status of Mauritius-based FPIs, in light of certain provisions in the Operational Guidelines ("OGs"), which restrict investment by FPIs based out of jurisdictions identified by the FATF as "high risk" and "non-cooperative" jurisdictions.

The Securities and Exchange Board of India ("SEBI") issued a press release ("Press Release") on February 25, 2020, providing clarity and assurance that "FPIs from Mauritius continue to be eligible for FPI Registration with increased monitoring as per FATF norms", putting the abovementioned concerns at bay. The guidance from FATF to its members (which includes India) in such cases is to take this into account in their risk analysis; accordingly, the view taken by SEBI to not restrict participation by Mauritius-based FPIs and new applicants but, subject them to enhanced monitoring, is pragmatic. Further, had Mauritius been considered a "non-cooperative" jurisdiction in FATF terms, the same could have also triggered restrictions on remittances to Mauritius under the Liberalized Remittance Scheme ("LRS") of the Reserve Bank of India, which allows Indian resident individuals to remit a certain amount of money during a financial year to another country for investment and expenditure.

In this article, we have attempted to take a closer look at and analyse these developments.

FATF RELEASE

As per the guidance in the FATF Release and generally on the FATF website, jurisdictions identified as being subject to increased monitoring, are the ones actively working with the FATF to address strategic deficiencies in their regimes to counter money laundering, terrorist financing, and proliferation financing. The FATF Release states that when the FATF places a jurisdiction under such a 'grey list', it means the country has committed to resolve swiftly the identified strategic deficiencies within agreed timeframes, besides being subject to increased monitoring.²

As per the description on the FATF website, in respect of the review process for 'High-risk' and 'other monitored jurisdictions' (ie. jurisdictions in the 'black list' and 'grey list', respectively),³ if it is deemed by the FATF that the progress is insufficient to address the respective strategic deficiencies, the FATF develops an action plan with the jurisdiction to address the remaining strategic deficiencies.

The FATF Release accordingly identified areas⁴ wherein Mauritius may still have deficiencies and is expected to improve on as per the action plan formulated in such regard.

PROVISIONS UNDER THE 2019 REGULATIONS AND OGS

One of the conditions for registration of any FPI, under the 2019 Regulations, is that:

"the applicant or its underlying investors contributing twenty-five per cent or more in the corpus of the applicant or identified on the basis of control,

- *shall not be the person(s) mentioned in the Sanctions List notified from time to time by the United Nations Security Council, and*
- *is not a resident in a country identified in the public statement of Financial Action Task Force as— (i) a jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or (ii) a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies".*⁵

As per the OGs, if a jurisdiction which was a compliant jurisdiction at the time of grant of registration to the FPI concerned, becomes a non-compliant jurisdiction i.e. on account of it being listed in an FATF public statement as a "high risk" and "non-cooperative" jurisdiction or otherwise, the concerned Custodian shall not allow such FPIs to make fresh purchases till the time the jurisdiction/FPI is compliant with the Regulations.⁶

REACTIONS AND PRESS RELEASE

Pursuant to the FATF Release, there was speculation in the following days, as to whether Mauritius' inclusion in the so called 'grey list' would entail consequences under the OGs as described in the foregoing paragraph.

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To address the issues, SEBI has forthwith issued the Press Release on February 25, 2020, acknowledging that the placing of a jurisdiction under the FATF 'grey list' is different from it being placed in FATF's 'black list' (previously referred to as 'Public Statement'), and such a case would not fall within the purview of Reg. 4(f) of the 2019 Regulations as discussed above, which targets only jurisdictions which are identified as "high risk" and "non-cooperative". Consequently, it is also fair to deduce that there should not be any adverse implications for master-feeder structures involving an Indian Alternative Investment Fund ("AIF") registered under the SEBI (Alternative Investment Funds) Regulations, 2012, and a feeder fund set up in Mauritius as part of the same platform, except that the 'grey list' categorization of Mauritius may lead to diligence related red flags.

CONCLUSION

Starting from early 2018, the period up till now has been tumultuous for the FPI investor class, considering restrictions (and subsequent relaxations) around ownership and management of FPIs by Indian residents / NRIs / OCIs in 2018, changes in the tax regime (by way of higher surcharges) affecting several FPIs in 2019, introduction of a new Common Application Form and declarations for FPI registration earlier this year, and so on. The increased reliance of the Indian regulator on FATF guidance and classifications has also become evident under the 2019 Regulations, which poses potential complications for a number of institutional investors and asset managers who till this day, prefer Mauritius as a familiar and efficient jurisdiction for investing into India, on account of lower operational costs in Mauritius and favourable tax treatment under the India-Mauritius tax treaty, for interest income and capital gains from sale of securities other than shares. Hence, as Mauritius continues to remain amongst the most significant sources of foreign portfolio investment as well as foreign direct investment into India, issuance of the Press Release is a welcome move in perspective.

— Ishaan Vyas, Richie Sancheti & Kishore Joshi

You can direct your queries or comments to the authors

¹ Available at <http://www.fatf-gafi.org/publications/high-risk-and-other-monitored-jurisdictions/documents/increased-monitoring-february-2020.html>.

² Specifically in respect of Mauritius, the FATF Release recognizes that *"In February 2020, Mauritius made a high-level political commitment to work with the FATF and ESAAMLG to strengthen the effectiveness of its AML/CFT regime. Since the completion of its MER in 2018, Mauritius has made progress on a number of its MER recommended actions to improve technical compliance and effectiveness, including amending the legal framework to require legal persons and legal arrangements to disclose of beneficial ownership information and improving the processes of identifying and confiscating proceeds of crimes..."*

³ Available at [http://www.fatf-gafi.org/publications/high-risk-and-other-monitored-jurisdictions/more/more-on-high-risk-and-non-cooperative-jurisdictions.html?hf=10&b=0&s=desc\(fatf_releasedate\)](http://www.fatf-gafi.org/publications/high-risk-and-other-monitored-jurisdictions/more/more-on-high-risk-and-non-cooperative-jurisdictions.html?hf=10&b=0&s=desc(fatf_releasedate)).

⁴ *"Mauritius will work to implement its action plan, including by: (1) demonstrating that the supervisors of its global business sector and DNFBPs implement risk-based supervision; (2) ensuring the access to accurate basic and beneficial ownership information by competent authorities in a timely manner; (3) demonstrating that LEAs have capacity to conduct money laundering investigations, including parallel financial investigations and complex cases; (4) implementing a risk based approach for supervision of its NPO sector to prevent abuse for TF purposes, and 5) demonstrating the adequate implementation of targeted financial sanctions through outreach and supervision."*

⁵ Reg. 4(f) of the 2019 Regulations.

⁶ Paragraph 16 in the OGs.

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