

ASSOCIATION OF GLOBAL CUSTODIANS

Communication of the Association of Global Custodian's Asia Focus Committee¹

21 August 2023

Shri B Rajendran,
Executive Director,
Alternative Investment Fund and
Foreign Portfolio Investors Department,
Securities and Exchange Board of India.

(Sent by e-mail to: rajendran@sebi.gov.in)

Dear Mr.Rajendran,

Identification and verification of Beneficial Owners (BO) of Foreign Portfolio Investors (FPIs)

We refer to the Securities and Exchange Board of India's (SEBI) email dated 3rd February 2023 to six of the member banks of the Association of Global Custodians² (AGC) providing custodial services in India (DDPs), regarding more in-depth information on the identification and verification of Beneficial Owners (BO) of Foreign Portfolio Investors (FPIs).

The email and subsequent communications require increased detailed disclosures of FPIs, their BOs and their senior managing officials (SMO). Whilst this is a challenge in respect to non-public Collective Investment Vehicles (CIV) FPIs, AGC member banks and those non-public fund FPIs are striving very hard to meet SEBI's 30 September deadline. However, it is proving significantly challenging in respect of public mutual funds, unit trusts, common trust funds and other pooled vehicles (including ETFs). AGC member banks and their public FPI fund clients are extremely concerned regarding the implications, if the requirements are not met by the deadline: non-compliant FPIs would become ineligible to continue with their registration beyond that date. Such FPIs would be required to liquidate their holdings and surrender their registration by 31 March 2024.

¹Mr. Rafizain Rafii, Chairman, The Association of Global Custodians, Asia Focus Committee, c/o Northern Trust, One George Street, #12-06, Singapore 049145

² The Association of Global Custodians is an informal group of 12 financial institutions that provide securities safekeeping services and asset-servicing functions to primarily institutional cross-border investors worldwide and administer collectively over USD150 trillion of assets . As a non-partisan advocacy organization, the Association represents members' common interests on regulatory and market structure matters through comment letters, white papers and interaction with legislative and regulatory authorities and financial industry organizations around the globe. The members of the Association are: BNP Paribas; BNY Mellon; Brown Brothers Harriman & Co; Citibank, N.A.; Deutsche Bank; HSBC Securities Services; JP Morgan; Northern Trust; RBC Investor & Treasury Services; Skandinaviska Enskilda Banken; Standard Chartered Bank; and State Street Bank and Trust Company.

The AGC understands the underlying rationale of what SEBI hopes to achieve by these enhanced disclosure requirements: the identification of parties to a FPI where the FPI is undertaking trades not in accordance with ownership restrictions on those parties in India.

Based on our understanding, as detailed by the six AGC member banks providing custodial services in India in their recent email letter to SEBI dated 10 August 2023, on practices followed in a few key mature markets in Asia, it appears that the requirement of identification of SMO at the 'end of the legal chain' is unique to India. Furthermore, asking for a specific corporate designation of SMO, except for South Korea, is not a common practice followed in other Asia markets.

It is understood that this requirement stems from a concern that an investor in a FPI, intent upon conducting irregular trades, could disguise themselves through a public CIV. However, this would indeed likely be a very remote occurrence. Public CIVs are highly regulated entities similar to SEBI's regulation of such funds in India.

We, therefore, suggest that the recommended FATF "risk-based approach" (RBA) to CDD and AML/CFT checks of public CIVs, remains the most practical approach.

FATF Recommendations:

The FATF Recommendations are the most widely established international standards for ensuring the availability of beneficial ownership information.

Although they are recommendations and, therefore, subject to the laws and regulations of adopting countries such as India, all AGC member banks and the majority of their clients globally use them as their chief operative guide, along with local regulatory requirements, for CDD and AML/CFT activities.

Under Recommendation "17" covering the introduction of business rule and reliance on third-parties, financial institutions, if allowed under national regulations, can rely on the CDD conducted by another, fully regulated entity or person, provided they have taken adequate steps to satisfy themselves that copies of identification data and other relevant documentation relating to the CDD requirements will be made available from the third-party upon request without delay.

Adoption of this Recommendation is especially important to DDPs in India and all other global markets regarding the CDD and AML/CFT checking of public CIVs, as Global Custodians are best placed to undertake such activities.

Furthermore, these funds are not only sold locally, but also distributed globally: UCITS funds sold outside the EU, as at 31 December 2022, totalled EUR4.4 trillion. Funds constituent investors, whether local or global, are constantly changing.

The FATF Recommendations allow for simplified customer due diligence measures in lower risk situations. Public CIVs registered in the US, Canada, EU, UK and financial centres in the Asia-Pacific region are very highly regulated and often assessed as lower risk. The record-keeping requirements are set forth in FATF Recommendation "10" and state that the CDD information and transaction records should be available to domestic competent authorities upon appropriate authority.

Identification of Beneficial ownership (BOs) for fund structures:

Investors who ultimately own or control an FPI are identified in accordance with Rule "9" of the PMLA Rules. Where there is no natural person identifiable on a basis of control or ownership, the BO is then the relevant natural person who holds the position of SMO of the FPI. When a SMO is identified as the BO, it means that individual, or individuals, have been designated by the FPI as holding a senior management position(s) and is/are making key decisions relating to the FPI.

Specifically obtaining ultimate BO information beyond the SMO of the fund manager or the fund officers would not be useful, as the ultimate owner of the fund manager or fund management company are not the ones responsible for overseeing the management, policies, operations and administration of the fund.

Given that in some cases the distribution chain can be particularly long with three, four or even five intermediaries between a fund and the BO, the AGC requests SEBI to consider exempting public CIVs from the enhanced BO disclosure requirements, or at a minimum not applying the reduced threshold of 10% to such funds and instead retaining the original threshold for such funds of 25%.

Required identification of SMOs

Global Custodians and their FPI clients stress that identification of SMOs of all non-natural entities that are identified on the basis of ownership and control parameters, is an extremely onerous task and in many cases unfeasible. The AGC earnestly requests SEBI to understand this situation.

In regard to SMOs we seek clarity on the PMLA legal chain rule related to the identification of SMOs as the non-natural person holding greater than the prescribed threshold needs to be applied only at the Legal entity/Controlling Person level and not for the underlying investors/registered FPI it represents.

Furthermore, we very respectfully request an extension of six months to the deadline to 31st March 2024, if there is not a significant relaxation regarding the disclosure requirements for public CIV FPIs announced in the near future.

The freezing or liquidating of a possible significant number of FPI accounts we envisage would have quite a detrimental effect on foreign investment in the market which neither the AGC nor, we are sure, SEBI would wish to contemplate.

Reporting within seven business days

The requirement to update BO information within seven business days is an extremely tight timeline, given that many public CIV funds are distributed locally and globally through numerous intermediaries, distributors and sub-distributors, across a number of different time-zones. For the required BO information to be obtained within seven business days will be an immense challenge, if not impossible in many cases, especially with the high frequency of changing information due to new fund subscriptions and redemptions.

There is the very distinct possibility that this requirement, if the timeline is not relaxed, will lead to increased non-compliance with the 15 March Amendment Regulations, even with best efforts being employed by all the parties involved.

This tight timing issue, though still requiring review, would be substantially reduced if public CIV FPIs' KYC requirements could be significantly reduced, or the BO and SMO information is limited to that of the fund manager or fund officers with whom the responsibility for the daily management and administration of the fund lie.

Given all the above observations, the AGC urges SEBI to review again the increased disclosure requirements issued to our six member banks in India in your email dated 3 February 2023.

The AGC also recommends that for those FPIs unable to meet the current, or any revised deadline, that following any suspension of their registration their accounts are frozen, not liquidated, on 31st March, or any new deadline set, until they can meet the increased disclosure requirements or SEBI specifically determines otherwise.

Please feel free to reach-out to our Chairman, Mr. Rafizain Rafii, or myself if you seek further clarification on any content of this letter, or any other related matter

Yours sincerely,



Robert Edwards, (as attorney in fact)
For and on behalf of, Mr. Rafizain Rafii,
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