

Increased Transparency for India Inc. —New Beneficial Ownership Rules

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Amidst growing concern to protect financial systems against money laundering and terrorist financing across the world, the Indian government has taken significant strides in 2018 to enhance its corporate transparency rules. The key global standards are framed largely due to efforts by the Financial Action Task Force (the “FATF”), an independent body which conducts periodic analyses and makes recommendations to the G20. Earlier this year, the Indian government aligned its laws with the FATF recommendations by amending Sections 89 and 90 of the (Indian) Companies Act, 2013 (the “Act”), which deal with the disclosure of beneficial interest in a company. The

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revised provisions introduced the definition of a “significant beneficial owner” (“SBO”) and imposed disclosure obligations on SBOs and companies, along with penalties for non-compliance. Companies in India are now required to maintain a register of SBOs and to make it available for inspection by their members. In June 2018, the Indian government took a further step by issuing the Companies (Significant Beneficial Ownership) Rules 2018 (the “SBO Rules”), which enhance compliance requirements for SBOs and companies, and cover a wider scope of SBOs by reducing the SBO threshold of ownership from 25% to 10%.

These regulatory developments are comparable with efforts by other G20 member countries and are a reflection of evolving requirements to tackle money laundering. While the SBO Rules are a noteworthy development even when viewed in isolation, their significance and implications are better understood in the context of recent regulatory changes in other key jurisdictions. For instance, the United Kingdom was one of the first countries to create a publicly available SBO register for companies and LLPs (called the registers of Persons with Significant Control (the “PSC”)) and has set a high standard for corporate transparency, pegging the SBO threshold at ownership of 25% of economic or voting rights, rights to appoint/remove the majority of the board or other exercise of significant influence or control over the entity. The European Union adopted the fourth Money Laundering Directive (“MLD4”) in June 2017 to strengthen its corporate transparency regime and establish central SBO registers. The directive was recently revised by the Fifth Money Laundering Directive (“MLD5”), which sets the minimum standards member states are required to implement by 10 January 2020,

and makes SBO information in relation to companies and other legal entities available to the general public. *An indicative chart of key distinctions between the SBO regimes in the United Kingdom, European Union and India is attached as an Annex to this update.*

The SBO Rules. Section 90 of the Act, which was brought into effect earlier this year, defines an SBO as an individual who (i) holds a beneficial interest of at least 25% of a company's shares, or (ii) has the right to exercise, or actually exercises, significant influence or control over the company. However, the SBO Rules, which were notified on 13 June 2018, contain more detailed and strict compliance requirements for SBOs and companies. Most notably, the SBO Rules reduce the SBO shareholding threshold from 25% (under Section 90 of the Act) to 10%, similar to proposals made under MLD5 in the European Union. The SBO Rules further provide that where no natural person is identified as an SBO (in the case of a company or partnership), the SBO will be the relevant natural person who holds the position of senior managing official. Unlike the regimes in the United Kingdom and European Union, the mandatory SBO registers to be maintained by companies in India are only required to be accessible to their own members.

The SBO Rules apply to all companies, but do not extend to interests held in pooled investment vehicles or investment funds (such as mutual funds, alternative investment funds, real estate investment trusts and infrastructure investment trusts), which are regulated separately by the Securities and Exchange Board of India, India's securities regulator. The SBO Rules also clarify that instruments in the form of global depository receipts, compulsorily convertible preference shares and compulsorily convertible debentures will also be treated as "shares" when determining whether a person is classified as an SBO.

Companies are required to identify SBOs and provide notice to any person whom the company knows or has reason to believe is an SBO (or has been an SBO in the preceding three years). If the company does not receive satisfactory information within 15 days of expiry of the notice, it must then apply to the National Company Law Tribunal to impose restrictions on the relevant shares, which may include transfer prohibitions or suspension of voting or dividend rights. Defaulting companies, as well as their officers in default, may be subject to monetary fines of up to INR 50 lakhs (approx. USD 71,000), with additional fines for continuing defaults.

The obligations also extend to SBOs, who must provide details of their beneficial interests to the relevant company by 13 September 2018. Changes in SBO holdings must also be declared within 30 days of the change. Shareholders who fail to comply with the SBO Rules may be subject to monetary fines extending to INR 10 lakhs (approx. USD 14,000) with additional fines for continuing defaults.

The SBO Rules are still fairly new and may undergo refinement over the coming months to bring in more clarity and better alignment with the FATF standards. For instance, once of the determining factors for a SBO is the exercise of “significant influence” over a company, but this term has not yet been defined, leaving room for ambiguity. Nevertheless, in light of the more stringent disclosure requirements now imposed on companies and shareholders under Indian law, foreign investors may need to consider conducting periodic due diligence regarding their investments in India, particularly in transactions where there is a higher risk of money laundering.

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Please note that this firm does not practice Indian law, and that this update is based on publicly available information.

Please do not hesitate to contact us with any questions.

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Annexure

Indicative comparative chart of key SBO provisions in the United Kingdom, European Union and India

	United Kingdom	European Union (MLD4)	India
Shareholding threshold for beneficial ownership	25%	25%	10%
Exemptions	<p>Secretary of State may make regulations to exempt a person/entity from registration requirements.</p> <p>Companies House accepts applications to protect information of individuals at risk of violence or intimidation from being on register.</p>	<p>Companies listed on regulated markets subject to disclosure requirements consistent with laws of the European Union, or subject to equivalent international standards that ensure adequate transparency of ownership information.</p>	<p>Pooled investment vehicles/investment funds such as Mutual Funds, Alternative Investment Funds, Real Estate Investment Trusts and Infrastructure Investment Trusts regulated by the Securities and Exchange Board of India.</p>
Accessibility	<p>Register at the Companies House is publicly accessible.</p> <p>PSC register maintained by company must be open to inspection by any person without charge.</p>	<p>Register is accessible to:</p> <ul style="list-style-type: none"> • Competent authorities and financial intelligence units, without any restriction; • Obligated entities, within the framework of customer due diligence; and • Any person or organisation that can demonstrate a legitimate interest. 	<p>Register is open for inspection by members of the company during business hours, on payment of a fee specified by the company, not exceeding INR 50 (approx. USD 1).</p>

		<p>(Note that MLD5 extends accessibility to information (i) in relation to companies and other legal entities, to the general public; and (ii) in relation to trusts and similar legal arrangements, to anyone who demonstrates a “legitimate interest” or files a written request.)</p>	
<p>Penalties</p>	<ul style="list-style-type: none"> • Failure to take steps to determine if person subject to the registration requirements: fine and/or up to twelve months’ imprisonment; • Failure to provide information, or providing false information, to the register: imprisonment of up to two years; and • Failure to keep and maintain register: fine and additional penalty per day of violation. 	<p>Criminal sanctions and/or administrative sanctions and measures.</p> <p>Breaches that are serious, repeated and/or systematic: administrative sanctions and measures, including at least (a) public statement identifying natural or legal person and nature of breach; (b) order requiring natural or legal person to cease conduct and desist from repetition of conduct; (c) withdrawal or suspension of authorisation for obliged entity; (d) temporary ban against manager in obliged entity exercising managerial duties; and (e) maximum administrative pecuniary sanctions of at least twice the amount of benefit derived from breach where benefit can be determined, or at least €1 million.</p> <p>Where obliged entity concerned is credit institution or financial institution, higher fines may be imposed.</p>	<ul style="list-style-type: none"> • Failure by SBO to declare interest: fine of up to INR 10 lakhs (approx. USD 14,000) with additional fines for continuing defaults. • Failure by the company to maintain the SBO register or file SBO returns with the Companies Registrar: fine of up to INR 50 lakhs (approx. USD 71,000), with additional fines for continuing defaults. • Willfully supplying false/incorrect information or suppressing material information of which such person is aware: fine of up to three times the amount involved in the fraud and imprisonment of up to ten years.