

## INTRODUCTION

The Prevention of Money-Laundering Act, 2002 (“**PMLA Act**”) and the rules thereunder govern the activities relating to money laundering in India. In the year 2023, the Ministry of Finance notified the amendments to the Prevention of Money Laundering (Maintenance of Records) Rules, 2005, on 07 March 2023, 04 September 2023 and 17 October 2023 (“**PMLA Rules**”). One of the key provisions of the PMLA Rules relates to identifying and verifying the identity of clients of the reporting entities (*please refer to the meaning of ‘reporting entities’ below*), understanding the ownership and control of the client entity and tracing the beneficial owner of such entity.

In this Article, we have discussed the increasing compliance requirements relating to beneficial ownership, recent amendments to the PMLA Rules in this regard and the impact of the amendments to the PMLA Rules on Indian entities and foreign shareholders.

## REPORTING ENTITIES

The PMLA Act provides a list of the entities which fall under the purview of the definition of reporting entities. It means a banking company, financial institution, intermediary or a person carrying on a designated business or profession.

In March 2023, the Ministry of Finance clarified that the definition of ‘person carrying on designated business or profession’ now includes such persons who carry out activities for or on behalf of another natural or legal person in the course of business as an activity, in relation to exchanges between virtual digital assets (“**VDAs**”) and fiat currencies, exchange between one or more forms of VDAs, transfer of VDAs, safekeeping or administration of VDAs or instruments enabling control over VDAs, and participation in and provision of financial services related to an issuer’s offer and sale of VDA.

## BENEFICIAL OWNERSHIP

The PMLA Rules lay significant emphasis on identification of a beneficial owner. Beneficial owner is determined to be a person who individually or together, or through one or more juridical persons has a controlling ownership interest or exercises control through other means.

*What is control and controlling ownership interest?*

Any individual who is entitled to appoint majority of the directors of a company or control the management or policy decisions in any manner including due to his shareholding, management rights, shareholders agreement or voting agreement, is said to control a company. The concept of beneficial ownership also extends to various other entities such as a partnership firm, an unincorporated association or body of individuals and a trust.

Controlling ownership interest would mean ownership of or entitlement to more than 10% of the shares, capital or profits of a company. Prior to the 04 September 2023 amendment to the PMLA Rules, the threshold for ascertaining controlling ownership interest was 15%.

What is a lesser-known fact is that there is a maximum threshold of 25% for determining controlling ownership, which is recommended by the Financial Action Task Force (“**FATF**”) to its 39 member countries based on a particular jurisdiction’s assessment of risk. India being one of the member nations, has adopted the threshold well within the recommended threshold of the FATF.

#### *Client due diligence*

One of the significant amendments to the PMLA Rules relates to the conduct of due diligence of its clients by a reporting entity using ‘reliable and independent sources of identification’. Although the PMLA Rules previously contained provisions for undertaking client due diligence, including on the client’s beneficial owner, the amendments to the PMLA Rules emphasize that additional actions should be undertaken by the reporting entities to understand the nature of their clients’ business, ownership and control. The PMLA Rules, including the amendments thereto, draw direct inference from the FATF recommendations on ‘International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation’ in relation to identification of the beneficial owner.

The earlier PMLA Rules provide for conducting client due diligence of its existing clients (i) considering the materiality and risk aspects, and (ii) at appropriate times or as may be specified by the relevant regulating authority. Further, reporting entities, at the time of conducting due diligence, should check whether client due diligence measures were undertaken previously and whether sufficient data was obtained at that time. The amendments to the PMLA Rules clarify that reporting entities should ensure that the information or data relating to all its existing clients is updated and relevant, especially where there appears to be a high risk.

It is obligatory for all the reporting entities to maintain an updated client information database. Accordingly, the reporting entities will now need to conduct client due diligence in multiple instances, such as, at the time of commencement of an account-based relationship, or at the time of undertaking an occasional transaction of an amount equal to or exceeding INR 50,000/- (whether conducted as a single transaction or several transactions that appear to be connected), or any international money transfer operations.

#### *Client beneficial owner exemption for certain listed entities*

Rule 9(3)(f) of the extant PMLA Rules provides for certain exemptions for identifying a beneficial owner. According to Rule 9(3)(f) of the PMLA Rules,

*“(f) where the client or the owner of the controlling interest is an entity listed on a stock exchange in India, or it is an entity resident in jurisdictions notified by the Central Government and listed on stock exchanges in such jurisdictions notified by the Central Government, or it is a subsidiary of such listed entities; it is not necessary to identify and verify the identity of any shareholder or beneficial owner of such entities.”*

The Ministry of Finance, on 28 November 2019 notified the following jurisdictions to whom the above sub-rule would apply: (i) United States of America, (ii) Japan, (iii) South Korea, (iv) United Kingdom excluding British Overseas Territories, (v) France, (vi) Germany, (vii) Canada, (viii) International Financial Services Centre in India. Accordingly, one of the few instances where the reporting entities could refrain from identifying or verifying the identity of shareholder or beneficial owner of the client would occur if such shareholder or beneficial owner of the client is a resident entity and listed in any of the above 8 jurisdictions.

#### *Information and documentation*

Reporting entities are required to verify the details of each new client, to their satisfaction, whether regular or occasional, to determine the purpose of the intended banking relationship. This would mean that the documentation and information available with the reporting entities must be sufficient to ultimately satisfy the competent authorities that necessary diligence was undertaken by the reporting entities and that owing to the background checks conducted by them, such reporting entities are fully aware of the beneficial owner and the transactions undertaken by their clients under the directions of the beneficial owner. Moreover, reporting entities will need to inform the relevant authorities of any illicit activities which are being undertaken under the guise of beneficial ownership.

All the data provided by clients is required to be maintained by the reporting entities with the Central KYC Records Registry set up by the Central Registry of Securitisation Asset Reconstruction and Security Interest of India (“**CERSAI**”). Further, RBI has the powers to inspect such data maintained with the Central KYC Records Registry.

The PMLA Rules provide that based on its constitution, client of a reporting entity will need to submit certain prescribed documents to the reporting entities for its identification and verification such as (i) Permanent Account Number (PAN) card, aadhaar card, photograph (in case of an individual), (ii) incorporation documents, board resolutions and powers of attorney in relation to authorization granted to officers to transact on its behalf, PAN card, names of the persons holding senior management position, documents relating to registered office and the principal place of business (if different), documents relating to the beneficial owners, managers, officers or employees (all in case of a company), or (iii) registration certificate, trust deed, the names of the beneficiaries, trustees, settlor, protector, if any and authors of the trust and the address of the registered office of the trust and PAN card (in case of a trust). Additionally, the PMLA Rules also prescribe documents which will need to be submitted by partnership firm, unincorporated association and a body of individuals. However, reporting entities could apply their prudence for completion of the diligence process and request for additional documents from its client, on a case-to-case basis and as it may deem necessary.

#### *Provisions relating to beneficial ownership under various regulations*

The concept of beneficial ownership is under the radar of various regulators in India. Authorities are introducing more stringent regulations for instances where beneficial ownership could come into play. Prior to the 07 March 2023 amendment, the PMLA Rules provided 25% as the threshold to identify beneficial ownership. However, the above percentage of 25% has been significantly

reduced to 10%, which is now in alignment with the existing rules under Companies Act, 2013 prescribed for determining a significant beneficial owner (“**SBO**”). With the reduction in the threshold for identifying a beneficial owner, the Indian authorities have considerably broadened their horizon to investigate a wider base of controlling persons. Further, in addition to reporting under the PMLA Rules where the information of the beneficial owner needs to be reported, the Ministry of Corporate Affairs (“**MCA**”), also requires the significant beneficial owner to provide declarations of his ownership, subsequent to which the Indian entity will need to report the same with the MCA in form BEN-2.

Further, the Companies (Significant Beneficial Owners) Rules, 2018, lay down extensive provisions governing significant beneficial ownership. It provides a clear mechanism for Indian entities to identify an SBO and mandates such entities to duly report details of such SBO and any subsequent change to such details.

Further, pursuant to the notification dated 22 April 2020, the regulations have been amended to prohibit any initial or subsequent investment by a beneficial owner who is situated or a citizen of a country sharing land border with India without prior government approval. It is important to note that the regulations do not prescribe any specific threshold with respect to such investment by beneficial owner. However, various authorised dealer banks seem to take a view that government approval will be required to be obtained prior to the investment, if the total beneficial ownership interest will be 10% or more post such investment.

## **IMPACT ON INDIAN ENTITIES AND FOREIGN SHAREHOLDERS**

Although the earlier PMLA Rules provide for conducting client due diligence, reporting entities are now undertaking client due diligence (for new clients) or additional checks in relation thereto (for existing clients) rigorously, pursuant to the amendments to the PMLA Rules. Accordingly, clients will need to provide all the data and documentation requested by the reporting entities. This could include identity proof of the beneficial owners, details of the latest and relevant shareholding or capital table of not only the immediate parent entity, but also of the ultimate holding entity of the client, in India or abroad.

The practical implementation of the client due diligence process by reporting entities, pursuant to the amendment to the PMLA Rules, has created a lot of confusion amongst clients. One of the possible reasons for such confusion is that many reporting entities are randomly sending checklists to their clients requesting for additional data and providing limited or no background of the statutory requirement. Due to the unstructured process, it is highly possible for clients or the beneficial owners to be uncertain of the requests from the reporting entity for the personal information and documents.

## **CONCLUSION**

The stringent checks prescribed under the amended PMLA Rules for the reporting entities are fairly new. With the reporting entities having commenced the due diligence and KYC procedures, there is a lot of ambiguity from the perspective of the clients of such reporting entities. Reporting entities are demanding certain information and documentation from their clients which was never provided

by the clients prior to the amendments to the PMLA Rules. It is vital that the reporting entities provide some background to their clients at the time of calling for any details and ensure protection of the data provided by such clients.

It is pertinent to note that countries globally are incorporating mechanisms to identify the beneficial owner at the controlling end of the corporate chain. Recently, in January 2024, the United States of America (USA) has launched a beneficial ownership registry where certain companies are required to report information pertaining to beneficial ownership. Such report, *akin* to Indian requirements, is not an annual requirement and the information needs to be updated as and when there is any change in the data submitted to the registry. However, on 01 March 2024, it appears that a federal judge in Alabama issued a ruling that the existing Corporate Transparency Act (“**CTA**”) is unconstitutional and that the reporting requirement under the CTA is unnecessary. While the impact of the ruling on the other entities is unclear, the reporting requirements by the plaintiffs are on hold.

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## **ABOUT KOCHHAR & CO**

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The Firm has built a formidable Corporate Transactions’ practice that is supported by pan-India teams of market leading experts in real estate, tax, employment, anti-trust/ competition, intellectual property, regulatory and litigation as well as teams offering the full range of finance support including all aspects of banking and finance and restructuring transactions.

The Firm advises on a broad spectrum of issues and procedures involved in funding transactions and the firm’s solution-oriented approach combined with its expertise in managing multi-disciplinary teams of lawyers, accountants, financial advisers often minimizes roadblocks and transactional time and maximizes efficiency.

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