India: God's own country for FPI Investors?

Vanishing Mysticism - Enabling Ease

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While much focus is centred on the growing FDI investments with Financial Year 2016-17 recording the highest ever FDI inflows, on a separate stream the number of FPIs and their investments have shown increase.

Nos. of FII(Net)

As on	
March 31, 2014 *	8159
March 31, 2015 *	8214
March 31, 2016 *	8717
March 31, 2017 *	8738
July 31, 2017**	8782

* Source SEBI ** Source NSDL

Assets Under Custody**
USD Billion as on June 2017

Equity	Debt	Total
387.66	62.67	450.33

At the heart of all these changes wrt. FPI's are initiatives of The Securities Exchange Board of India (SEBI). SEBI over the last two decades, focussed on a number of key Capital Market related development & initiatives- boosting the confidence of Foreign Portfolio Investors, resulting in growing inflows.

To capsule: T+ endless became T+2 in 2002 (Europe yet to completely move into T+2 !!); Clearing houses demutualised and became stronger (Europe's OTC markets moving to Clearing house structures); Demat became a Global success story (India home to the second largest nos of Investors holding stocks in DEMAT mode); Capital market products became diverse; Exchanges became stronger, speedier with cutting edge technology and ranked amongst the Top five globally; Corporate Governance norms emerged and grew the confidence in Corporates/ Industry(Prime Database's role in developing this aspect can't be over emphasised); interoperability enabled greater STP; Regulatory bodies like Income Tax Dept., RBI, SEBI together developed joint solutions, banking became robust and secure. Exchanges, Clearing Houses, Depositories as well as market intermediaries collaborated to enable greater ease of Information. They invested in Investor education, Risk management system, in integrated systems and adoption of Global best practices. The Era also witnessed new players emerge, jostling for business with cutting edge service and delivery systems.

Much has been written/discussed about the complexities and high costs faced by FPIs in accessing Indian Capital markets. While this is true versus some of the advanced markets, continued focus on easing KYC processes by the Regulators (particularly SEBI) also through constant engagement with FPIs, SROs, Intermediaries- has resulted in significant changes: access period down from 4-month period to 12-15 days. In our experience, the costs of access and doing business, has reduced significantly- in certain aspects of upto 70%, as newer solutions and providers emerged.

The Mysticism of India being a complex market is GONE.

'Easing access' is the new mantra.

India, which was hitherto considered to be a risky market (leading to questions of trade settlements, ever-changing Tax regimes etc) increasing assumed a new demeanour- of a market offering multiple opportunities (products), more investor friendly and stable policies.

It also led to greater capital formation, significant market capitalisation, advent of India as a leading derivatives market especially in single stock futures.

India experienced political stability with a single party majority paving way for improved governance and building Investor confidence. The PM Modi Government together with the MoF, SEBI, RBI continued the focus on enabling greater, easier and faster access.

The game changer for FPIs, is the advent of the Foreign Portfolio Investment (FPI) Regulations of 2014. SEBI's dynamic team at IMD, Division of Foreign Portfolio Investors and Custodians. in June 2014, activated the new FPI

Regulations enabling, a sea of opportunities, besides harmonisation of Investor Categories. Though the FPI Regulations focussed on harmonisation- the real benefit and outcome was-enabling "EASE OF DOING BUSINESS" for all class of FPIs. For the first time a new class of FPIs, loosely referred to as Category III, became eligible to invest in India. This was accompanied by minimal Tax changes, even as Indian policy makers actively engaged in harmonising tax treaties with other countries; New Indian intermediaries entered the business of custody, tax, broking and banking. P notes, a key product used by FPIs in early 2000(57% of FII inflows around year 2005) lost its charm (currently at 3.47%) as FPIs now easily access Indian market with greater ease, at lower costs and lesser risks. FAQs as well as excellent guidance notes by SEBI; emergence of DDP as points of inflection- became a norm. The migration to the new regime was remarkably without hiccups, thus paving path to faster growth and Inflows.

Investors flock from new jurisdictions– Korea, China, Russia, Japan, Australia etc.; this in addition to greater inflows e from the well-established Inflow Jurisdictions (USA, Luxembourg, Canada, Mauritius, Ireland, UK, Japan, Singapore, HongKong etc). Post 2014, new Intermediaries added marketing muscle in showcasing India as an Investment destination. PIVOT set up in 2014, develops, hosts and assists to the "India Attractiveness" initiatives, globally.

BSE, world's leading Stock Exchange by listings, is the first Exchange in the world, to have a dedicated webpage for Foreign Portfolio Investors in 10 International Languages. Investors are able to access 'India Access information" in downloadable format. Foreign Consulates and Indian Consulates find this useful and have hosted the link on their websites, thus enabling 'Ease of Information'. http://www.bseindia.com/#intfpi.

Growth of Intermediaries: I8 Bank/ Non- Bank Custodians act as DDPs(Custodians). This includes Indian and Global Institutions. While India has well established non-Banks Custodians (unique to India), India does not have Custodian Banks as DDPs! Over thirteen leading Local and Global Tax firms provide Tax services to FPIs. Growing class of Brokerage Firms and Banks provide value added services at attractive pricing.

Are we doing enough?

Introduction of new products, diverse segments and their growth benefits a country through- Inflows, Revenues for the State and SROs, employment, Revenue for Intermediaries, adoption of global practices etc. This is no different in the case of India

FPI Inflows have increased significantly since 2015, even as their base has widened and diversified. There is an increase in the countries from which FPI Inflows are coming. Additionally, the FPI division of SEBI reaches out clarifying/ informing of steps, taken to enable greater ease in accessing India.

Much of the thrust to attract FDI and FPI was driven by the Government, with the current PM Shri Narendra Modi and the Finance Minister Shri Arun Jaitley leading from the front; the FPI initiatives were fast tracked by SEBI, with the current Chairman Shri Ajay Tyagi, though new in the role, moving equally fast along with his team in making India more accessible. The recent SEBI Consultation paper on, "Easing of Access Norms for Investments by FPIs" is one such instance of Industry engagement by the policymaker.

Can India attract more FPIs? What then is it we need to do more/differently?

In the face of high visibility of FDI related developments and Inflows, the fast growing FPI story is yet to get the visibility it deserves. A combination of new initiatives, showcasing growth more prominently, consider/implement rolling out below Global practices and products, could assist.

● **Implement the Custodian Bank Concept:**

Globally the large and leading Custodian Banks are primarily specialist Custodian Banks. E.g. Bank of New York Mellon, JPMorgan, Northern Trust, BBH, State Street. Current RBI regulations do not enable such banks to operate, though carried in the policy paper of May 2015. The absence of such Global Banks adds to costs of servicing FPI clients, operational inefficiencies, limited marketing to FPIs resulting in higher risks etc. Indian Regulators could encourage Indian Non-Bank Custodians to become Custodian Banks. PIVOT in Jan 2015 had released a detailed note on the efficacy and need for Custodian Banks to be operationalised.

It's interesting to note that in the recently concluded Global Custodian Survey of 2017 of Indian Domestic Market, 3 of the top four Custodians were Non-bank Indian Custodians (Stockholding, Orbis, Edelweiss), ahead of many a well-recognised Indian and foreign Custodians. This asserts the quality of local expertise of these Institutions, in the face of well-established Global players.

● **Introduce new products: Listed warrants:**

India has a well-developed equity market as well as Derivatives market. The Indian Capital market has well established, renowned Intermediaries. Current Regulations facilitate growth. In such instances introducing globally tested products like Listed warrants will not only provide diversity of products to FPIs, but also lead to capital formation and market capitalisation.

● **Enable Interoperability between Clearing houses:**
The presence in India of multiple Exchanges, multiple Depositories, Multiple Clearing corporations, Multiple Banking, adds costs, risks, inefficiencies, compliances, additional operational capability etc, without much value add. Interoperability between Depositories had significantly contributed to promoting STP, reduction of costs greater operational efficiencies reduction of risks and turnaround time. A similar exercise wrt Clearing houses will reap in advantages to all the participants, including FPIs.

● **Invest in global standards in Fund Accounting standards and practices**
The increasing diversity of products, new Investor segments across Equity, Debt, Currency, Commodities, REIT etc adds complexities to the valuations. The size of India fund accounting Industry is approx. of USD 300- 350 Billion, when one considers the Mutual Fund segment, PE segment, AIF segment, Pension, Real Estate and PMS segment. These segments will experience multiplier growth. While Fund accounting standards and guidelines do exist, investing more and more in global best practices will lead to standardisation, greater transparency, increasing Investor confidence, assist the faster growth of the said segments and foster more inflows.

●**Develop new segments:**
AIFs and SME segment's growth attract FPI interests. These segments offer opportunities to increase market cap, offer new products and create wealth. India is home to the MSME segment. Certain class of investors viz. Wealth Management FPIs/ certain countries (where Wealth FPIs abound) are particularly interested in staying invested in these segments.

In this regards the BSE's steps in developing the SME segment is commendable, with scope to actively position this with the Global investors/ foreign Jurisdiction.

Development of these segments also includes the need to develop an impartial, continuous, qualitative and consistent information, to Investor benefit. Currently we lack this, thus limiting the visibility that could add confidence and grow the Inflows.

● **Creating visibility and positioning:**
NSE has literally put India on the Global map as the Exchange for Single Stock Futures. This is no mean achievement. FPI's over decades have actively acknowledged this by increasing their volumes. However, beyond the business presentation, roadshows by various participants, this aspect is not actively positioned at a Country level as "Home for Single Stock Futures" for general and Global consumption. Much can be done and more achieved, in promoting this feature of the Indian Capital Market. An analogy being, the Global positioning of Kerala as 'Gods own Country'!

● **Is it a time to consider Omnibus structure?**
SEBI over decades, actively enabled growth of Indian Capital Markets as well as protection of interests of the beneficial owner. The need to have segregated accounts, is a step in the said direction. Over years banks, FPIs being Funds/banks with underlying beneficial owners, have invested through the Bank/ Funds structure.

Globally, investors have the choice to access Capital Market either through a segregated structure or through the Omnibus structure. Each of these structures have merits and separate set of investor bases. Many advanced and developing markets enable both structures. This maximises inflows into a country, enables all class of Investors to invest, while generating greater revenue, no additional risks to market etc.

While India has been steadfast in developing the segregated account structure, it also has developed a number of mechanisms to seek out Investor information. Thus, enabling Omnibus structure, in light of the above well-developed mechanisms in place, provides an opportunity to India to substantially increase inflows (approx. USD 30-50 Billion) from FPIs who prefer the Omnibus structure. This also paves way for India being regarded as a truly open market, aligned to Global practices, similar to ones in the advanced markets.

● **Developing an ecosystem that facilitates greater interest from Category III FPIs:**
FPIs comprised in different segments, have different service needs, when investing in India Capital Markets. For over 2 decades Indian Intermediaries (Broking housing, Custodians, Tax firms, Banks) have understood and serviced FII/FPIs that categorised in I and II.

The advent of Category III FPIs (currently numbering over 1200) since June 2014, require a different class of services. In many an instance, full-service is no longer the need; nor many of these FPIs have dedicated India Fund Managers, given the smallness of the size of the fund and high costs of employing a single country dedicated Fund Manager, in the initial phase of the fund (read FPI). In such instances, developing ecosystems and policies that facilitate ease of doing business, at lower costs, without applying some of the requirements (one size fits all-especially wrt dedicated Fund Managers) will attract more inflows from this normally considered "sticky" FPIs. India attractiveness will grow. At PIVOT, our experience on development of the Ecosystem by - promoting Global quality, showcasing local expertise, facilitating ease of access and enabling lower costs – is well received.

Developing the Eco-system also requires the development and constant nurturing of flow of information. Investors look for consistent and fair information. This is more important in the case of FPIs, as it provides to them an expert view of a different market, than their own. The almost single-handed development of this segment by Prime Database has improved significantly the confidence of the Investors- local and foreign. Additionally, consulting firms including PIVOT, by providing expert view, support this need of Investors. However more needs to be done and more frequently.

- **Visibility, Visibility, Visibility……..**

Finally, thanks to the initiatives by the Govt., Regulators especially SEBI, RBI and Income Tax Department, supported by Exchanges, clearing houses, Depositories etc. we have a throbbing and fast growing FPI segment. Current Asset valuation is of over $ 450 Billion, not counting the Derivatives volumes and inflows- these magnify the inflow number! This is a stupendous achievement. In my over 13 years as Country Manager of Securities Services of leading Global Banks, in India and Overseas, I haven't come across such a co-ordinated seamless effort in developing Capital Markets, by Policy makers and Regulators, resoundingly supported by FPIs, whose inflows keep growing.

Indian Policy makers, Regulators, SROs need to showcase the above and much more, through multiple touch points- the Indian Consulates; by considering the above listed suggestions; enabling the roll out of the Depositary Receipts announcements of year 2014 and more importantly creation of an 'Indian paper' (I mean a survey and not a negotiable instrument) that can be consistently used to position India across boundaries to all classes of Investors. Visibility creation until now has been limited and sporadic. Likewise, Investors would do better by leveraging the significant ease of doing business, at lower costs, lower challenges and of higher opportunities.

Though we still have a way to go in enhancing inflow, I believe enhancing what's well started, aspire and enact what needs to be done can …...

…. assist in rollout/project India as, 'Gods own country for FPI Investors'!!