FPIs in our Capital markets

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Key highlights of the FPI Policy

Under the FPI regime which went live on June 2014, Securities and Exchange Board of India ("SEBI") has harmonized foreign institutional investors ("FIIs"), sub-accounts and qualified foreign investors ("QFIs") into a single investor class – foreign portfolio investors ("FPI") and provide a single approval for portfolio investment into India through designated depository participants ("DDPs").

- Simplified access: There is now risk-based KYC as opposed to one-size fits all approach to KYC.
- Wider opportunities: Under the concept of varying categories of foreign investors the FPI framework allows easier access to corporates, non-broad based funds, individuals and unregulated entities. There is a broader range of investors as it removes structural registration barriers. For example, for banks the erstwhile FII regulations required them to sponsor broad based funds, which is done away with under the FPI guidelines.
- Quicker onboarding and registration: The move from one approving agency to more than 18 DDPs is expected to distribute the activity and hence improve turnaround times and should allow the foreign investors to start investing early.

Categories of Foreign Portfolio Investors

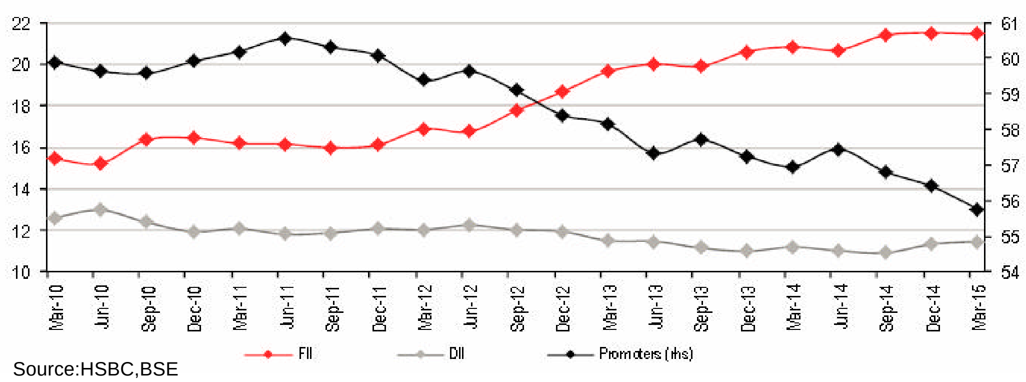
Category I	Government and Government related investors
Category II	1. Appropriately regulated broad based funds 2. Appropriately regulated persons such as banks, asset management companies, investment managers/ advisors, portfolio managers 3. Broad based funds that are not appropriately regulated but whose investment manager is appropriately regulated 4. University funds and pension fund 5. University related endowments already registered with SEBI
Category III	All other investors not eligible under Category I and II (such as endowments, charitable societies, charitable trusts, foundations, corporate bodies, trusts, individuals and family offices)

Trends in Foreign Portfolio Investment

Top jurisdictions for FPI Investments in India

While observing the category of FPI equity investors and mapping the funds to investor domiciles since 2012, USA, Mauritius, Luxembourg and Singapore continue to be the top domiciles. Total Assets from top 10 domiciles continuously increased on an average. Ireland is the new domicile to enter top 10 domiciles since 2014 whilst USA has been the top domicile since 2013 with total assets growing consistently.

Ownership pattern of BSE 200 companies (%)

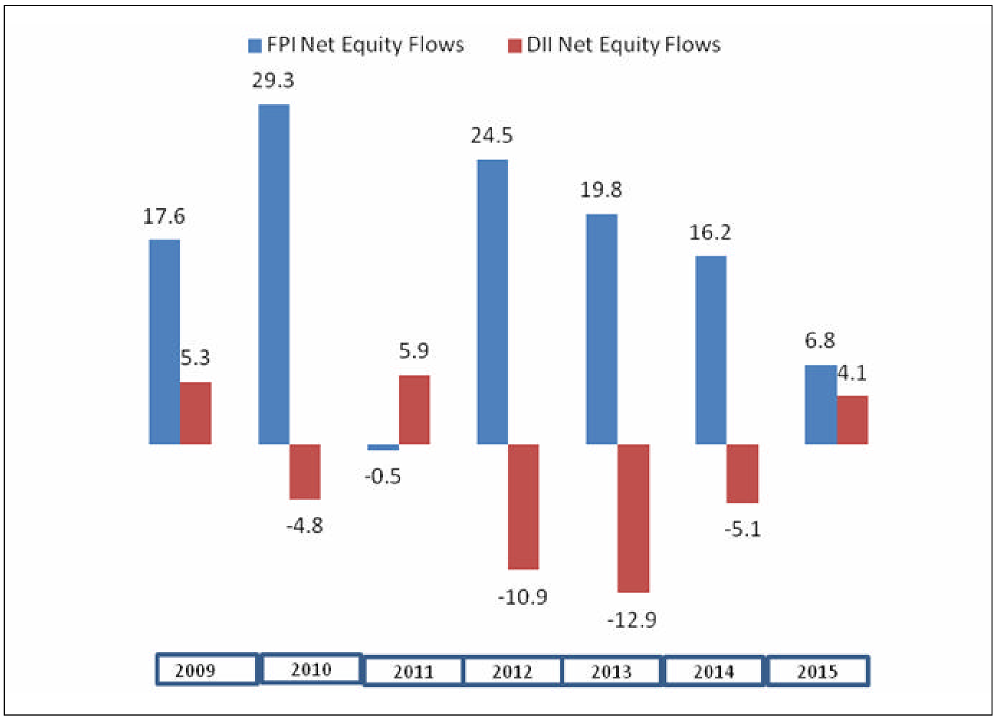


Source:HSBC,BSE

FPIs have remained the key driving force for the market over the past 4-5 years. FPIs investment as percentage of total Indian Equity market capitalization has progressively increased. Currently FIIs own more than 20% of the overall market capitalization, up from the 15% in 2009. In term of overall free float market cap, FIIs currently own more than 40% of the total BSE market cap. The consistent increase of their ownership showcases the faith of FPIs in Indian Capital market. The total FPI investments as at end May 2015 are in excess of USD 378.23 Bn and are large commitments for the Indian market.

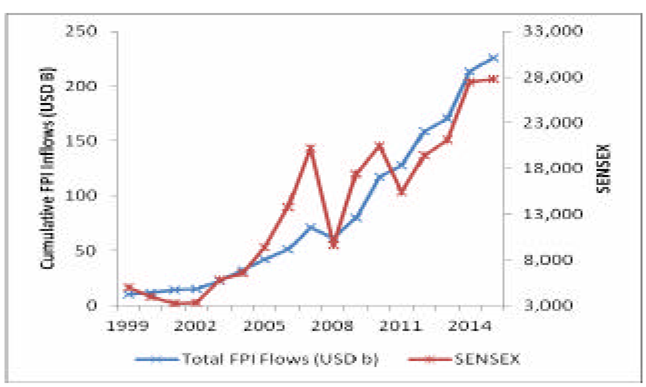
Comparison of FII Flows vs DII flows in Indian Equity Capital markets since 2009 reflects higher periods of positive flows compared to DIIs. FPIs continue to add stake in Indian companies. In 2014, FIIs added USD16bn to Indian equities after injecting USD20bn in CY13. Whilst FPIs have contributed to market growth, it is also noticeable that Domestic Institutional Investors (DIIs) have been increasing activity and share in the market from 2H14 onwards.

USD Bn



Source : SEBI

Interest in India continues with foreign portfolio investors investing aggregate approx USD 13 Bn into India in the calendar year period till June 2015. The graph captures the FPI flows in to the market since 2009 and provides an indication of the extent of the correlation between the stock market index and FII/FPI activity. Historically we have seen a positive correlation between FIIs flows and Returns from the Sensex



Source: CDSL /NSDL / SEBI

Trends in Fixed Income investments by FPIs

Foreign investor appetite for Indian bonds in the last one year has been immense amid expectation of interest rates cuts and a stable currency. FPIs have exhausted their investment quota in the government debt segment and have topped over 75% limits in the corporate debt segment. There is a material change over past 18 months in the direction of flows into greater fixed income participation and appetite here remains strong.

FPI framework

Apart from enthusing a wider set of investors to consider accessing the Indian market, the change of framework importantly, signals to an even larger set of existing investors that their views have been heard. Foreign investors had shared their challenges with the prescriptive nature of documentation needed in India to establish KYC. The new risk-based approach to KYC for institutional regulated portfolio investors is in significant alignment with global norms and a result of the coordinated efforts across various departments and regulators. FPI rules and the simplification achieved on the KYC front are examples of how different departments of the government have coordinated and aligned their approaches to achieve a common goal.

While FPI regulations make a strong case for sustained improvement in the manner of access to the Indian markets, they have also made India more easily accessible to Banks and Investment Managers with the removal of structural access requirements, which should bode well for the corporate and government debt securities market.

The overall FPI framework is set out in a manner that will be viewed as an evolutionary change in the context of the Indian capital markets. After a year of implementation of FPI regime it can be said that the market participants including the DDPs, depositories and the stock exchanges have been able to progressively integrate their activities and resolve in excess of 150 queries through a well-established FAQ process with the Regulator. Hence significant progress has been made by the industry though it been a period of learning across various stakeholders and FPIs involved. There remain areas to focus to further simplify the process and this remains a subject of industry discussions which are focused to address documentational challenges. This is also exacerbated by the market wide up-dation of the KYC getting linked to the FPI conversion process and is an area of consideration to further simplify the documentation process.

Conclusion

Foreign investor flows are large stakeholders in India’s success and also very important to the Indian Capital market and economy aiding lower cost of capital, greater liquidity, better asset price determination and a vital ingredient to our forex reserves.

India remains a material emerging market for investors by virtue of its well-developed capital market with competitive, wider availability of listed entities across range of sectors and underlying macro growth.

While the market is attractive for FPIs, it should be noted that FPIs consistently benchmark against other emerging markets and hence the ease of investing should be consistently benchmarked against other emerging markets to ensure that we remain attractive.

There are a few key considerations to ensure that liquidity improves and the foreign investor flows continue their upward trend like availability of Indian Government Debt limits, progressive inclusion of Indian fixed income in Bond Indices, predictable and stable tax regime and greater number of Issuances and listing in the markets.

Implementation of FPI has put responsibility on market participants and need for clarity around various situations. However the response of the market authorities with consistent market level detailed FAQs and resolving each specific situation to ensure that investor interests are protected and entry facilitated has not gone unnoticed. Whilst jurisdictions which permit omnibus structures and low level of disclosures are easier to access, India with its segregated account structures and disclosures is still not the easiest market to access but has made strong steps. It is this directional movement which is important to sustain and to make sure that the road travelled by investors is consistently enabled for better speeds and efficiency.

Mr.Kapil Seth is Managing Director and Head - India (HSBC Securities Services) and the views expressed here are personal