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Foreign investor count little changed since 2013

Contrary to belief, most new investor additions on account of FII to FPI conversion

Pavan Burugula | Mumbai June 28, 2017 Last Updated at 20:01 IST

The foreign investor count in the capital markets has remained about the same in the past four years, despite overhaul of regulations to ease the entry process.

At the end of May, there were 8,781 foreign institutions. Of which 7,807 were foreign portfolio investors (FPIs) and 974 were deemed-FPIs (foreign institutional investors, yet to transit to the FPI regime). In December 2013, before the new FPI regime took effect, there were 8,557 FIIs, including 6,410 sub-accounts.

This is in contrast to the popular perception that the foreign investor base has increased significantly in recent years, after introduction of the FPI regulations by the Securities and Exchange Board of India (Sebi).

Regulators and market players tend to claim there has been a sharp increase in direct FPI registration, following tightening of the participatory notes (p-notes) framework. The surge, however, is more on account of transfer of erstwhile FIIs to the new FPI regime, rather than a drastic increase in new investor count, shows analysis of data from Sebi.

Custodians say the actual number of new investors which have entered the Indian market in these years could be less than 500. This, too, could be seen only as offsetting the foreign funds that have shut shop due to tightening of various regulations.

In January 2014, Sebi discontinued the old FII regime and notified the new FPI regulations. The regulator gave the entities a time of three years to transit to the new regime. This time frame elapsed in March this year. Hence, there was a rush towards the end among foreign funds to convert. This led to a near doubling of total number FPIs between March 2016 and March 2017, say sectoral entities.

"We have seen a lot of foreign institutions exit Indian markets, especially in the sub-accounts space which largely consisted of small and medium size investors. Under the new FPI regime, there is no concept of sub-accounts; an overseas investor has to either register as an FPI or subscribe through p-notes. However, the compliance burden is high in both these routes," said a custodian with a foreign brokerage.

Sub-accounts are entities that include foreign companies, foreign individuals and institutions, funds or portfolios established outside India, on whose behalf FIIs make investments here. This was a preferred route for small-size investors, as the participation costs were less than for an FII registration, and there were also relaxations given in terms of compliance.

Global reasons

Experts say this stagnancy in the foreign investor base could be more on account of global factors than domestic reasons, as Sebi has been working to simplify the rules for FPI participation in Indian markets.

"The markets regulator has introduced several measures to improve the attractiveness of direct portfolio investments. While the regulator now permits retail-type participation in the Category-III FPI format, in a phased manner they have been simplifying the registration process, ongoing reporting and compliances. From a tax perspective, too, certain categories of FPIs have been given certainty on the indirect transfer issue," said Richie Sancheti, head of investment funds practice, Nishith Desai Associates.

After the Lehman Brothers crisis, the focus of a lot of foreign funds shifted towards emerging markets such as India, Brazil and China. However, due to less-than-expected return from some of these markets, many investors exited.

Big got bigger

Interestingly, the value of foreign investments has shot up significantly during the period, even as the number of investors remained the same. This was on account of heavy buying by the big-ticket FPIs. The total value of stocks owned by foreign institutions in Indian equity markets has increased multifold to Rs 53.3 lakh crore in May 2017 from Rs 13.3 lakh crore in December 2013, depository data show. The stake of big-ticket FPIs has also increased significantly during the period. The share of the top 50 in total FPI investment has increased from 22 per cent to the current 36 per cent.

The value of holdings of Europacific Fund, largest FPI in the country, surged to Rs 54,392 crore in the quarter ending March 2017 from Rs 21,423 crore in the quarter ending December 2013. Similarly, the market value of the Government of Singapore's holding had gone up to Rs 29,206 crore in March 2017 from Rs 14,822 crore in December 2013. The benchmark Sensex had gone up 46 per cent during the period.