Regulation Asia

Roundtable

How Regulatory Easing is Attracting Global Capital to India

Indian regulators' forward thinking on market participation and products benefits investors and infrastructure providers alike

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Indian regulators' forward thinking on market participation and products benefits investors and infrastructure providers alike.

A combination of regulatory developments on foreign investment, available products and increasing uncertainty around China's capital markets is rapidly making India Asia's go-to destination for international capital.

Last week Regulation Asia held a roundtable discussion with senior management from BSE Limited, operator of one of the country's two major exchanges, ICCL, which runs the second largest clearing corporation in the securities market, Stock Holding Corporation of India, the largest custodian and depositary participant, and PIVOT Management Consulting, a leading consulting firm in securities services to assess the most recent developments and prospects for the market.

Creating the right environment

The introduction of the FPI (Foreign Portfolio Investor) scheme has drawn international investors' attention to Indian capital markets as it has made the process of investing much easier. Prior to FPI's introduction in 2014, only specific categories of foreign institutions and individuals could only invest in India, and in limited products.

The scheme is split into three categories of investors, which require varying degrees of KYC. Category 1 includes government and government-related foreign investors, international and multilateral organisations. Category 2 includes regulated institutions or those with an appropriately regulated investment manager.

According to BSE's recent handbook, **FPI - Easing Access to India**, FPI investors now have a five step process, some of which can start simultaneously, before starting to invest register for tax; complete FPI registration; open a depository account and obtain a CP (custodial participant) code; open a trading account and remit money.

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> - Laxamanan Viswanathan, Stock Holding

Laxmanan Viswanathan, executive vice president and CFO of Stock Holding Corporation of India, notes that several approvals which had been arduous are now little more than formalities, adding that it typically takes an institution 20 days – or less if the FPI already registered for tax – to complete this process.

Uncertainties over tax were recently eased further when the government of India clarified that FPIs would not be subject to MAT (minimum alternative tax) on their investments.

"We have tied up with the 'Big Five' tax consulting firms but can also refer FPIs to a local tax consultant," Viswanathan says. "Resolution of MAT makes it a very easy process which involves us providing transaction certificates to their systems and repatriating the assets as early as the day after settlement."

As well as making it easier for international investors to access Indian markets, regulators have pro-actively made substantial efforts to increase their investment options.

Viraj Kulkarni, founder of PIVOT Management Consulting and former head of securities services at Citibank, notes that regulatory easing has also allowed rapid expansion of the suite of investment products being sold in India.

"A combination of government policies and capital markets infrastructure development has considerably eased access to the market. Foreign investors have been able to move from being able to invest in a single product, equities, to multiple products," he says.

"I believe enabling custodian banks concept and framework, will hasten the development of capital market infrastructure as it will result in greater operational efficiency, lower costs to investors, remove duplicity of documents, better risk management, faster entry process to name a few. This will also mean that India follows the global model with regards to custodian bank setups and universal banks which render custody services"

"This has been supported by government and infrastructure and the preparedness of custodians, brokerages taxation firms, legal firms and the banking industry"

In the last year there has been a 12 percent increase in the number of foreign institutions investing in India via the FPI scheme. In effect, between June 2014 and August this year about 1,040 institutions entered India to invest in secondary markets, Kulkarni adds.

As well as interest from FPIs, pensions reform is also drawing money into India's capital markets, according to Stock Holding Corporation vice president Ram Anand.

"The largest pension fund, the Employees' Provident Fund, is allowed to invest 5 percent of its portfolio in equity, usually ETFs, and the National Pension Scheme is larger so can invest up to 30 percent in the equity market and has also set up separate, 100 percent equity schemes," he says.

New frontiers

The next levels of development will come from a combination of financial sector reform, market infrastructure development and further product advancements, the panellists believe.

On the first front, there is already major restructuring underway with India adopting Basel III standards, with confirmation from

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the government expected within the next two months.

"This will have an impact on capital and financial markets. The latter is mostly the debt markets – corporate and government bonds – with both equally well traded," says Viswanathan. "The appetite for government bonds is tremendous, with state-issued paper coming into demand and being subscribed to."

"Limits on the amount foreign investors can invest in government debt have been continuously raised over the last few years which shows the appetite there is for Indian paper," adds Anand.

On the product front, the emergence of IPOs by start-up companies is attracting domestic and overseas capital, as is India's currency market, already the second largest in the world.

"Currency derivatives have picked up tremendously and as a new product for BSE we are actively competing here and has gained significant market share. It is a good, competitive product as the market is looking at it from both the main

"A combination of government policies and capital markets infrastructure development has considerably eased access to the market. Foreign investors have been able to move from being able to invest in a single product, equities, to all products."

- Viraj Kulkarni, PIVOT Management Consulting exchanges," explains Neeraj Kulshrestha, chief of business operations at BSE.

Equity derivatives are also increasingly popular, and regulators have introduced upfront margin and clearing requirements to ensure market safety, although Kulshrestha points out that the market is currently dominated by individual rather than institutional investors given the small minimum contract size. However, here again India's regulators are looking to foster more long-term, institutional investment.

"India has the second highest ratio of equity derivatives to equity turnover after Korea, at 34x versus 14x, and there is no certification requirement to trade in derivatives, which could be seen as a bit dangerous," says Piyush Chourasia, ICCL's chief risk officer and head of strategy.

"One of the steps the regulator took [to secure the market] was to increase the contract size to INR500,000 (USD7,556) from INR100,000. If you are doing an options contract you still don't need to pay too much but it is a step in the right direction."

On the flipside, authorities have been slower to convince individuals to look at investments that are conventionally seen as less volatile and less risky.

"Government securities (issued by India's central bank) are 100 percent subscribed to by banks and primary dealers and they hold to maturity as part of their reserves," explains Chourasia.

"Retail investors should be able to invest directly in these as it would have multiple effects, including better secondary market liquidity which is lacking in India in any bond market."

Commodity markets look set to be the next phase of development, although FPIs cannot yet invest in the sector, with the groundwork laid by the recent absorption of the FMC (Forwards Market Commission) into SEBI (the Securities and Exchange Board of India).

"This is putting in place proper risk management systems and regulatory overview. Now the regulatory change has occurred SEBI is looking at allowing FPIs to enter once the framework is in place," Anand points out.

"The choice for the government was to either empower the commodities regulator and wait for it to learn or to merge it with a regulator that is already experienced and mature," adds Kulshrestha.

India Lines up Level Playing Field for Traders

BSE, operator of one of India's two main stock exchanges, has used creative thinking in an attempt to address concern that HFTs (high-frequency traders) gain an unfair advantage.

At its colocation centre in Mumbai, it has given all traders the exact same length of cable to connect their terminals to the exchange's servers regardless of where they sit.

"We ensured democratisation by making every connection the same," says Neeraj Kulshrestha, BSE's chief of business operations. "Everyone has an equal length of cable wherever they are located in the room. If you are closer to the server, we will roll up the cable and put it under your desk … but everyone's the same distance away."

He and colleague Piyush Chourasia, BSE's chief risk officer and head of strategy, say it been keen to stress to regulators that exchange access should be democratised, although Kulshrestha notes SEBI and BSE have an open mind on the HFT question.

"We do not provide any separate order types for HFT and there is no bifurcation," Chourasia says. "Anyone can come and use the same feature at the same cost and will get the same speed."

That speed, in short, is super-fast, as BSE now believes it has the quickest response time of any equity exchange in the world, having taken on a Deutsche Borse trading system which the German firm uses only for derivatives.

"It started at 200 milliseconds, went to 200 microseconds and lately we have brought the time down to just six microseconds," says Kulshrestha.

"We encourage anyone who wants to use the market to come, and provide them the opportunity to host a server and start trading."

"This provides a good counterfoil to foreign institutional investors and FPIs, as it is important for the health of any market that it is not reliant on one source of flows."

- Neeraj Kulshrestha

As long as rules are in place that are transparent, even if they are conservative, and the regulator has a decent reputation there should not be any problems. SEBI has had the wherewithal in areas like equity derivatives and all that professionalism can now be extended to commodities."

For its part, BSE offers a single platform through which FPIs, domestic institutional and retail investors are able to access the growing variety of products on offer in India.

"There will be more regulation, but on the flipside there will be more products, and more importantly in a year or so we will probably have single platforms for all products. Today the commodity and stock exchanges are separate, and even if you want to trade as a broker-dealer you still require two legal entities which is a big hassle," says Chourasia.

"Having a common clearing house across asset classes will create a lot of netting benefits so cost will come down for market participants."

China's loss, India's gain

Just as the easing of capital markets regulation by SEBI over recent years has been a major factor in drawing international money into India, the country is now also benefiting from concerns that one of its major rivals in the global economy, China, is rolling back measures to open its borders to overseas money.

In the first place, India's equity market is typically less volatile than those in China, driven by a healthy balance of local institutional and retail money, and international investors, the panellists believe.

"Indian institutional investors will typically be local mutual funds and insurance companies, which are very big investors in equities and have been in the market for a very long time," says Kulshrestha.

"This provides a good counterfoil to foreign institutional investors and FPIs, as it is important for the health of any market that it is not reliant on one source of flows."

China's stock market meltdown, which prompted the regulatory rollback, did not impact Indian equity markets as much as it did those in the US or elsewhere in Asia such as Singapore and Hong Kong.

"In India we see duration of investment is much longer, and foreign investors no longer seem to be running away at signs of change," says Chourasia. "The Fed's upcoming increase of interest rates will mean more outflows of money across global markets but we are not too concerned about it."

"There must have been some reason China chose the path it did to manage the situation," adds Kulshrestha. "Sitting in your 'drawing room' it is easy to say they could have done this or that but it did rattle people, and there has been a reassessment of risk."

None of this would be possible without the strong growth of the Indian economy.

"The government is making the right kind of investments and spending a huge amount on sectors like infrastructure and power. This will have a cascading effect on other industries which will in turn further improve capital market flow," Viswanathan concludes.

This article was written from a roundtable hosted by Regulation Asia and partenered by BSE, ICCL, Stock Holding Corporation of India and PIVOT Consulting in Hong Kong in November 2014. The event was moderated by Samuel Riding, Editor, Regulation Asia

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Roundtable Participants

Neeraj Kulshresta, Chief of Business Operations, BSE

Neeraj Kulshrestha joined BSE as Chief Operations Officer in 2015. He is responsible for Trading (Operations and Development), Listing (Sales and Operations), Membership and IT operations. He is a member of the Executive Management Committee of BSE and is on the Boards of Indian Clearing Corporation Limited (ICCL) and Asia Index Private Limited.

He has completed his Bachelors in Computer Science from Delhi University and a MBA (Finance) from Indore University.

Piyush Chourasia, Chief Risk Officer and Head of Strategy, ICCL

Piyush Chourasia is the Chief Risk Officer and heads the Strategy function at ICCL. He is responsible for setting up and implementing the risk management procedures and testing the adequacy of risk management measures with Indian as well as international benchmarks including the CPMI, BIS, IOSCO, EMIR, Dodd-Frank, among others. He is also responsible for policy making and conceptualising new product innovations including designing the risk management frameworks.

Piyush has a B. Tech from NIT Nagpur and a PGDM from IIM Ahmedabad.

Viraj Kulkarni, Founder, PIVOT Management Consulting

Viraj is the founder and CEO of PIVOT Management Consulting, India's specialist Securities Services Consulting firm. Viraj's Securities Service experience as India Country head at 3 of the top 5 Global Custodians and as Country Head at Citibank Switzerland provides an indepth exposure to emerging and advanced Capital Markets.He also served as Operations Head at Morgan Stanley Securities, India and BSE.

Viraj is the only Indian to receive a personal recognition for leadership in India from GLOBAL CUSTODIAN magazine through ASPAC Industry Nomination. A fellow member of the ICSI India, he is on industry commitees related to Capital Market development.

Laxmanan Viswanathan, Executive Vice President & CFO, Stock Holding Corporate of India

Mr. L. Viswanathan is the Chief Financial Officer and Executive Vice President of Stock Holding Corporation of India Ltd (StockHolding), India's largest Custodian. As a member of the Senior Management, he heads Custodian Business (an SBU), Finance, Strategy, Human Resource Development and oversee the functioning of two subsidiaries. Additionally, he is on the Board of SHCIL Projects Limited (SPL), Trustee - SHCIL Foundation. He has extensively interacted with large Institutions (Nationally & Internationally), Regulatory and Government officials. Earlier he was also responsible for setting up the Retail business. He has an overall experience of 33+ years.

Ram Anand, Vice President, Stock Holding Corporation of India

Currently Head of the Custodian Business at StockHolding, the largest Custodian in India. Anand has an overall experience of 25 + years in Custodial functions. He regularly interacts with top level officials of large Institutions, Regulatory and Government officials on various regulatory clearances and new clientele acquisitions.

He holds a Bachelor's degree in Commerce from University of Madras and a MBA from University of Philippines, Manila.