Concerns with FPI

What is the issue?

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- Singapore stock exchange and Dubai Gold and commodities exchange are planning to expand their portfolios in India.
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- These decisions are taken in a backdrop of uncertain environment for Foreign Portfolio Investments in India.
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What are recent portfolios decisions about?

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- A portfolio is a grouping of financial assets such as stocks, bonds and cash equivalents, as well as their funds counterparts, including mutual, exchange-traded and closed funds.
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- Portfolios are held directly by investors and/or managed by financial professionals.
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- Usually an investors should construct an investment portfolio in accordance with risk tolerance and investing objectives.
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- Recently Singapore Exchange (SGX) has decided to offer single-stock futures (SSF) on Indian stocks.
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- The Dubai Gold and Commodities Exchange (DGCX) is also considering expanding its portfolio of Indian SSF.
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- Volumes in India’s derivatives trading segment is expected to be adversely affected by these decisions.
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How these decisions would hurt India?

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- Unlike the National Stock Exchange (NSE) and the BSE, the SGX and the DGCX are open 24x7 and these are hard-currency environments.
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- There are no transaction taxes akin to India's securities transaction tax (STT) and the local regulators also place no restrictions on foreign portfolio investors (FPIs).
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- Given that the SGX and the DGCX offer comfortable regulatory environments, a lot of the derivatives trading volume will likely shift to these offshore centres.
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- India will lose out on tax revenue and brokerage income and traders will face disadvantage of beingresponsive.
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Whatare the barriers for FPI in India?

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- In July, SEBI banned trading in derivatives via P-Notes and demanded direct registration of FPIs carrying out derivatives trades.
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- The regulator said derivatives trading via P-Notes would be allowed only to hedge underlying cash positions.
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- At the time of the ban, P-Note holders had open positions of over Rs 40,000 crore in the futures and options segment of the NSE, all of them where closed out after this move .
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- A further barrier for US-based funds was that they cannot take direct exposure to derivatives offered by Indian exchanges, which are not approved by America's Commodity Futures Trading Commission (CFTC).
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- Many used P-Notes to bypass that requirement, as both SGX and DGCX are CFTC-approved and Indian exchanges are not.
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- High Securities Transaction Tax (STT) in India is being another source of friction for FPIs, which are being significant cost for high-volume traders.
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Source: Business Standard

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Quick facts

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FPI

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- Foreign portfolio investment (FPI) consists of securities and other financial assets passively held by foreign investors.
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- It does not provide the investor with direct ownership of financial assets and is relatively liquid depending on the volatility of the market.
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- Foreign portfolio investment is different from foreign direct investment (FDI).
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Participatory Notes (P-Notes)

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- These are financial instruments used by investors or hedge funds that are not registered with the Securities and Exchange Board of India (SEBI) to invest in Indian securities.
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- Any dividends or capital gains collected from the underlying securities go back to the investors.
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- Indian regulators are against participatory notes because they fear that hedge funds acting through participatory notes will cause economic volatility in India's exchanges.
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SSF

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- Single Stock Futures (SSF) are derivatives instruments that give investors exposure to price movements on the underlying share.
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- A futures contract is a legally binding agreement that gives the investor the ability to buy or sell an underlying listed share at a fixed price on a future date.
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STT

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- Securities Transaction Tax is levied on every purchase or sale of securities that are listed on the Indian stock exchanges.
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- This would include shares, derivatives or equity-oriented mutual funds units.
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- The rate of tax that is deducted will vary with different types of transactions and securities.
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- STT is deducted at source at the time of the transaction itself, the net result is that it pushes up the cost of the transaction done.
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