Uptrend in FPI Inflows

Why in news?

Due to increased flow of FPIs the Sensex market is close to its life time peak.

What is FPI?

- Foreign portfolio investment (FPI) consists of securities and other financial assets held by investors in another country.
- It does not provide the investor with direct ownership of a company's assets and is relatively liquid depending on the volatility of the market.
- Along with foreign direct investment (FDI), FPI is one of the common ways to invest in an overseas economy.
- FDI and FPI are both important sources of funding for most economies.

- In a developing economy foreign portfolio investors (FPIs) are perceived to be more fickle than domestic institutional investors.
- Thus foreign investment flows do tend to be less stable as these are influenced by global liquidity drivers.

What is the status of FPIs in India?

- Assets of FPIs increased by Rs. 3,19,766 crore between February and May 2019.
- Mutual fund assets increased by a far lower Rs. 1,24,856 crore in this period.
- The FPI assets between February and May, the largest increase in assets has been recorded by foreign mutual funds, whose assets have increased by Rs. 1,56,657 crore in the four-month period.
- Similarly, pension funds, who invest for the long haul, also registered an increase of Rs. 25,859 crore, these are long-term investors.
- Category I foreign portfolio investors, which include multi-lateral organizations, foreign banks and government agencies, have also grown their assets by Rs. 44,180 crore implying that these larger investors too became hopeful about the prospects of the country with stability restored in the Central government.
- The increase in assets based on the country of origin of the FPIs, investors

from the US seem to have made the maximum amount of investment between February and May this year, with their AUC (assets under custody) increasing Rs. 1,23,018 crore.
- Investors from offshore financial centers such as Mauritius, Luxembourg and Singapore witnessed a far lower increase.

What are the reasons behind increasing flow of FPI?

- FPI flows into the Indian equity market since February has seen increased money flow from foreign investors with a longer investment horizon, belonging to the less risky categories.
- Also, fund flows from low-tax jurisdictions have been receding.
- The inference is that the regulatory tightening over the last few years has helped sanitize this channel considerably.
- SEBI's moves seem to have curbed the short-term and risky varieties of foreign portfolio flows.
- Share of the opaque participatory notes has declined from more than 50 per cent of FPI assets to 2.4 per cent due to higher disclosure requirements and clamp-down on opaque structures.
- Tax evasion and money laundering through brass plate companies set up in offshore financial centers has also been addressed with the tweaking of the DTAA (double tax avoidance agreement) with Mauritius and Singapore in 2017.
- Capital gains recorded on shares purchased after April 1, 2017, by investors from these countries have become subject to tax from FY18.
- However, a 50 per cent concession on the tax rate was given on gains made from April 1, 2017 to March 31, 2019, if the investors show that they have a substantial presence in the country of origin.
- From April 1, 2019, these investors will be taxed at the full domestic capital gains tax rate.
- The General Anti Avoidance Rules (GAAR), that became effective from April 2017, is another reason why dubious inflows posing as FPI flows might have reduced.

What lies ahead?

- The large inflows into mutual funds since 2015 had led to the expectation that domestic mutual funds will be able to support the equity market even when foreign flows turn adverse.
- But with flows into MFs turning more muted and sensitive to fund performance over the last year, the market will once more turn to FPIs for

liquidity support.

- While the foreign flows in 2019 were driven by domestic factors, it needs to be noted that these flows are largely a function of global liquidity availability, which in turn depends on global central bank policies.
- If central banks move towards a tightening stance again, these flows will be affected.
- Intensification of trade war, geo-political tensions, and so on, can also throw a spanner in the works.
- On the positive side, India's demographic advantage and faster growth numbers will continue to be a draw for investors from developed countries, ensuring inflows over the long-term.
- In short, the dependence on FPI flows has rendered our market more vulnerable to short-term fluctuations, the flows are from more legitimate sources now.

Source: Business Line

Quick Fact

Brass Plate companies

- A brass plate company or brass plate trust is a legally constituted company whose only tangible existence in its jurisdiction of incorporation.
- It is common for Corporate Service Provider CSPs (legal, accounting or secretarial etc.) to have hundreds of brass plate companies legally registered at their office.
- Brass plate structures are associated with tax havens, corporate tax havens and offshore financial centers.