MARKET COMPASS FOR INDIA

SHARE IN THE GROWTH STORY

BNP PARIBAS

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for a changing
world

REPUBLIC OF INDIA

India has set itself a formidable task in seeking to double its Gross Domestic Product (GDP) to USD 5 trillion by 2024 via its union budget 2019-20. The government acknowledges that it will need fiscal prudence, improved access to capital markets, and financial markets empowerment. It will also require higher infrastructure investment, measures to improve ease of doing business along with the implementation of economic and governance reforms. International investors have highlighted the need to remove barriers to foreign participation in India's debt capital market, to reform tax and regulatory systems, and to encourage a greater role for foreign investors in the economy.

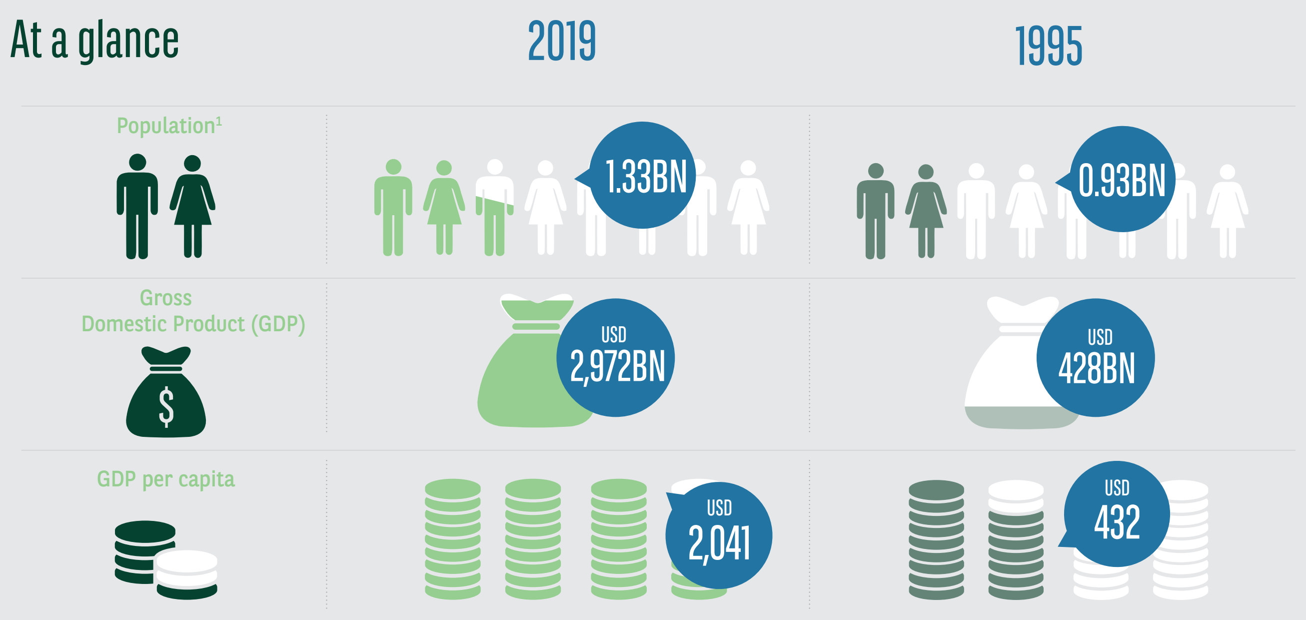
Despite the challenges, confidence in India's political and macro-economic stability has increased making it a viable emerging market destination for global investors. The government has taken key steps by creating schemes and policies to boost foreign investment in various sectors, easing regulations related to foreign investment, and providing guidance to investors with regards to infrastructure availability and market structure. It has also made foreign direct investment easier by permitting investment via automatic route. The range of regulations and operational guidelines put in place in 2019 by the securities market regulator, the Securities and Exchange Board of India (SEBI) is a testimony to the efforts to boost foreign investment.

A growing and well-diversified economy

India has a rich cultural heritage of multiple languages and traditions. It is the seventh largest country by area and is the world's largest democracy with estimated population of 1.38 billion in 2020[1]. It is the third largest country by purchasing power parity (PPP) and is the sixth largest economy by GDP.

In recent years, India has created a more welcoming business environment. Its rank in the World Bank's Ease of Doing Business index – which assesses how conducive each of 190 nations' regulatory environments are to starting and operating a business – rose to 63 in 2019, up from 130th place in 2016. Its reforms have placed it in the top 10 most-improved nations for the third consecutive year, according to the World Bank's *Doing Business* 2020 report.

The country's flourishing agricultural, information technology and quality services sectors have given a strong impetus to its economy, while its youthful population is driving demand and growth in its services sector.



[1]United Nations Department of Economic and Social Affairs. See: https://population.un.org/wpp/Download/Standard/Population/

THE FINANCIAL MARKETS

India's key regulatory bodies

The Securities and Exchange Board of India (SEBI) is the regulatory and registering authority for the various intermediaries and institutional investors connected with the securities market, e.g. brokers, mutual funds, foreign portfolio investors, domestic and custodians.

The Reserve Bank of India (RBI) is India's central banking institution and performs various functions such as:

- The monetary authority
- The regulator and supervisor of the financial system
- The manager of foreign exchange
- The issuer of currency
- The regulation of operations on foreign currency accounts or special non-resident rupee (SNRR) accounts held by foreign portfolio investors (FPIs).

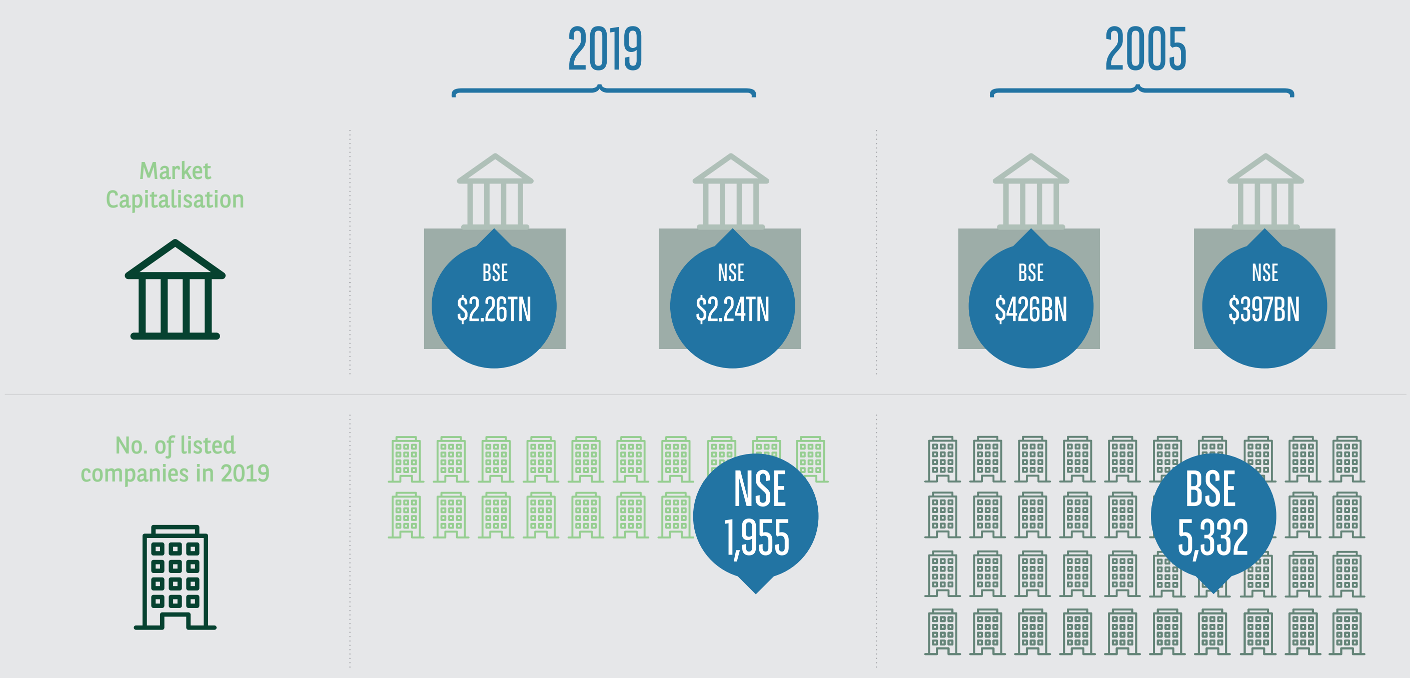
Though stock exchanges fall within SEBI's overall regulation, they are self-regulatory organisations with their own rules, regulations and bye-laws administered by their boards of directors. They are also responsible for ensuring orderly, transparent and fair trading practices, controlling the admission and expulsion of members, maintaining investor protection and addressing investor grievances.

Stock exchanges

The two major stock exchanges in India, the **National Stock Exchange (NSE)** and the **Bombay Stock Exchange (BSE)**, play pivotal roles in the development of India's financial industry along with the **Metropolitan Stock Exchange (MSE), the National Commodity and Derivatives Exchange (NCDEX) and Multi Commodity Exchange (MCX).**

The NSE and BSE have similar market capitalisations, and India's major companies are listed on both. The BSE, founded in 1875, is well known outside of India; thanks to its Sensex index which provides a snapshot of Indian markets. The NSE, created in 1994, handles 80 per cent of daily transactions in India. In 2016, two new international stock exchanges were created to grow financial markets and attract capital – the India International Exchange (India INX) and the NSE International Exchange Ltd (NSE IFSC). Both are located in Gujarat, Gandhinagar at Gujarat International Finance Tec (GIFT) City.

Market capitalisation of the two major stock exchanges



Source: World Federation of Exchanges,2019, www.knoema.com and SEBI bulletin

Post trade infrastructure

Both NSE and BSE have their own clearing houses, NSE Clearing Ltd (NCL) and the Indian Clearing Corporation Limited (ICCL) respectively. The Clearing Corporation of India Ltd (CCIL) acts as the central counterparty for trades undertaken on the RBI's dealing system.

There are **three depositories**:

- National Securities Depository Limited (NSDL) for equities, mutual funds, soreverign and non-sovereign securities
- Central Depository Services Limited (CDSL) for equities, mutual funds, soreverign and non-sovereign securities
- RBI's Public Debt Office for sovereign securities.

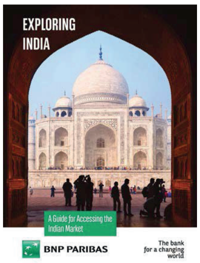
Securities are dematerialised and are held at the depositories on segregated securities accounts, whereas sovereign debt is held with the RBI in bearer form.

Equities settlement takes place on a T+2 basis. Non-sovereign debt settlement cycles range from T to T+2; depending on the marketplace and the debt type. Sovereign securities are settled on a T+1 or a T+2 basis.

SETTLEMENT CYCLES	
Equity	T+2
Mutual Fund	T+1
Non-Sovereign Debt i.e. Corporate Bonds	T+1 or T+2
Sovereign Debt i.e. Government Securities	T+1 or T+2

CUT OFF TIMES OF DIFFERENT SEGMENT (AS PER IST)		
Equity	Pay in	10.30 am
	Pay out	12.30 pm
Mutual Fund	Pay in	02.00 pm
	Pay out	07.00 pm
Non-Sovereign Debt	Pay in	02.00 pm
	Pay out	By 4.00 pm
Sovereign Debt	Pay in	01.00 pm
	Pay out	By 2.00 pm

A SIMPLER INVESTMENT REGIME FOR FOREIGN INVESTORS



In 2014, SEBI created a new investor class, called the **Foreign Portfolio Investor (FPI)** to facilitate foreign investments into India's securities market. The FPI merged the three previous classes: Foreign Institutional Investors (FII), sub-accounts (SA) and Qualified Foreign Investors (QFI). SEBI's enactment in 2019 of the SEBI Regulations for Foreign Portfolio Investors further streamlined the FPI regulatory regime, simplifying the registration process and rationalising KYC compliance and regulatory impositions on FPIs.

Who can be a FPI?

There are now two FPI categories:

CATEGORY I	CATEGORY II
• Government and government-related investors such as central banks, sovereign wealth funds, international or multilateral organisations. • Pension funds and university funds. • Regulated entities including insurance or re-insurance entities, banks, asset management companies and investment managers/ advisors, portfolio managers, broker dealers and swap dealers. • Regulated funds set up in a Financial Action Task Force (FATF) country. • Unregulated funds set up in an FATF member country, provided that the Investment Manager (IM) of the fund is regulated and registered as a Category I FPI. • University endowments set up in an FATF member country, provided the endowment has been in existence for more than five years. • Any entity whose IM is from an FATF member country and is also registered in India as a Category I FPI. • Entities whose IM is from an FATF member country and registered as a Category I FPI or entities which are at least 75 percent owned, directly or indirectly, by entities from FATF member countries and mentioned in bullet-points 2 and 4.	• Regulated funds that have not been set up in an FATF member country. • Endowments and foundations. • Charitable organisations. • Corporate bodies. • Family offices. • Foreign individuals. • Regulated entities (e.g. private banks) investing on behalf of their clients. • Unregulated funds. • Any other investor that meets the FPI eligibility criteria but does not qualify as Category I.

Get in touch with our BNP Paribas experts

Our client onboarding team can answer your queries about FPI registration and KYC documents. They are also responsible for the migration of accounts from other custodians, and for keeping track of FPI renewals to ensure that the FPI remains compliant.

1. Non-members of the Bank for International Settlements (BIS) central banks are now permitted to register as FPIs.
2. Offshore funds set up by Indian mutual funds also need to register in India as FPIs.

THE FOUR STEP PROCESS

Step 1: How to set up as a FPI

For FPI registration and account opening in India's capital markets, an FPI is required to appoint a **Designated Depository Participant (DDP)** and a custodian.

The DDPs are responsible for issuing the FPI registration according to the regulations and can do so on behalf of SEBI.

The custodian mainly undertakes to:

1. Safekeep the FPI's assets and provide reports to the FPI
2. Monitor the FPI's investments.
3. Provide daily reports to the depositories and SEBI regarding the FPI's transactions.
4. Maintain records and documents, and report the FPI's holdings to SEBI.

Additionally, the FPI must also appoint an Authorised Dealer bank (AD bank) to manage cash related activites, a broker for trade execution, and a compliance officer.

Get in touch with our BNP Paribas experts

BNP Paribas is authorised by the regulator to issue FPI registrations. A dedicated team can help you to meet all of the KYC requirements and fulfil regulatory requirements

At BNP Paribas, we provide a one-stop solution that includes onboarding, banking alongwith Foreign exchange, a trading platform, clearing and settlement, safekeeping, proxy services, accounting and tax support.

Step 2: Fees for FPI registration and renewal

The cost of a Category I FPI registration or renewal is USD 3,000. For Category II, it is USD 300.

FPI registration fees are not levied on international or multilateral agencies (such as the World Bank) that qualify for international privileges or immunities.

Failure to pay SEBI's FPI registration fees after three years will be deemed as a surrender of registration provided there are no remaining balances in the FPI's cash or depository accounts.

Step 3: Eligible instruments to invest as an FPI

FPIs are permitted to invest in almost all types of listed securities including equities, bonds, derivatives, domestic mutual funds and alternative investment funds, etc. (subject to certain restrictions and caps).

INSTRUMENTS	PERMITTED FOR FPIS TO INVEST
Fixed Income	• Dated government securities • Treasury bills • Commercial papers • Listed and unlisted bonds • Corporate non-convertible bonds • Corporate convertible* bonds • Credit enhanced bonds • Non-convertible debentures (NCDs)/bonds which are under default • Securitised debt instruments • Municipal bonds • Perpetual debt Instruments**
Equity market	• Initial public offers, offers for sale • Listed equity, compulsory convertible preference Shares (CCPS) and compulsory convertible debentures (CCDs) • Unlisted equities# • Preference shares • Warrants • Partly paid shares • Units of mutual funds
Derivatives Contract	• Index futures • Index options • Stock futures • Stock options • Interest rates futures • Currency derivatives
Others	• Perpetual debt instruments - tier I instruments • Perpetual debt instruments - upper tier II instruments • Collective investment scheme • Asset reconstruction companies (ARC) • Security receipts issued by ARC • Units of real estate investment trusts (REITs), infrastructure investment trusts (InvITs) and Category – III alternative investment funds (AIF) • Units of equity oriented MF and debt oriented MF • Securities lending and borrowing • Rupee denominated bonds (RDB) issued outside India • RDB issued by a non-banking financial company - infrastructure debt fund • Municipal bonds • Indian depository receipts • Privately placed bonds if listed within 15 days • NCDs/bonds issued by infrastructure finance companies (IFCs) • Bonus non-convertible/redeemable preference shares or debentures subject to prescribed conditions

* Subject to additional restrictions & conditions as applicable to the specific instrument and instrument route.

\+ FPIs were initially allowed to invest in commercial papers. However, RBI vide its circular dated 6 Feb 2015 clarified that FPI are not allowed to invest in CP since the minimum residual maturity requirement for debt investment was three years. In April 2018, the minimum residual maturity requirement is reduced to one year. Further, RBI has clarified that amount invested by SEBI registered FPIs are eligible for repatriation outside India.

\# FPIs can invest in equity shares to be listed on stock exchange

** Investment in perpetual debt instruments should not exceed aggregate ceiling of 49 per cent of each issue and investment by individual FPI should not exceed the limit of 10 per cent of each issue.

Voluntary Retention Route (VRR)

The RBI introduced this scheme in 2018 to encourage longer-term investments by FPIs into the debt market. The scheme provides greater operational flexibility by easing the restrictions applicable under the General Investment route.

VRR investments are classified into three groups:

- VRR-Corp: referring to a VRR for FPI investment in corporate debt instruments.
- VRR-Govt: referring to a VRR for FPI investment in government securities.
- VRR-Combined: referring to a VRR for FPI investment permitted in both instruments above.

Foreign Direct Investment

Foreign direct investment (FDI) refers to an investment by a non-resident in the permissible instruments of an Indian company (being in either an unlisted company or in ten percent or more of the post-issue paid-up equity capital on a fully diluted basis of a listed Indian company) or in the capital of a Limited Liability Partnership (LLP).

There are two sectors in which FDI is permitted. This is split into:

- Investments under the automatic route; and,
- Investments under the government route i.e. with prior approval of the government.

Step 4: Taxation implications

The Securities transaction tax (STT) is payable on the value of a securities transaction i.e. the purchase and sale of securities through a recognised stock exchange in India. The STT is not applicable to off-market transactions. Taxation depends on the securities type (equities, fund units and futures).

Tax is payable in advance through a self-assessment process that is based on an estimate for the coming financial year (starting on 1 April). Non-corporates must pay a certain percentage of the tax in advance by different time intervals; at least 30 per cent before 15 September, 60 percent before 15 December and 100 percent on or before 15 March. Additionally, the FPI must appoint a tax consultant to manage all tax-related matters.

Category I vs Category II FPI – Key differences

PARTICULARS	CATEGORY I	CATEGORY II (INSTITUTIONAL INVESTORS)	CATEGORY II (INDIVIDUALS /BODY CORPORATE /FAMILY OFFICES)
Issue or subscription of offshore derivative instruments (ODIs)	Allowed	Not allowed	Not allowed
KYC requirement	Less stringent*	More stringent**	More stringent
Qualified Institutional Buyer status	Granted	Granted	Not Granted
Margining of trades	T+1	T+1	Upfront
Position limits for investments as follows			
Equity stock derivatives***	20% of market-wide position limits of stock derivatives	10% of market-wide position limits of stock derivatives	5% of market-wide position limits of stock derivatives
	Higher of – INR 5 billion or 15% of total open interest of the market in index derivatives	Higher of – INR 3 billion or 10% of total open interest of the market in index derivatives	Higher of – INR 1 billion or 5% of total open interest of the market in index derivatives
Applicability of overseas transfer provisions	Relaxed	Likely to be relaxed#	Unlikely to be relaxed#

* KYC equivalent to Category II FPIs shall apply to FPIs from high risk jurisdiction
** KYC equivalent to Category I FPIs shall apply to appropriately regulated Category II FPIs
*** Separate position limits applicable to equity index futures and equity index options
# Clarification from CBDT may be required

Relaxation of KYC Requirement for FPIs

In 2019 SEBI simplified KYC requirements:

DOCUMENT TYPE	KYC DOCUMENTATION DETAILS	CATEGORY - I	CATEGORY - II
Applicant level	Constitutive docs (Memorandum of Association, Certificate of Incorporation, prospectus, etc.)	Required	Required
	Proof of address*	Required	Required
	Permanent Account Number (PAN)	Required	Required
	Board resolution**	Not Required	Required
	FATCA/CRS form	Required	Required
	Registration form/KYC form	Required	Required
Authorised Signatories	List of signatures**	Required	Required
Ultimate beneficial owner (UBO)	List of UBO including details of the intermediate beneficial owner***	Required	Required
	Proof of identity	Not Required	Required

* Power of Attorney having address provided to custodian is accepted as address proof.
** Power of Attorney granted to Global custodian/local custodian is accepted in lieu of Board Resolution (BR). BR and the authorised signatory list (ASL) is not required if SWIFT is used as a medium of instruction.
*** UBO is not required for government and government-related entities.

How to repatriate funds out of India

The Reserve Bank of India has delegated and empowered authorised dealer (AD) banks to handle any remittances outside of India. As such, an FPI wanting to repatriate funds out of India has to provide the supporting documents to the AD bank in order to do so. There are a number of conditions required to make an international cash remittance, including the payment of applicable taxes prior to remittance.

Get in touch with our BNP Paribas experts

- Facilitate your international remittances.
- Clarify the related rules and processes regarding fund repatriation out of India.

How we can support you

BNP Paribas Securities Services is a multi-asset servicing specialist with local expertise in 35 markets around the world and a global reach covering 90+ markets. This extensive network enables us to provide our institutional investor clients with the connectivity and local knowledge they need to navigate change in a fast-moving world.

As of 30 September 2019, BNP Paribas Securities Services had USD 11.491 trillion in assets under custody, USD 2.759 trillion in assets under administration and 10,491 funds administered.

We are committed to delivering a high quality service. Our team in India of local experts are experienced in corporate actions, custody and reconciliations and can guide clients through the requirements of the different investment options. Furthermore, your dedicated client service manager will be on hand to support your activities in the Indian market.

FOR ADDITIONAL INFORMATION, PLEASE CONTACT

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