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PRIME
BROKERAGE SERVICES

PRIME TIME

NEWS & VIEWS

MONTHLY BULLETIN - FEB 2018

INDEX

FROM THE DESK OF - Dipesh Shah, Head Prime Brokerage & Custodial Services

Dear Patrons,

Dipesh Shah

2017 was a happening year for us all.

While we began 2017 with a lot of nervousness and caution all around, the year turned out to be one of the calmest years for the markets globally, with recovery a common theme amongst most major economies.

It was a great year for India as well, especially on the structural front. Amidst a series of structural reforms like Demonetization and GST; enactment of Insolvency and Bankruptcy Code (IBC), strong growth rate and a $2 trillion+ economy; India has poised itself for a sustained and significant compounding effect. Similar to long-term investments these reforms may not reflect immediate returns but will surely have an impact adding on to the momentum of Indian economy.

As for 2018, we expect a sustained recovery in Indian GDP growth, led by the steadfast vision of the central government striking a fine balance between growth and fiscal prudence. While there is wide-spread scepticism on earnings growth; we believe a base for broad base earnings recovery has been built and the turn in the cycle will become more and more evident as corporate profits start going up. While domestic fundamentals are strong, global concerns with regards to liquidity and balance sheet tightening of the Fed & ECB may be areas of concern. Expect heightened volatility, but overall market momentum should continue to be positive.

On the regulatory side, India access norms have been further eased in both FDI and FPI investments. Following on from the **"Easing of Access Norms"** consultation paper issued by SEBI last year and after taking into consideration suggestions from various stakeholders, SEBI last month came out with norms to further ease India access for FPIs. SEBI's forthcoming approach to take suggestions from the market participants was highly appreciated and the team at Edelweiss actively contributed in the developing the same. Further steps like Single window clearance are in the offing and this should streamline and make the overall registration process much easier.

Another important development from the Indian capital markets was ban of trading of derivative contracts based on Indian indices on overseas bourses. This joint action taken by the Indian exchanges would also lead to more investor interest in the exchanges set up in Gift City, which is India's first international financial services centre (IFSC). In presumption that Gift City would soon get a unified regulator while all transactions done on exchanges based in the special zone would be exempted from short term and long term capital gains tax, India would continue remain a focused investment market.

The above regulatory and policy changes has left a positive impact on the foreign investors and provided more reasons to the foreign investors to consider India as one of the most favoured investment destination.

At Edelweiss Prime Brokerage Services too we are geared up for all these positive changes that 2017 left us with. It's overwhelming to share that **Edelweiss Custodial Services Limited (ECSL) was rated as a Leading India Custodian - both in the Global Custodian (GC) Indian Domestic Survey 2017 and also in the Global Custodian (GC) Agent Banks Emerging Market survey 2017** with clients rating us highly in Relationship Management, Knowledge of market intricacies, process and legal structures, value delivered and asset servicing.

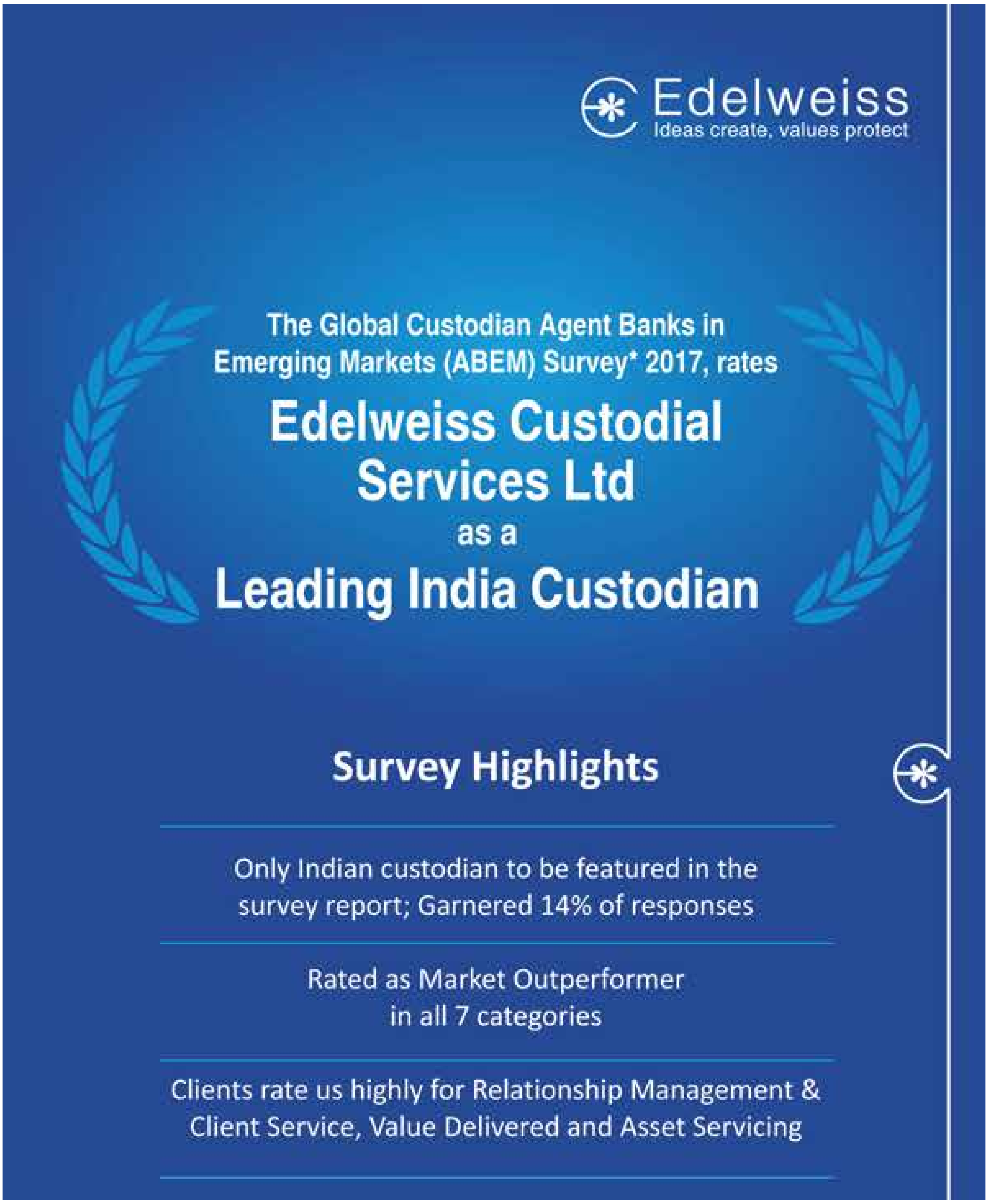
While we celebrate this success and thank all our stakeholders for their faith and trust in us, we also acknowledge that this recognition is a big responsibility and drives us further to constantly work towards enhancing customer experience through our products, platforms and services.

Happy Investing!

Warm Regards
Dipesh Shah

OUR GLOBAL RECOGNITION

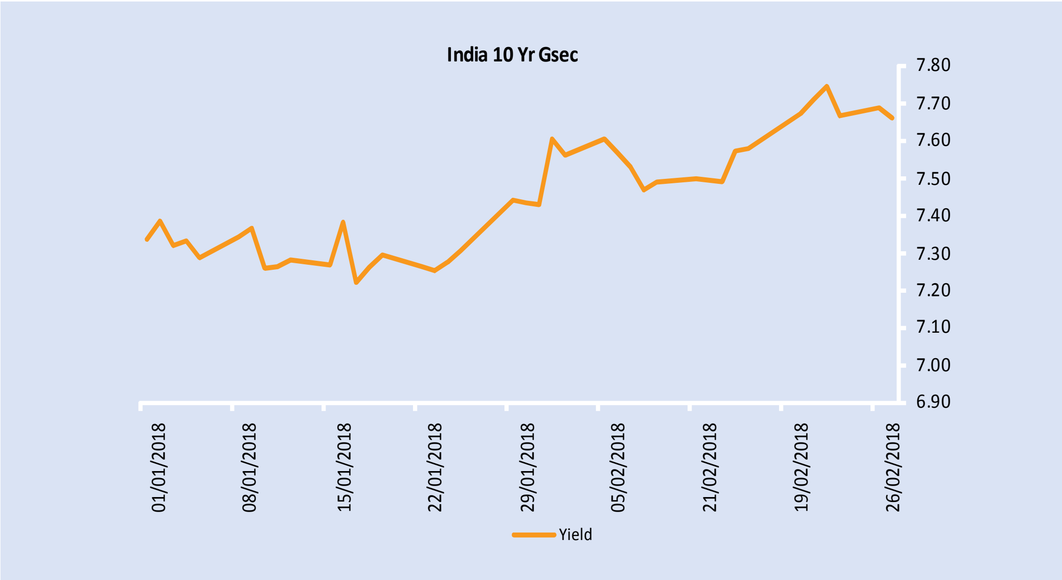
Edelweiss Custodial Services Ltd rated as a "Leading India Custodian" in the Global Custodian (GC) Agent Banks Emerging market survey 2017



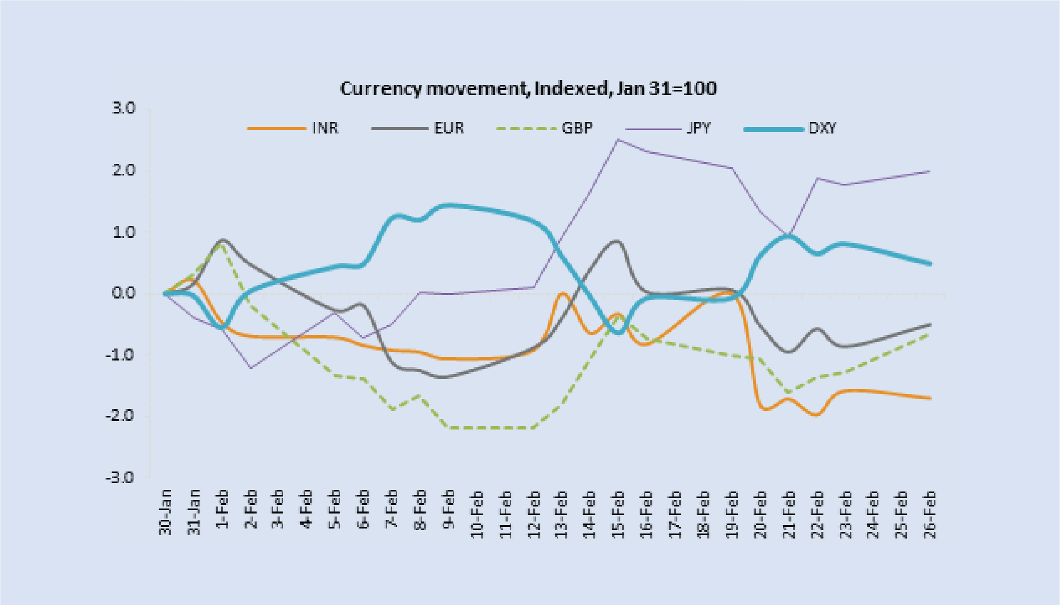
MARKET UPDATE

FIXED INCOME

Bond yields continued their ascent this month as well post the Union Budget and amidst the global volatility across asset classes. The 10Y benchmark yield rose to as much as 7.80% during the month and currently stands around 7.70%. US treasury yields have been hardening and domestic retail inflation is expected to hover around the 5% handle in the near term. The impending concern at the moment for the bond markets is the hawkishness projected by the India MPC as well as the US FOMC at their latest policy review meetings. This has not only driven yields higher but has also resulted in subdued participation from the key investor segments.



FOREX



DXY

Dollar continued to trade on a weak note for most part of the month before gaining some ground post the release of Fed monetary policy minutes. Fed in its minutes released indicated faster pace of rate hike contingent on substantial underlying economic momentum which should take inflation higher towards targeted levels. Following the release of somewhat hawkish minutes, Dollar index recovered from lows of 88.25 and was up almost 2% from troughs after 10yr benchmark yield jumped to high of 2.96%.

EURUSD

Euro was trading with an upward bias during the first fortnight and breached the previous top to make new high of 1.2555. However, the currency gave up its gains tracking bounce in Dollar that followed the release of Fed minutes. While data has held up well, EURUSD continued to consolidate ahead of crucial political events in early March including Italy elections and Social democrats poll on forming coalition with Angela Merkel's government.

GBPUSD

As Dollar index gained, Pound also retraced from its highs and depreciated by 0.65% in the month of February. BoE monetary policy lent some support after the central bank hinted at faster pace of rate hike but gains were not sustained thereafter. Downward revision of GDP data for 4Q 2017 to 0.4% from 0.5% also added to the pressure on currency.

USDJPY

Against other major currencies, JPY appreciated by 2% in Feb-18 particularly after the risk off scenario when equity markets tumbled globally. Concerns over rising yields drove 10% correction in Dow Jones from the peak of 2018 which triggered flight to safe assets and JPY gained on account of its safe haven stature.

USDINR

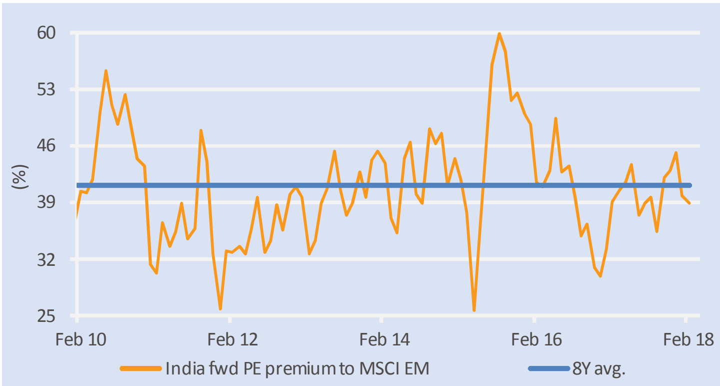
USDINR witnessed volatile movement in the month of February and rose to high of 65.10, its highest level since Nov-17. India's trade deficit widened to 56 month high of USD16.3bn in January against USD14.9bn in December. In a single day that followed, Rupee depreciated to lowest levels in three months with USDINR rising by 58paise. Subsequently, pressure eased off but INR underperformed other major currencies depreciating as much as 1.7% on monthly basis.

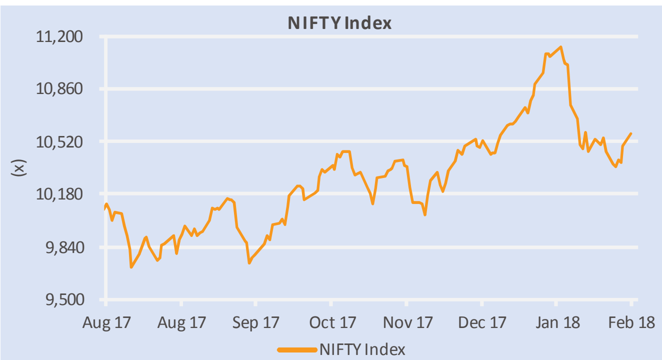
EQUITY

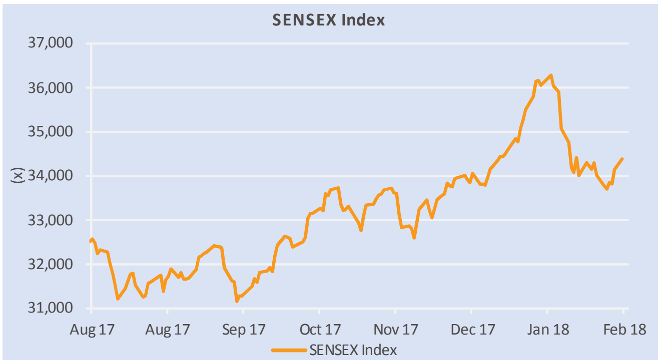
In light of weak global markets, Indian equities were also under pressure. Post a decent run up of 6% in January, Indian Equity Markets were down 4%. From the Union Budget front, long term capital gain tax was sentimentally a negative outcome for the markets. On earnigns front, Q3FY18 was better than Q2FY18 and upward trend of earnings continued in Q3FY18 (Q3FY18 earnings up 9% YoY vs 0% in H1FY18). On flows side in February'18 FII have sold USD 1.5bn in equity market, whereas DII's have pumped in into equities around USD2.1bn. On sectoral performance side, financials, healthcare & discretionary have corrected most by 8%, 7% & 7% respectively whereas consumer staples and energy outperformed broader market.

On valuation side MSCI India is trading at 17.5 times on 12 months forward PE where as MSCI EM is trading at 12.6 implying a premium of 40% for India over Emerging Markets (EM) , which is its long term average.

MSCI India 12months forward PE premium at its long term average







Nifty has corrected from its all time high

REGULATORY UPDATES

FOR DOMESTIC CLIENTS

FEB 02 2018

Review of additional expenses of upto 0.30% towards inflow from beyond top 15 cities B15

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Charging of additional expenses of upto 0.20% in terms of Regulation 52 (6A) (c) of SEBI (Mutual Funds) Regulations, 1996

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FOR FPI CLIENTS

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FOR FPI / DOMESTIC CLIENTS

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GUEST COLUMN - 01

SEBI eases access norms for Foreign Portfolio Investors

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The opening up of Foreign Direct Investment ('FDI') accompanied by introduction of the new Foreign Portfolio Investment ('FPI') Regulations makes India a more accessible destination amongst markets. The SEBI (FPI) Regulations, 2014 has considerably eased the entry norms for FPIs to access the growing Indian Capital Markets, since the introduction of the said Regulations, by SEBI on January 7, 2014.

India still holds being an attractive investment destination. Infusion of foreign capital to the secondary market has always received more attention due to the special nature of this investor segment.

With a broad based objective to attract more FPI in the country, SEBI had issued a consultation paper titled 'Easing of Access Norms for Investment by FPIs' with a view to solicit comments from public at large.

After taking into consideration the various comments received on the proposals contained in the aforesaid consultation paper, SEBI has brought about the following revisions in extant regulatory provisions vide its recently introduced circular easing the access norms for investment by FPIs:

1. **Discontinuance of requirements for seeking prior approval from SEBI in case of change in local custodian/ Designated Depository Participant ('DDP'):**

   At the time of change of local custodian/ DDP, the new DDP shall be permitted to rely on the registration granted by previous DDP at the time of transition. The move is expected to avoid duplicate efforts and incremental documentation by the FPIs as well as the DDPs

2. **Rationalization of procedure for submission of PCC/ MCV Declarations and Undertakings (D&U) and Investor grouping requirement at the time of continuance of registration of FPIs:**

   Procedural requirements have been simplified for FPIs. At the time of seeking continuance of registration, FPIs are no longer required to re-submit declarations and undertakings in cases where there is no change in the information already submitted, thereby reducing paperwork.

3. **Placing reliance on due diligence carried out by erstwhile DDP at the time of change of Custodian/ DDP of FPIs:**

   With a view to reduce documentation and delay in transitions, in the process of change of local custodian/ DDP, the new DDP may rely on the due diligence carried out by the old DDP.

4. **Exemption to FPIs having Multiple Investment Managers ('MIM') structure from seeking prior approval from SEBI in case of Free of Cost ('FOC') transfer of assets:**

   Regulations provide that transaction in securities should be executed only through registered stock brokers. However, in case of FOC transfers between FPIs operating under MIM structure bearing same PAN are now exempted from seeking prior approval from SEBI.

5. **Simplification of process for addition of share class:**

   All FPIs maintaining segregated portfolio were required to obtain prior approval of DDP in case of any addition in class of shares. In the revised regulation, where an FPI maintains common portfolio across all class of shares no prior approval is required to be obtained from DDP.

6. **Permitting FPIs operating under the MIM structure to appoint multiple custodians:**

   SEBI has now allowed FPIs operating under MIM structure to appoint multiple custodians/ DDPs.

7. **Permitting appropriately regulated Private Bank/ Merchant Bank to invest on their behalf and also on behalf of their clients:**

   It has been decided that private bank/ merchant bank that are appropriately regulated are now allowed to invest on behalf of their clients, subject to following conditions –

   - *Details of beneficial owners is provided to SEBI as and when called for; and*
   - *Banks do not enter into secrecy arrangement with the investors and secrecy laws do not apply to the jurisdiction in which bank is regulated.*

8. **Other Clarifications on Conditional registration:**

   The facility of granting conditional registration is now extended to existing funds proposing to convert as India dedicated funds. A time period of 90 days will be provided to achieve the Broad based status.

Concluding Remarks

On one hand, the introduction of long term capital gains tax on listed shares has acted as a damper and therefore apprehension is that whether the same level of interest for continuing to invest in India will exist or not, for the FPIs.

Although, the consultation paper was released in June 2017, the final regulations coming out just after the Budget proposal seems to be an attempt to woo the FPI community.

GUEST COLUMN - 02

Permitting Private Banks / Merchant Banks to Invest on behalf of their Clients

Richie Sancheti

Head - Investments Funds - Nishith Desai Associates

Synopsis - SEBI eases access norms for Foreign Portfolio Investors

In line with its stated policy to encourage direct participation in Indian markets, the Securities and Exchange Board of India ("SEBI") has, through a recent circular[1](**"Circular"**), announced several reforms for foreign investors accessing Indian capital markets. The major changes are:

- SEBI has amended the FPI regulatory framework in respect of appointment of DDPs and local custodians, PCC/MCV declarations, free of cost transfers and broad-based criteria.
- Omnibus structures: Appropriately regulated private banks and merchant banks are now permitted to invest on behalf of clients as well.
- Sovereign wealth funds, insurance/reinsurance companies, pension funds, exchange traded funds have been recognized as institutional investors.
- Category II FPIs that are broad based but subsequently fail to meet the criteria, shall be provided a three month window to regain its broad based criteria.
- Free of cost transfers permitted without prior SEBI approval for 'Multi- investment managers' structure in instances where the transferor and transferee FPIs have the same beneficial owners.
- Existing India focused funds permitted to obtain conditional registration as an FPI.
- FPIs and authorized global custodians are now permitted to change local custodians without prior approval from SEBI.

PERMITTING PRIVATE BANKS / MERCHANT BANKS TO INVEST ON BEHALF OF THEIR CLIENTS

Currently, private banks and merchant banks that are "appropriately regulated" are eligible for grant of registration as an FPI. However, prior to the Circular, such entities were only permitted to invest in a proprietary capacity. SEBI has announced that, private banks and merchant banks will now be permitted to invest on behalf of their clients after providing a declaration to the effect that:

(a) The details of the beneficial owners are available and will be provided as and when required by the regulators; and

[1]CIR/IMD/FPIC/ 26 /2018, Dated February 15, 2018, available at:
https://www.sebi.gov.in/legal/circulars/feb-2018/easing-of-access-norms-for-investment-by-fpis_37866.html

(b) The banks do not have any secrecy arrangement with the investors and all required legal / regulatory arrangements have been for any secrecy laws or confidentiality to not impede disclosure of beneficial owner details, if required.

This amendment should enable overseas pooled accounts / omnibus accounts maintained with global service providers to access the Indian capital markets. Omnibus accounts refer to accounts where securities are held in a single account for and on behalf of several investors. There are several reasons for investors preferring such arrangements, mainly:-

(a) Foreign investors with global investment programs prefer to have a single service provider for holding securities when trading locally or globally. Since such a service provider may provide such services to numerous clients, it is operationally cumbersome and expensive to open a separate account for each client to access markets in a single jurisdiction. The fact that only one account is needed reduces the fees associated with setting up and maintaining an account for trading in a particular jurisdiction.

(b) The issuers would only be required to deal with the single service provider who holds the accounts on behalf of the investors and not a large number of investors. Also, the responsibility of dealing with the issuers shifts from the investor to the service provider.

(c) A structure where a single representative investor is permitted to invest on behalf of several clients creates economies of scale, lower transaction costs and enhances liquidity. Subject to the taxation related aspects, sophisticated operators may also be able to offset certain credit and debit entries and the settlement process may be internalized to a certain extent.

(d) The amendment is also in line with changing global trends on the role of banks that operate across jurisdiction and investor preferences for accessing capital markets. Brokers could look 'at' and not look 'through' omnibus accounts and to treat the holder of an omnibus account as the customer whose identity they needed to know. However, a system of checks and balances has also been brought about by the regulators to curb abuse of such structures.

The amendment brought about by SEBI represents a fair balance between the commercial needs of banks / merchant banks (as such programs form an integral part of their offering) and SEBI's prerogative of identifying the source of funds and the beneficial owners in such transactions.

CONCLUSION

The Circular comes as a positive for market participants. Clarity of law and delegation of certain administrative actions are essential steps in reducing the operational lags that are being faced by FPIs. The opening of private banking channel to participate in Indian markets should help in broadening the access to a larger investor base.

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