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Foreign Funds Welcome

Finance minister **Pranab Mukherjee** has announced that equity schemes of mutual funds registered with SEBI may accept subscriptions from foreign investors directly. Currently only FIIs and sub accounts registered with SEBI are allowed. **Mehul Dani** gets reactions from CRISIL, CARE Ratings and Nishith Desai Associates:

D.R. Dogra, CARE Ratings

Foreign investors, in addition to the FIIs and sub-accounts registered with SEBI, can now invest in Indian mutual funds thereby allowing these investors to access the expertise of the Indian fund managers. As a result the subscriber base for the mutual fund industry will increase and is likely to lead to higher assets under management. Also since a lot of mutual funds in India have tie-up / joint venture with a foreign partner, their ability to use the foreign partner's network to find investors would also be high. Total AUM (monthly average) of the industry increased by 52% YoY to ₹7.47 lakh cr for March 2010 that reflected the overall growth in the stock markets and improvement in market liquidity thereby increasing the AUM under debt schemes. As against this, AUM had fallen by 7% during FY09.

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It is a welcome move. This announcement once implemented would allow market access for large overseas institutional investors as well as overseas retail investors desirous of participating in the Indian capital markets, without an intermediary. This move seems to have been motivated as a first step towards implementing the proposals of the Working Group Report and is clearly one of the most significant developments proposed in this budget as far as the Indian capital markets are concerned. Foreign investment in listed securities is currently open only to NRIs and foreign investors registered as a FII with the SEBI. Though categories of foreign corporate and individuals sub-accounts do exist in theory, the eligibility criteria had raised the threshold significantly, leaving non-residents with little choice but to come through intermediated structures like FII or broad based sub-accounts. Further, indirect access to the Indian markets through the Offshore Derivative Instruments (ODI) has always remained shrouded with uncertainty and restrictions.

CRISIL

There was a sharp decline in mutual funds' assets under management during 2010; retail participation is expected to increase in 2011.The domestic mutual fund industry was impacted by liquidity tightening in the banking system, which resulted in systemic outflows from the industry. A key factor for the tight liquidity was the 3G/broadband auctions in the latter half of the year, from which the government collected over ₹1 trillion. Mutual funds experienced net outflows aggregating ₹0.91 trillion in 2010 compared with net inflows of ₹1.43 trillion in 2009. Debt oriented funds accounted for the majority of these outflows, at ₹0.83 trillion. In January 2011, the industry recouped most of the losses with inflows of ₹0.84 trillion, the highest since April 2010. Money market funds registered the highest inflow at ₹0.73 trillion, followed by income funds at ₹0.10 trillion. Debt oriented funds continued to garner a major share of the mutual fund assets at 68% as of January 2011 vis-à-vis 70% in the year-ago period. Equity oriented funds accounted for the rest. According to CRISIL Fund Services, as far as this budgetary measure is concerned, this step will widen the investor base of mutual funds and give non-SEBI registered foreign investors an opportunity to invest in Indian equity markets. To liberalize the portfolio investment route, the government has decided to permit this move. The measure will also provide an avenue to boost AUM of equity mutual funds. More innovative and technology enabled products with enhanced risk management practices are expected to be launched for overseas investors.