

P- Notes and its Significance in Indian Stock Market

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Abstract

The significance of participatory notes (PNs) by foreign investors [1], as an instrument for portfolio flows into Indian stock markets has been probed in this paper. India's foreign investor base widening recently seem to be inclined towards hedge funds/unregistered foreign investors who invest primarily via PNs. This gained popularity, especially when it accounted for 50% of all foreign portfolio assets in India [2]. Therefore, the laws relating to PNs have transformed to remain more transparent and an ascending trend in PNs was registered during September to November 2012.

Keywords: FDI, FII, Participatory Notes, SEBI, Securities and Capital Market

1. Introduction

Participatory Notes also known as P-Notes or PNs are instruments issued by registered foreign institutional investors (FII) to foreign investors [3]. Participatory notes are instruments used for making investments in the stock markets within the country and outside India for making investments in securities listed in the stock markets [3]. PNs are also named as Overseas Derivative Instruments, Equity Linked Notes, Capped Return Notes and Participating Return Notes etc. Participatory notes are generally issued overseas by the associates of India-based foreign brokerages and domestic institutional brokerages [4]. Therefore, an attempt has been made to find out the importance of Foreign Direct Investment in India. This paper concludes that FDI in India has a vital role in the economic proliferation of India.

2. Review of Literature

Krishna Reddy Chittedi [5] analyzed the performance of sensex v/s. FIIs' foreign investments in BSE and concluded that the liquidity as well as volatility was highly influenced

by the FII flows. Kulwantraj N. Bindu [5], conducted a study to find out the determinants responsible for the flow of FIIs and their degree of impact. Raj Chaitanya [5], discussed exhaustively about the FIIs and their impact on the Indian economy and concluded that the stock market performance was the sole driver of FII flows.

3. Importance of the Study

The present study seeks to throw light on the PNs contribution to the growth of Indian capital market and to the economy in general, and in specific with respect to the PNs in underlying securities in India. This study would be useful to understand the flow of PNs and the effect of policy and SEBI regulation on PNs and identification of encouraging/discouraging aspects of PNs in Indian capital markets, in the scenario of the globalization and liberalization of the host country, India.

4. Scope of the Study

The economic liberalization and globalization scenario in India has significantly enhanced the policy of

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attracting foreign investments and has liberalized various restrictions on flow of investment into India through PNs. This has prompted to undertake a study during the period from 2009 to 2014 with underlying Indian securities to highlight on the major strengths and weaknesses of PNs' participation in the Indian capital market, the recent changes in the Government policies and SEBI regulations in India with special reference to PNs.

5. Objectives

- To find out the recent trends of PNs inflow in the Indian capital market.

- To identify the measures taken by SEBI for investment promotion and to identify the government initiatives to regulate the PNs investment for sustainable growth of Indian capital market.

6. Methodology

6.1 Sources of Data

Secondary data was collected largely from Reports, Press Releases and RBI Statistics during 2009 to 2014 for the study. The paper attempts to study the Annual Growth Rate of PNs in the Indian capital market, pros and cons

Table 1. Total Value of PNs with Underlying Indian securities and their Mean, SD and CV (in Crores of Rs.)

Month	2009	2010	2011	2012	2013	2014	Mean	S.D	C.V
January	65,812	131,938	174,485	151,956	162,139	163,348	137266	38350	27.9
February	60,948	124,177	171,601	183,151	164,271	172,738	140830	44600	31.7
March	69,445	145,037	175,097	165,832	147,905	207,639	140663	37317	26.5
April	72,314	154,340	166,444	130,012	157,578	187,486	136138	34119	25.1
May	103,470	159,927	211,199	128,895	168,263	211,740	154351	36587	23.7
June	97,885	168,016	153,291	129,851	147,498	224,248	139308	24050	17.3
July	108,345	165,749	150,414	129,586	148,118	208,284	140442	19733	14.1
August	110,355	163,657	152,288	141,710	164,817	211,499	146565	19964	13.6
September	129,100	200,927	175,291	146,600	171,154	222,394	164614	24743	15.0
October	124,575	182,056	180,002	175,829	183,862	265,675	166067	24123	14.5
November	129,943	188,325	179,035	177,170	183,237	249,210	167346	21706	13.0
December	168,632	175,584	138,711	151,084	167,566	236,677	156498	12404	7.9
Mean	103,402	157,085	168988	150973	163867	213412			
S.D	30965	22461	18054	19358	11816	28360			
C.V	29.9	14.3	10.7	12.8	7.2	13.3			

Source: RBI Statistics from 2009 to 2014

of PNs attracting highest inflows, during the period of analysis between 2009 and 2014.

7. Inflow of P- Notes in Capital Market

Participatory notes are a preferred route for High Net worth Individuals (HNIs) and hedge funds from abroad to make investment in Indian capital market [6]. P-Notes, mostly used by overseas HNIs, hedge funds and other foreign institutions, allow such investors to invest in Indian markets through registered Foreign Institutional Investors (FIIs). It was over 50 per cent at the peak of Indian stock market Bull Run during 2007 and 25 – 40 per cent in 2008 [7]. From 2009 onwards P-Notes accounted for 15-20 per cent only of the total FII holdings in India [7].

The total value of investment in PNs inclusive of equity, debt and derivative as underlying stood at Rs.2,07,639 Crores in March 2014 compared to Rs.1,47,905 Crores in March 2013 [8]. The total value of P-Note investments in

Indian markets (equity, debt and derivatives) rose to Rs.2, 65,675 Crores at the end of October, 2014 [9].

Table 1 shows the monthly and yearly inflow of investment in P- notes.

From Table 1, it is clear that during the year 2014 the mean value was Rs.2, 13,412 Crores with a SD of 28,360 and CV of 13.3. When comparing the flow of PNs from 2009 to 2014, the uniformity in inflow was found during the year 2013 having a low CV of 7.2 (92.8% Uniformity) and the highest variation in PNs flow was found in 2009, because the PNs value in January 2009 was Rs.65812 Crores and its value during the month of December was increased by 156 per cent amounting to Rs.168632 Crores.

Further it is found that during the month of December every year from 2009 to 2014, the CV was 7.9. When comparing the flow of PNs month wise from 2009 to 2014, the high variation was found during the first half of the year i.e., January to June during which the highest CV of 31.7 was registered in February every year with the corresponding highest SD of 44600. The second half of the year i.e., July to December recorded a high mean value

Table 2. Participatory Notes inflow - Comparative Statement

Month/ Year	2009-10 in (%)	2010-11 in (%)	2011-12 in (%)	2012-13 in (%)	2013-14 in (%)
January	200	132	87	107	101
February	204	138	107	90	105
March	209	121	95	89	140
April	213	108	78	121	119
May	155	132	61	131	126
June	172	91	85	114	152
July	153	91	86	114	141
August	148	93	93	116	128
September	156	87	84	117	130
October	146	99	98	105	144
November	145	95	99	103	136
December	104	79	109	111	141

Source: RBI Statistics from 2009 to 2014

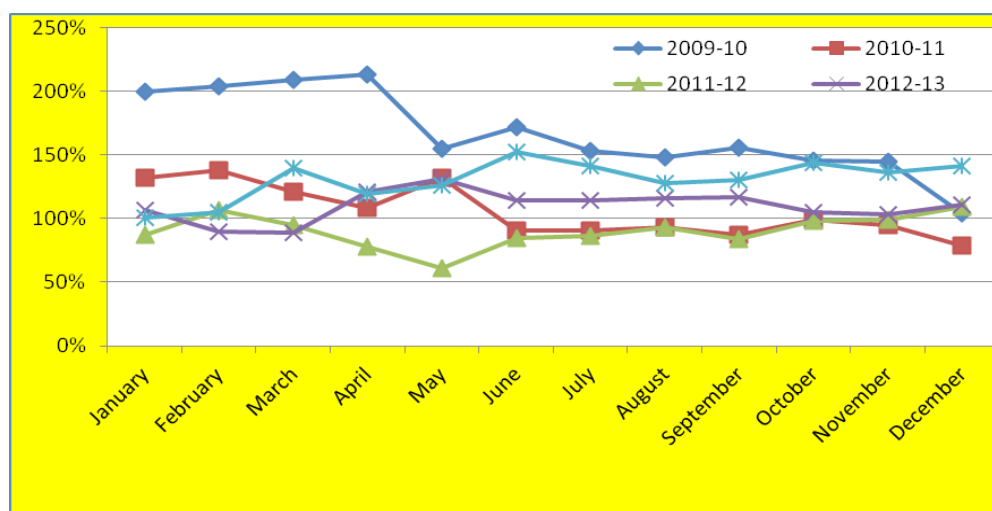


Figure 1. Inflows of PNs in Indian Capital Market- Comparative Percentage.

Table 3. Percentage of Absolute Increase/Decrease of PNs Total Value in Indian Capital Market from 2009 to 2014

Month/Year	2009-10	2010-11	2011-12	2012-13	2013-14
January	100	32	-13	7	1
February	104	38	7	-10	5
March	109	21	-5	-11	40
April	113	8	-22	21	19
May	55	32	-39	31	26
June	72	-9	-15	14	52
July	53	-9	-14	14	41
August	48	-7	-7	16	28
September	56	-13	-16	17	30
October	46	-1	-2	5	44
November	45	-5	-1	3	36
December	4	-21	9	11	41

Source: RBI Statistics from 2009 to 2014

with a low variation in the flow of PNs, particularly in December the CV was at the lowest as 7.9 which means the highest uniformity of inflow found during the month of December every year.

In order to find the increase or decrease in the flow of PNs with previous years, the comparative analysis is made and the calculated increase and decrease in the flow in terms of percentage is given in Table 2 treating every previous year as base year assigned as 100 per cent. It is obvious to note that the years 2010, 2013 and 2014 had registered an increased inflow of PNs, while in 2011 and 2012 a

decreased inflow of PNs was witnessed. The analysis also reveals that the highest flow of PNs was recorded in 2010 over 2009 followed by 2014 over 2013.

From Table 3, it is clear that a descending inflow of PNs accounted in 2011 and 2012 and an ascending PNs' flow was recorded in 2010 and 2014. When comparing 2010 with 2009, during the months of January to April 2010, the inflow of PNs was high.

The flow of Participatory notes in underlying securities in Indian stock markets showed a positively growing trend in 2009, 2010 and 2014. Figure 2

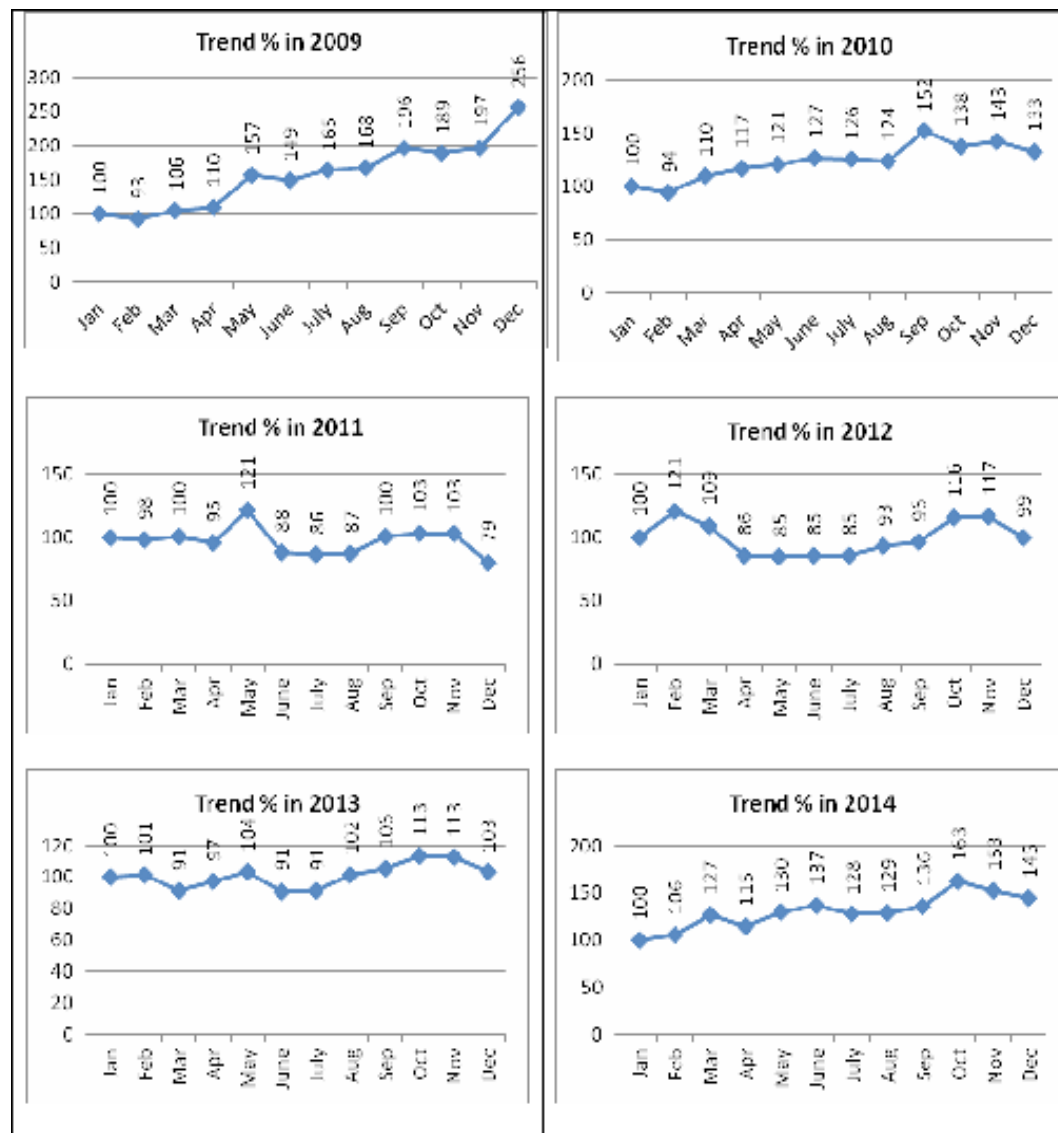


Figure 2. Trend percentage value of Participatory Notes from 2009 to 2014.

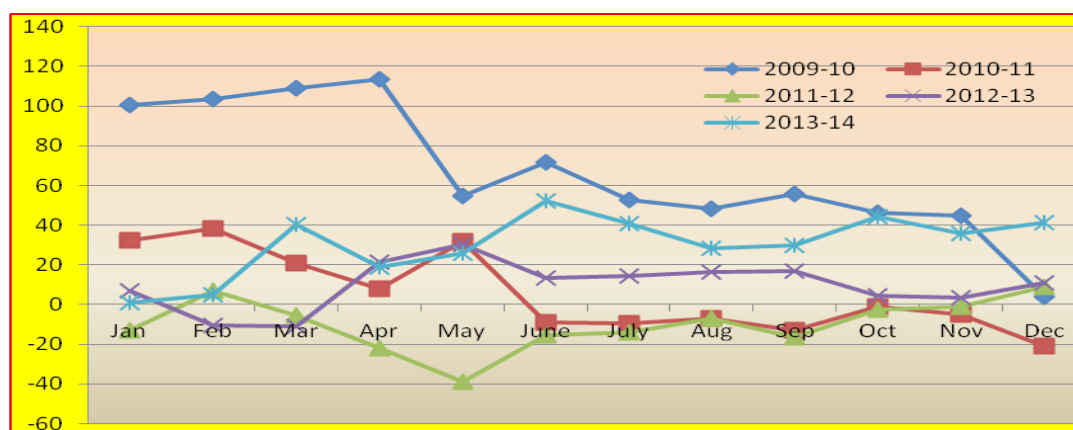


Figure 3. Percentage of Absolute Increase / Decrease in the Total Value of PNs.

portraits the trend percentage of PNs month wise during the period from 2009 to 2014.¹

8. Advantages of Participatory Notes

- The investors in PNs enjoy the economic benefits of investing in the security which is actually held by the FII.
- Investing through P-Notes is easy and found common amongst FIIs [10].
- While such FIIs have to mandatorily get registered with SEBI, the other entities subscribing to P- Notes do not require registration and hence can conceal their identity [10].
- PNs are easily negotiable by endorsement and delivery [10].
- Participatory notes yield the advantage of the tax laws of certain preferred nations [10].
- PNs reduce the transaction costs and also provide modified tools to manage risk, lower financing costs, and enhance portfolio yields.

9. Dark Side of P-notes

- Indian regulators do not perceive optimistically the participatory notes as the ownership of the underlying securities remains unknown [10].
- Participatory notes had always been subjected to sensational controversies.

- Investors seeking to stay undisclosed willingly opted for this investment.
- RBI and SEBI, often resort to measures of check on FIIs, which also impact the economy and the capital market unfavorably.

10. SEBI’s New Rules on P - Notes

As per the new rules –

- SEBI-registered foreign portfolio investor (FPI) can issue P-notes only to those entities based in countries whose securities regulator and the central bank are members of IOSCO and Bank for International Settlements (BIS) [11].
- SEBI has tightened the definition of regulated entities. Earlier, ODIs could be issued to any regulated entity, now SEBI has narrowed it to those bodies that are regulated by specific entities compliant with IOSCO [11].
- P-notes cannot be issued to entities residing in a country not compliant with Anti Money Laundering and Combating Financial Terrorism regulations [11].

11. Conclusion

In order to restrain black money via FII route, SEBI has tightened P-note rules [11]. However, PNs have started losing their gleam, due to a row of concrete restraints by the Finance Ministry and SEBI over the years. But then via PNs, more than 50 per cent of the funds are flowing

through anonymous route which therefore needs an exhaustive reorganization [12].

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