

INDIA 2019 MUTUAL FUNDS REPORT

Markets and Securities Services



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Currency note

References to size and scale of assets, markets, and other statistics originated in the Indian rupee (INR), which might have been stated in lakh or crore, part of the Indian numbering system. In most instances, these have been converted into the western numbering system and US dollars so global readers can comprehend the scale in international terms. Because the rupee exchange rate against the dollar has varied considerably over the years (see appendix), the exchange rate used would have been applicable to the date of the statistic. So statistics in 2019 are based on an approximate INR70 = US\$1.



INDIA: ASIA-PACIFIC'S NEXT MUTUAL FUNDS GIANT

The “Incredible India!” slogan, so often used to describe tourist opportunities in India, could just as easily be used to describe the development and growth of the Indian mutual fund industry over the last 20 years or India’s rapid turnaround in economic developments over the last 10 years or so.

India has become one of the world’s fastest-growing economies. With a massive population, it is perhaps the only possible challenger to China in terms of emerging markets. Yet it has also had active capital markets for over 140 years, with stocks listed on the Bombay Stock Exchange (BSE) as far back as 1875.¹ It was Asia’s first stock exchange. But gone are the days when large bundles of scrip issues or certificates of securities needed to be wheeled around Mumbai’s narrow streets between securities brokers, banks and custodians on metal carts in the monsoon rain.

In 1992, the National Stock Exchange (NSE) opened in Mumbai as the first demutualised electronic exchange in India. The NSE was the first Indian exchange to provide a modern, fully automated screen-based electronic trading system offering easy trading facilities to investors across the country. India has 24 different, regulated stock exchanges. Together they are the world’s 10th largest with an overall market capitalisation of more than INR154 trillion (US\$2.2 trillion as of May 2019).² Companies with businesses as diverse as banks, technology, steel producers, leisure and household products have sought a listing and in recent years have begun to attract attention from global investors following a period of strong returns. India has also embraced technology and become a world leader in all aspects of IT development. As one of the original BRICS designations, it could be argued that of all of these, India has turned out the best for investors.³

The first unit trusts (mutual funds) were introduced to India in 1963 and until 1987 the Unit Trust of India (UTI), which was government controlled, had the monopoly on the market.⁴ Subsequently, new product providers entered the market. Initially these were major public sector, government controlled banks. Later on, from around 1993, the private sector was allowed to enter with more dedicated fund management businesses that began to offer more diversified funds. Despite some periods of consolidation, often due to the impact of market volatility on investment returns, impacting popularity in the use of mutual funds, the fund industry today is now thriving, growing very strongly across a broad spectrum of individual and institutional investors.

Further afield, foreign-owned fund managers have not always found it easy to enter and compete in India. There have been a number of instances where, either from a joint venture or as a standalone business, global fund managers have chosen to pull out of India, usually due to an inability to achieve scale commensurate to the level of investment necessary to get started.

This too is changing, as the market opens further. Nevertheless, today most of the largest mutual funds managers have foreign ownership in part or in whole. This has been regarded as a way in which local Indian businesses with no prior experience can lean on the credibility of a foreign partner to gain acceptance in the market and build business.

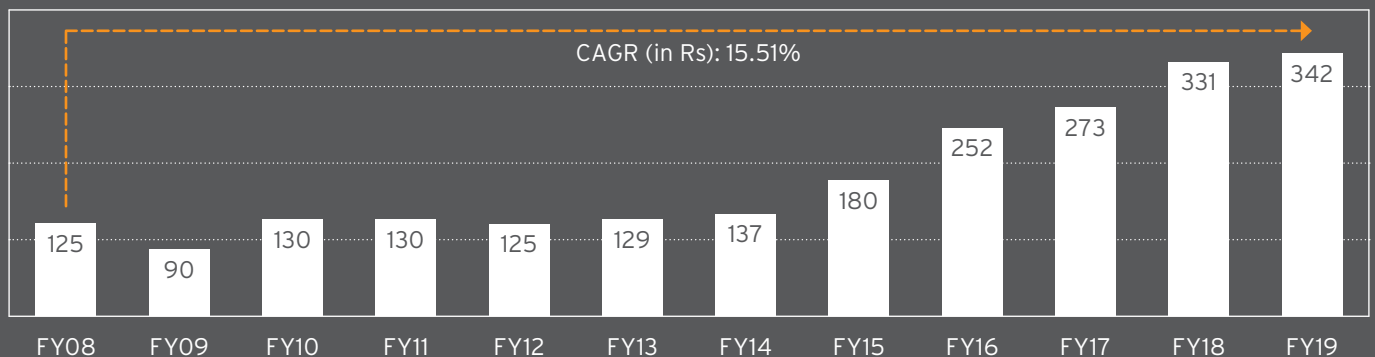
This report is designed to provide readers, particularly global fund managers, with an insight into the Indian mutual funds business. As at June 2019, the mutual funds industry AUM stood at INR24.47 trillion (US\$350 billion). CAGR for the last 10 years has been in excess of 15% per year. There are 44 mutual funds companies offering products in the market, covering a wide variety of investment choices. ETFs and hedge and alternative investment funds are also made available. The mutual funds market is evenly split between institutional and retail investors, with the latter increasing their proportion rapidly as local stock markets perform well. For fund managers, there is little opportunity in the institutional space to manage assets for pension funds, unless they can be added to the list of approved managers for India's National Pension System.

To date, the majority of fund sales have been made in the top 30 cities. However, industry forecasts are projecting substantial future growth from second-tier cities (B30 – beyond top 30) and from schemes such as the Systematic Investment Plan.

According to industry data, the numbers of investors in mutual funds in India is around 30 million, which represents less than 1.5-2% of the population. Interestingly, other related financial statistics (see below) demonstrate just where and why the potential for the Indian market remains so positive.⁵



Figure 1. Mutual funds AUM (US\$bn) 2008-19⁶



¹ Bombay Stock Exchange.

² From Wikipedia and www.ceicdata.com.

³ BRICS is the acronym for the five major emerging national economies of Brazil, Russia, India, China and South Africa.

⁴ From Securities and Exchanges Board of India and from Unit Trust of India.

⁵ "Less than 1.5% of India's population invests in MFs", from www.cafemutual.com.

⁶ From www.ibef.org.

ECONOMIC AND DEMOGRAPHIC ANALYSIS OF INDIA

India is, by land mass, the seventh largest country in the world, and is also the world's seventh largest economy.⁷ It has been growing fast in recent years and is expected to become a top three economy globally within the next 15-20 years.⁸ GDP growth in 2018-19 is estimated at 7.3%, up from 6.6% in the previous year.⁹

India has a huge population, exceeding 1.36 billion, which equals around 17.7% of the world's population.¹⁰ It is estimated that it will exceed the population of China before 2025 and grow to more than 1.66 billion by 2050. The rate of unemployment across the country is a surprisingly low 3.5% in 2019, although other economic monitors put the figure at 7.1%.¹¹ Measuring this metric accurately is notoriously difficult. Population growth remains among the highest worldwide, at 1.2%, although life expectancy rates are among the lowest at 66.9 for males and 69.9 for females. Similarly, literacy rates are low: 82.1% for males and 65.5% for females.¹² Population density is approximately 460 per square kilometre. Currently, 33.6% of the population is urban, but this is expected to increase to 49% by 2050. The median age of the population is 27.0 years.

India is by far the largest democracy in the world with more than 900 million citizens eligible to vote. Its constitution was implemented in 1950 and provided for a parliamentary system of government. There is a federal structure with elected governments in each of the 29 states. In the 2019 general election, more than 65% of the electorate actually cast ballots during the seven-week election process. The ruling BJP Party of incumbent Prime Minister Narendra Modi won the election for a second five-year term and gained a majority of the 543 elected members of parliament.

It has been estimated that there are 29 different languages spoken regularly in India, each by more than one million people.¹³ Of these, Hindi (41%), Bengali (8%), Telugu (7%), Marathi (7%), Tamil (6%) and Urdu (5%) represent around 75% of the total. English is also widely spoken and used as the lingua franca across government and business throughout India. The population is also subdivided by religion, the largest being Hindu (79.8%), Muslim (14.2%) Christian (2.3%) and Sikh (1.7%).

Major industries, which also attract high levels of foreign direct investment (FDI) inflows, include: services, telecommunications, computer software and hardware, construction, autos, trading, drugs and pharmaceuticals, chemicals and power.

Population centres¹⁴

The country is divided into 29 states. The top-ten most populous are shown in figure 2.

Figure 2. Top 10 States by population size in India

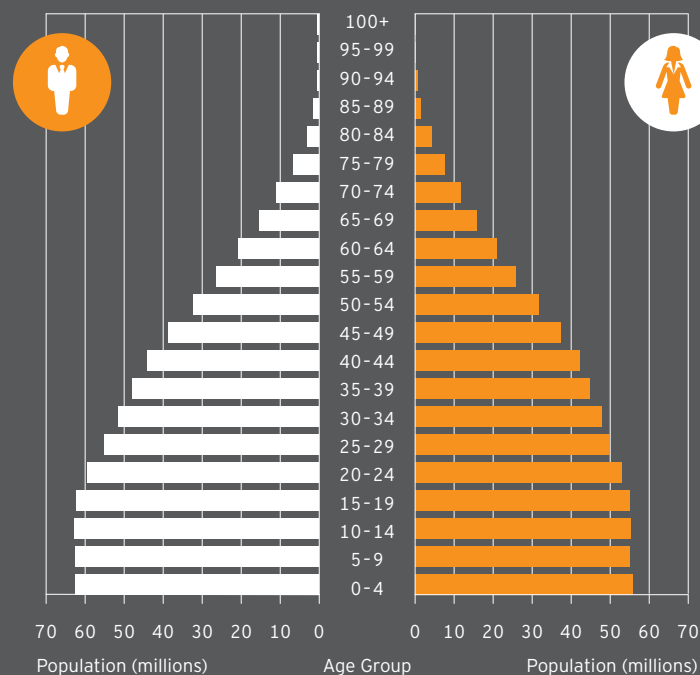
	State	Capital city	Population
1	Uttar Pradesh	Lucknow	199.8m
2	Maharashtra	Mumbai	112.4m
3	Bihar	Patna	104.1m
4	West Bengal	Kolkata	91.3m
5	Madhya Pradesh	Bhopal	72.6m
6	Tamil Nadu	Chennai	72.1m
7	Rajasthan	Jaipur	68.5m
8	Karnataka	Bengaluru	61.1m
9	Gujarat	Gandhinagar	60.4m
10	Andhra Pradesh	Hyderabad	49.5m



Figure 3. Top 15 cities in India by population size

	City	Population
1	Mumbai	12,442,373
2	Delhi	11,034,555
3	Bengaluru	8,443,675
4	Hyderabad	6,993,262
5	Ahmedabad	5,577,940
6	Chennai	4,646,732
7	Kolkata	4,496,694
8	Surat	4,467,797
9	Pune	3,124,458
10	Jaipur	3,046,163
11	Lucknow	2,817,105
12	Kanpur	2,765,348
13	Nagpur	2,405,665
14	Visakhapatnam	2,035,922
15	Indore	1,960,631

Figure 4. India population pyramid (2016)¹⁵



There are more than 35 cities with a population of over one million. Figure 3 captures the largest 15 in India. Figure 4 illustrates India's age and sex structure and provides an insight into its political and social stability and economic development. The population is distributed along the horizontal axis, with males shown on the left and females on the right. The male and female populations are broken down into five-year age groups represented as horizontal bars along the vertical axis, with the youngest age groups at the bottom and the oldest at the top. The shape of the population pyramid gradually evolves over time based on fertility, mortality, and international migration trends.



Based on industry data,¹⁶ there are over 110 cities regarded as key wealth centres around India. This is where the vast majority of mutual funds sales occur. In addition, sales are made to Non-Resident Indians (NRIs) globally, which also represents a significant portion of the total. The key city centres are captured in figures 6 and 7.

Figure 5. List of top 30 wealth centres/cities as at 31 March 2019¹⁷

	City		City		City
1	Mumbai	11	Surat	21	Patna
2	Delhi	12	Lucknow	22	Bhopal
3	Bengaluru	13	Kanpur	23	Rajkot
4	Kolkata	14	Nagpur	24	Guwahati
5	Pune	15	Udaipur	25	Jamshedpur
6	Ahmedabad	16	Indore	26	Ranchi
7	Chennai	17	Ludhiana	27	Bhubaneswar
8	Hyderabad	18	Nasik	28	Dehradun
9	Vadodara	19	Coimbatore	29	Visakhapatnam
10	Jaipur	20	Chandigarh	30	Raipur

Figure 6. Wealth centre split¹⁸



Mumbai and Delhi have an almost 50% share of all mutual funds sales in India. That said, the proportion per head of population of those who own a mutual fund is still very small, at around 1.5%, leading to the view that there remains an excellent long-term potential for growth in the market.

The penetration trend beyond the top 30 cities is still very patchy. There are almost 100 cities in India with a population in excess of 500,000 people where the use of mutual funds is still at a very early stage of development.

In addition to the numbers for Indian cities, it is estimated there is a population exceeding 31 million NRIs all over the world.¹⁹ These NRIs are often also more experienced in mutual funds investing, and have become a significant source of inbound capital and investment.

Figure 7. Top 25 countries by estimated NRI population

	Country	NRI		Country	NRI		Country	NRI
1	United States	4.46m	10	Canada	1.02m	19	Bahrain	0.32m
2	United Arab Emirates	3.10m	11	Kuwait	0.93m	20	Fiji	0.31m
3	Malaysia	2.99m	12	Mauritius	0.89m	21	Guyana	0.30m
4	Saudi Arabia	2.81m	13	Qatar	0.69m	22	Netherlands	0.24m
5	Myanmar	2.01m	14	Oman	0.80m	23	New Zealand	0.20m
6	Pakistan	2.00m	15	Singapore	0.65m	24	Italy	0.20m
7	United Kingdom	1.83m	16	Nepal	0.60m	25	Thailand	0.19m
8	Sri Lanka	1.61m	17	Trinidad & Tobago	0.56m			
9	South Africa	1.56m	18	Australia	0.50m			

HNWI, a rapidly growing sector

Within India, the numbers of high-net-worth-individuals (HNWIs) is also expected to grow rapidly over the next few years. Their wealth holdings are estimated to exceed US\$2 trillion currently, and could rise to over US\$3 trillion by 2020.²⁰

It is estimated there are around 150,000 families in India with a wealth in excess of INR250 million (25 crore or US\$3.5 million), and this number is expected to rise to more than 500,000 by 2025. According to reports, less than 25% of this wealth is professionally managed, leading to strong potential growth in this sector of the financial services market.

To meet the demand of these investors, there has also been substantial growth in the numbers of private banks and private bankers operating in India. In mid-2018, it was estimated there were in excess of 2,500 private bankers in India, working for around 45 private banking firms.²¹ This includes both domestic Indian firms as well as the larger global players.²²

Figure 8. HNWI in India 2009-20

Net worth	2009	2010	2011	2015	2020
US\$ 1-5 million	157,000	183,333	210,000	315,000	508,127
US\$ 5-30 million	36,000	43,000	50,000	84,000	13,280
Above US\$30 million	17,000	21,000	26,000	40,000	56,000
Total wealth holdings of millionaires (US\$ billion)	361.8	503.1	584.5	1,559.1	2,950.1

⁷ From www.ibef.org.

⁸ From www.ibef.org.

⁹ From www.ibef.org.

¹⁰ From www.worldometers.info.

¹¹ From www.tradingeconomics.com and www.cmie.com.

¹² From www.ibef.org.

¹³ From 2011 Census of India www.censusindia.gov.in.

¹⁴ From Wikipedia, with numbers in 2011 based on Census of India.

¹⁵ From www.cia.gov.

¹⁶ From www.portal.amfiindia.com.

¹⁷ From www.amfiindia.com.

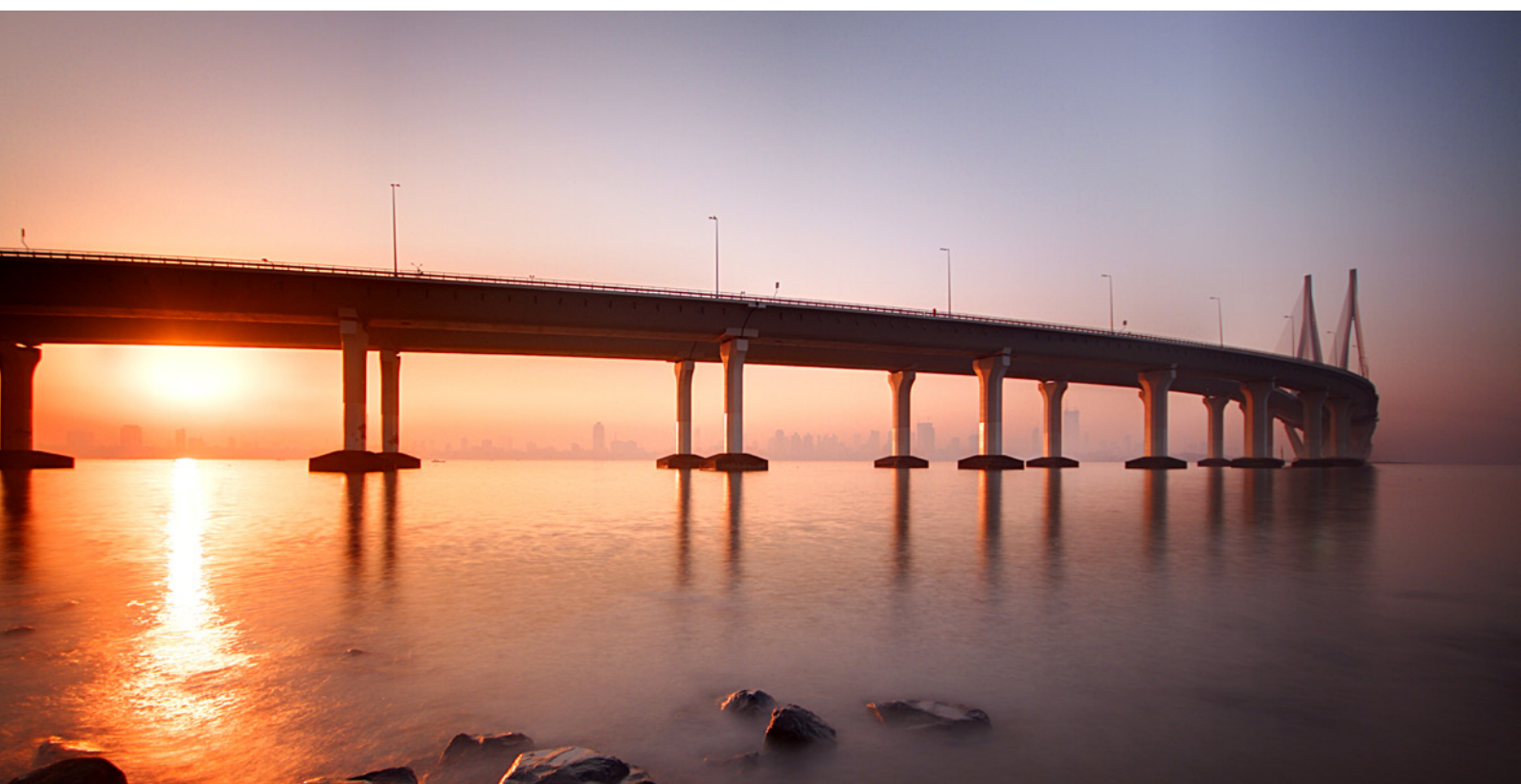
¹⁸ From www.amfiindia.com.

¹⁹ From Wikipedia, December 2018, quoting Ministry of External Affairs of India.

²⁰ From www.ibef.org, September 2017.

²¹ From "Wealth management is the new buzzword in financial services sector" at www.economictimes.indiatimes.com.

²² From www.ibef.org.



A HISTORY OF THE DEVELOPMENT OF INDIA'S MUTUAL FUNDS INDUSTRY

Most commentators, when reviewing the history of the Indian mutual funds industry, refer to there being six distinct phases, each defined by a specific time period.



Phase 1: 1963-1987

The UTI was established in 1963 by the Reserve Bank of India (RBI) and for 24 years had market exclusivity. It launched the first fund in 1964. In 1978, control over the UTI changed from RBI to the Industrial Development Bank of India (IDBI), which had both regulatory and administrative responsibility.



Phase 2: 1987-1993

In 1987, public sector banks and insurance companies were allowed to also set up mutual funds in competition with the UTI for the first time. A number of mutual funds companies were established and as a result this commenced a period of strong industry growth.



Phase 3: 1993-1996

Private sector businesses were allowed to set up funds from 1993, significantly widening the choice of funds available to the public. Banks and insurance companies led the way here, providing more competition and further enlarging the market.



Phase 4: 1996-2003

Regulations were brought under the control of the Securities and Exchange Board of India (SEBI) from 1996.



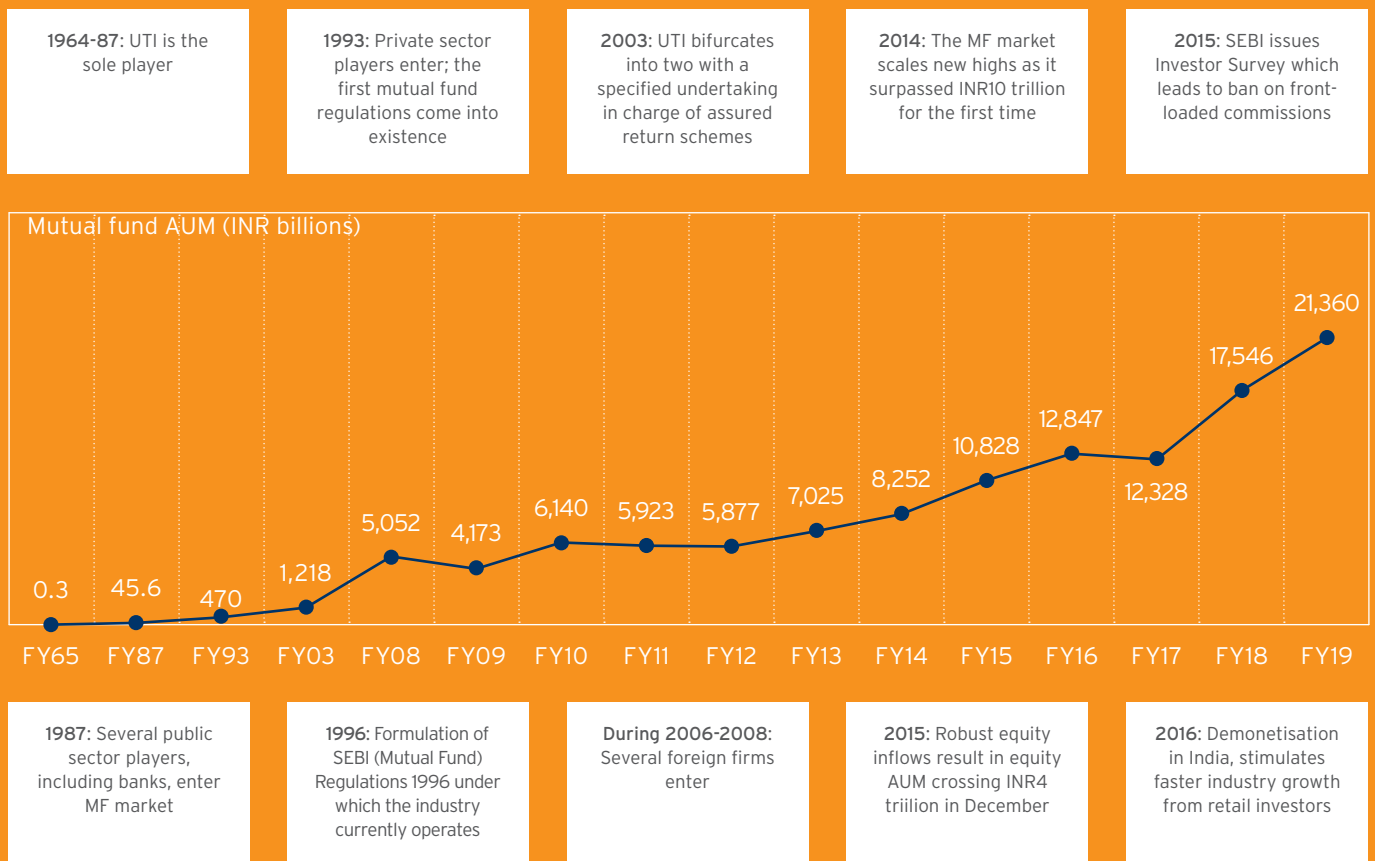
Phase 5: 2003-2006

The UTI was split into two separate entities. The larger, more public part became regulated by SEBI and began to compete more directly with the rest of the market. This has also led to further strong industry growth.



Phase 6: 2006 to date

Foreign-owned fund managers began entering the market, setting up as joint ventures or standalone businesses. In 2014, the AUM passed INR10 trillion (US\$143 billion) for the first time. Together with widespread economic reforms, these last 10+ years have seen significant growth across all parts of the financial services markets, and especially in the growth of mutual funds. In late-2016, demonetisation (see figure 10) provided a significant boost, and substantially increased the number of retail investors.

Figure 9. Timeline of developments²³

Source: Citi. Data source: AMFI. Diagram: EY.

UTI

The UTI was established in 1963 by an act of parliament, set up by the Reserve Bank of India (RBI) and operated under the regulatory control of the RBI until the two were delinked in 1978 and entire control was transferred to the Industrial Development Bank of India (IDBI).²⁴

In 1964, UTI launched its first fund called “Unit Scheme 1964” (US-64). It was designed to be an income fund and offered regular and stable dividends. It had a strong emphasis on debt rather than equity until 1979, when the Foreign Exchange Regulation Act (FERA) was introduced allowing foreign companies to hold up to 40% equity in Indian companies. The UTI's exposure to equity increased substantially after 1979.

In 1966-67, due to the popularity of US-64, UTI launched a reinvestment plan. Another popular scheme, the Unit Linked Insurance Plan (ULIP), was launched in 1971. The first decade of UTI's operations (1964-74) was the formative period. By the end of June 1974, UTI had 600,000 (six lakh) unit holders. The unit capital totalled around INR1.5 trillion (152 crores or US\$22 billion) and investible funds some INR1.7 trillion (172.4 crores or US\$25 billion). Six more schemes were introduced by UTI between 1981 and 1984. At the end of June 1984, the investible funds crossed INR10 billion (1,000 crores) or US\$143 million, and the number of unit holders reached 1.7 million (17 lakhs).

Between 1984 and 1987, more new schemes were launched, e.g. Children's Gift Growth Fund (1986) (India's first offshore fund), Master Share Unit Scheme (1987) and India's first Equity Diversified Scheme. By the end of 1987, UTI had launched 20 schemes raising AUM of INR12 billion (1,261.1 crore) and net AUM exceeding INR45 billion (4,563 crore or US\$650 million). The number of unit holders reached 2.9 million (29.8 lakhs).

For the period of 23 years between 1964 and 1987, UTI enjoyed a complete monopoly and thus was the biggest mutual funds organisation in the country. However, the majority of unit holders of the US-64 scheme were no longer individual investors (as was perceived at the time of launch) for whom the objective had been to channel small household savings. By now, a majority were from the corporate sector, which used it as a safe source of income for companies. This eventually led to the split of UTI in 2003. One part was the US-64 portion, which was regarded as a separate entity due to the nature of its investors, and the remainder, UTI Mutual Fund (UTI MF) was the majority retail mutual funds business, which came under SEBI regulatory control and more directly competed with the public and private sector-owned mutual funds companies.

Since 2003, UTI MF has competed in the Indian mutual funds market against others, without its monopoly positioning. In 2009, T Rowe Price Group (of the US) bought a 26% share in the business, with the remaining shareholders (State Bank of India, Life Insurance Corporation of India, Bank of Baroda and Punjab National Bank) each owning 18.24%. It has been expected these shareholdings would be reduced following a SEBI requirement that rival organisations may not hold more than a 10% stake in competitors, although that has yet to occur.

UTI MF manages assets across all areas of the asset management business. It is a household name in India and has a wide portfolio targeting the varied needs of investors. With 150 branches, 47,000 IFAs, 320 chief agents and business development associates and over 10 million (1 crore) investor accounts, UTI MF is one of the leading financial institutions with a pan-Indian presence.

Entry of international players, JVs and wholly owned mutual funds companies

The entry of global fund managers to the Indian mutual funds market began in 1996. It has not always been successful. In many instances, the foreign firm might set up a JV with a local Indian partner only to find after a few years that it didn't work. There have been many reasons given for the string of these failures, including incompatibility, lack of volume, management differences, other priorities, etc. In an age where margins in many global markets are being driven down, and so leading to lower levels of profitability, clearly quicker returns had been expected, in many instances, than appear to have been available from India.

That said, a very compelling case can be put forward for participation in the Indian mutual funds market. India has rapid economic growth, which will, based on current forecasts, become the third largest worldwide within 20 years. It has a young population, which will grow to become the largest in the world within a few years. It has a large and deep securities market. The level of provision for retirement is low. In the last couple of years, there has been exceptional growth in the size of the domestic market and to date very little has been invested outside India. All this leads to a great opportunity for global players, but getting set up and becoming competitive can be challenging.

It is not simply a matter of setting up an office in say Mumbai or Delhi. As elsewhere in the world, market competition is fierce and based on the usual three principles for selection: fund performance, commission and relationship. Many global managers have preferred to allow their Indian businesses to operate as independently as feasible within their corporate structures: local staff, managing local products, being sold by and to local people. Unlike in many parts of the Asian region, it has proven very difficult to insert someone from head office to set up and run a new entity. India has expected it to be as localised as possible.

In addition, and also unlike elsewhere in Asia, there is little or no significant institutional or pension fund money to access in the market. The accessible mutual funds business in India is very "retail". So it can take time to accumulate the level of assets necessary to make the business viable and become profitable. With the increasing move towards equity funds in the last couple of years, which have high margins, this is clearly a more profitable business, and top fund management skills can be more evident in this product type.

Figure 10. The sale and acquisition of mutual funds companies in India since 2004 ²⁵

Year	Acquiring Asset Management Company	Acquired Asset Management Company
2004	Sun F&C Mutual Fund Templeton Mutual Fund HDFC Mutual Fund Principal Mutual Fund UTI Mutual Fund Sahara India CanBank Mutual Fund	Jardine Fleming Mutual Fund Kothari Pioneer Mutual Zurich India Sun F&C Mutual Fund IL&FS Mutual Fund First India Mutual Fund GIC Mutual fund
2005	Birla Sun Life Mutual Fund Principal Mutual Fund	Alliance Mutual Fund PNB Mutual Fund
2008	Religare Invesco Mutual Fund IDFC Mutual Fund Fortis Mutual Fund	Lotus India Mutual Fund Standard Chartered Mutual Fund ABN AMRO Mutual Fund
2009	L&T Mutual Fund Sundaram BNP Paribas	DBS Cholamandalam Mutual Fund Fortis Mutual Fund
2010	Daiwa Mutual Fund	Shinsei Mutual Fund
2011	Goldman Sachs Mutual Fund	Benchmark Mutual Fund
2012	L&T Mutual Fund	Fidelity Mutual Fund
2013	SBI Mutual Fund	Daiwa Mutual Fund
2014	HDFC Mutual Fund Birla Sun Life Mutual Fund Kotak Mutual Fund	Morgan Stanley ING Mutual Fund Pinebridge Investments
2015	Reliance Mutual Fund Pramerica	Goldman Sachs Deutsche
2016	Edelweiss Edelweiss	JP Morgan Peerless Mutual Fund
2018	DSP	Blackrock
2019	Pramerica	DHFL

This is not a comprehensive list of all sales and acquisitions in India.

In recent years, however, there have been more global fund managers set up in India either as standalone businesses or as partnerships or JVs. They have achieved far more success than the earlier entrants, perhaps benefiting from the experience the early entrants gave to the market. Many have learned that their best route to success has been to develop their local fund management capabilities rather than attempt to import offshore funds or practices that failed to catch on. They also learned that local management in India had a far more realistic approach to achieving success, while being able to lean on global shareholders for support as needed. Many of the global firms, therefore, take a more passive role in the business than might have otherwise been the case.

It has been reported in recent months that there are a number of global firms looking to either set up or buy into the Indian mutual funds market. As is evident from the information given to date, negotiations can often be very slow. The different parties involved might have different priorities, both from a timing and a management perspective. Also, as very often the local Indian partner will usually not be an existing financial services business where a JV is contemplated, this can lead to additional complications that may take time to resolve. Nevertheless, there is no doubt the Indian mutual funds market is now firmly on the radar of global fund managers and more M&A action can be expected in the coming years.



The images of Indian currency are used for representation purposes only.

Demonetisation in India

On 8 November 2016, the Indian government announced the immediate demonetisation of all INR500 and INR1,000 banknotes and issued new INR500 and INR2,000 notes in exchange.²⁶ It claimed this action would curtail the shadow economy and reduce the use of illicit and counterfeit cash to fund illegal activity and terrorism. The announcement of demonetisation was followed by a prolonged period of cash shortages in the weeks that followed, which created some disruption throughout the economy. This was the third time India had demonetised, having previously done this in 1946 and 1978.

According to a 2018 report from the Reserve Bank of India, approximately 99.3% of the demonetised banknotes – or INR15.3 lakh crore (15.3 trillion) of the INR15.4 lakh crore that had been demonetised – were deposited with the banking system. The banknotes that were not deposited were only worth INR10,720 crore (107.2 billion), leading some analysts to state that the effort had failed to remove all black money from the economy.²⁷

Initially, the move received support from several bankers and some international commentators, but the move was also criticised as poorly planned and unfair. Overall, however, it has been widely regarded that this bold move by the Indian government did achieve its desired aim of starving much of the corruption and black economy of the cash with which it traded.

One of the consequences of this demonetisation has been to encourage greater use of mutual funds in India as an alternative to simply holding cash. A direct result has been to see a significant increase in the volume of sales and ultimately in the total AUM of mutual funds.

The mutual funds industry had been poised for growth for a number of years, but then faced various challenges that stalled the potential for a breakout, e.g. the 2007/08 global financial crisis. Also, prior to 2016, a majority of the AUM raised for mutual funds had come from institutional investors, and most retail investing had come from the top 15 cities (see Figure 3). A major consequence of demonetisation was to encourage greater use of mutual funds by retail investors, and across more cities in India, especially the smaller (i.e. bottom 15) cities.

In the immediate aftermath of demonetisation, the total AUM of the mutual funds industry rose by 32%, and the proportion of individual investors that represented the aggregate total industry AUM rose from 45.4% to 48.5%.²⁸ Reports indicate this increase has been maintained over the last two years amid strong industry growth in 2017-18.

Another consequence has been the increase in assets invested in equity funds versus fixed income, bond and money market funds. During this time also, the total industry AUM exceeded INR20 trillion (US\$286 billion) for the first time.

Distribution

Mutual funds in India have a very widely dispersed distribution. According to SEBI figures, there are more than 124,000 distributors of funds and over 1,130 investment advisers registered, both as at 31 March 2019.²⁹ Mutual funds companies may employ their own sales teams (not included in the above numbers), and may also seek third-party fund distribution. Banks, insurance companies and many other financial and wealth managers are all involved in distribution. Many banks primarily focus on their proprietary products, although some are now embracing “open architecture” fund distribution. International banks are also substantial distributors of mutual funds as part of their wealth management offering in bank branches.

In 2015, India’s Ministry of Finance issued a report that reviewed perceived mis-selling practices and sought to rationalise the various distribution incentives paid on financial products.³⁰ The report drew up many recommendations and made multiple conclusions regarding the broad range of financial product distribution practices. For the mutual funds industry, the primary recommendation was for there to be an immediate ban on front-loaded commission payable from fund managers to fund distributors. This was introduced and had an immediate impact on the industry with a significant reduction in the volume of sales.

Following requests from the industry, the total ban on commissions was amended, and in 2018 the regulator SEBI introduced further revisions. Initially this had a negative impact on the number of fund distributors, but as the limitations on commissions became resolved and better understood, mutual funds distribution has returned to being strongly supported across the whole of India.

Given the wide diversity of Indian languages, it is expected that the top fund managers establish local offices in the many centres around the country to service the needs of local distributors in each region. It has proven a challenge trying to provide adequate and competitive service country-wide using just a few locations. This can be costly too, especially in keeping top quality staff.

²³ From EY and Citi. Data AMFI.

²⁴ From UTI MF.

²⁵ From International Journal of Multidisciplinary Research and Development (Vol. 3, Issue 1. January 2016), Citi and market sources.

²⁶ See “Indian banknote demonetisation” at www.en.wikipedia.org.

²⁷ From “Demonetisation What India Gained and Lost” at www.indiatoday.in.

²⁸ From Morningstar India.

²⁹ From The Economic Times of India, 2 April 2019, SEBI statistics.

³⁰ From “Report of the Committee to Recommend Measures for Curbing Mis-selling and Rationalising Distribution Incentives in Financial Products” at www.finmin.nic.in.

SIZE AND SCALE OF INDIA'S DOMESTIC MARKET

The Indian mutual funds market is fragmented. There are currently 44 fully established and licensed businesses operating. Of the top 10 firms, eight are either partly or wholly owned by foreign players. In total, 16 firms have part or whole foreign ownership. Many of the more recent entrants to the market have yet to establish any significant market presence. Often SEBI is encouraging them to set up outside the top 30 cities to enable a broadening of the market beyond existing wealth centres.

Figure 12 shows that the top five mutual fund companies have a market share of almost 60%, leaving just 40% market share between the remaining 39 firms. Indeed, 30 firms have less than 1% market share each.

Given the rate of growth, however, it can be expected that there will be good opportunities in the next few years for smaller and newer firms to get better established and grow significantly. To do this will require both excellence in the product line-up and some degree of uniqueness in the manner with which products are being offered to the market.



Figure 11. Mutual funds managers in India with top 5 by market share³¹

	Name	AUM (US\$bn)	Market Share %	Insurance Co. or Foreign owned	Who?
1	HDFC MF	51.79	13.99%	Part foreign & Ins	Aberdeen Standard Life
2	ICICI Prudential MF	48.18	13.11%	Part foreign & Ins	Prudential (UK)
3	SBI MF	43.93	11.60%	Part foreign	Amundi
4	Aditya Birla Sun Life MF	36.28	10.07%	Part foreign & Ins	Sun Life
5	Reliance MF	31.80	9.55%	Part foreign & Ins	Nippon Life
6	Kotak Mahindra MF	23.03	6.14%	100% Indian	
7	UTI MF	22.55	6.53%	Part foreign	T Rowe Price
8	Franklin Templeton MF	17.85	4.86%	100% Foreign	Franklin Templeton
9	Axis MF	14.60	3.67%	Part foreign	Schroders
10	IDFC MF	11.75	2.83%	100% Indian	
11	DSP MF	11.09	3.20%	100% Indian	
12	L&T MF	10.50	2.90%	100% Indian	
13	Tata MF	7.66	2.22%	100% Indian	
14	Sundaram MF	4.46	1.25%	100% Indian	
15	Mirae MF	4.18	0.99%	100% Foreign	Mirae
16	Invesco MF	3.52	0.98%	100% Foreign	Invesco
17	Motilal Oswal MF	2.81	0.78%	100% Indian	
18	LIC MF	2.33	0.62%	100% Indian	
19	Canara Robeco MF	2.26	0.60%	Part foreign	Robeco
20	Edelweiss MF	1.73	0.48%	100% Indian	
21	HSBC MF	1.66	0.45%	100% Foreign	
22	Baroda MF	1.60	0.46%	100% Indian	
23	JM Financial MF	1.10	0.36%	100% Indian	
24	Principal MF	1.04	0.29%	100% Foreign	Principal
25	BNP Paribas MF	1.03	0.29%	100% Foreign	BNP Paribas
26	IDBI MF	0.92	0.37%	100% Indian	
27	DHFL Pramerica MF	0.77	0.31%	Part foreign & Ins	Prudential (US)
28	Mahindra MF	0.71	0.19%	100% Indian	
29	Indiabulls MF	0.65	0.20%	100% Indian	
30	Union MF	0.62	0.17%	Part foreign & Ins	Dai-ichi Life
31	BOI AXA MF	0.45	0.15%	Part foreign & Ins	AXA Life
32	PPFAS MF	0.30	0.07%	100% Indian	
33	IL&FS MF	0.22	0.07%	100% Indian	
34	IIFL MF	0.22	0.07%	100% Indian	
35	Quantum MF	0.21	0.06%	100% Indian	
36	YES MF	0.20	0.08%	100% Indian	
37	Essel MF	0.15	0.06%	100% Indian	
38	IIFCL MF	0.08	0.02%	100% Indian	
39	Taurus MF	0.06	0.01%	100% Indian	
40	Quant MF	0.06	0.01%	100% Indian	
41	Shriram MF	0.02	0.01%	100% Indian	
42	ITI MF	0.01	0%	100% Indian	
43	Sahara MF	0.01	0%	100% Indian	
44	SREI MF	0	0%	100% Indian	
	Total	349.5	100%		

³¹ Source: <https://www.amfiindia.com/research-information/aum-data/average-aum>.

UNIT TRUSTS, MUTUAL FUNDS, ETFS AND OTHER FUND PRODUCTS

The term “unit trust” or “mutual fund” in India is interchangeable. Indeed, most such funds are called “schemes”, with the issuing entity called “XYZ Mutual Fund”. Until recently, debt or fixed income had been the dominant asset class for Indian funds. This was due to the perceived market demand to provide steady returns plus income. Furthermore, yields from Indian debt securities were significantly higher than available globally. However, in the last few years, and following the entry of many global fund managers both with their own fund businesses and as investors in Indian listed securities, equity funds have become more popular with the retail investing public.

The regulator of the mutual funds business is SEBI, and in July 2018 it issued a Master Circular to all fund houses and other interested parties to fully update its many previous pronouncements, and to consolidate their regulations and guidelines to mutual funds companies.³²

In order to better categorise funds, SEBI seeks to define mutual funds into clearly identifiable categories. Broadly, these categories are:

- Equity schemes
- Debt schemes
- Hybrid schemes
- Solution oriented schemes
- Other schemes

Further uniformity was also sought in equity funds by categorising the investment universe according to market capitalisation of stock exchange-listed companies as:

- Large cap: top 100 listed companies by market cap
- Mid cap: 101-250 listed companies by market cap
- Small cap: 251 or below listed companies by market cap

As part of the attempt to clarify fund categories, SEBI then also sought to define subsections within the main categories. Thus, for equity schemes a further 10 subsector categories have been defined; for debt schemes, 16; for hybrid schemes, six. Under solution-oriented schemes, there is a split between retirement funds and children’s funds. Lastly, under other schemes appears index funds and ETFs, and fund of funds (overseas or domestic). In addition to these requirements, SEBI also likes to adopt a policy of restricting each fund house to only one fund per defined category.

Incorporated within the above mentioned Master Circular are all the various investment restrictions applicable to Indian mutual funds, issues such as fees, charges, expenses and commissions payable to distributors.

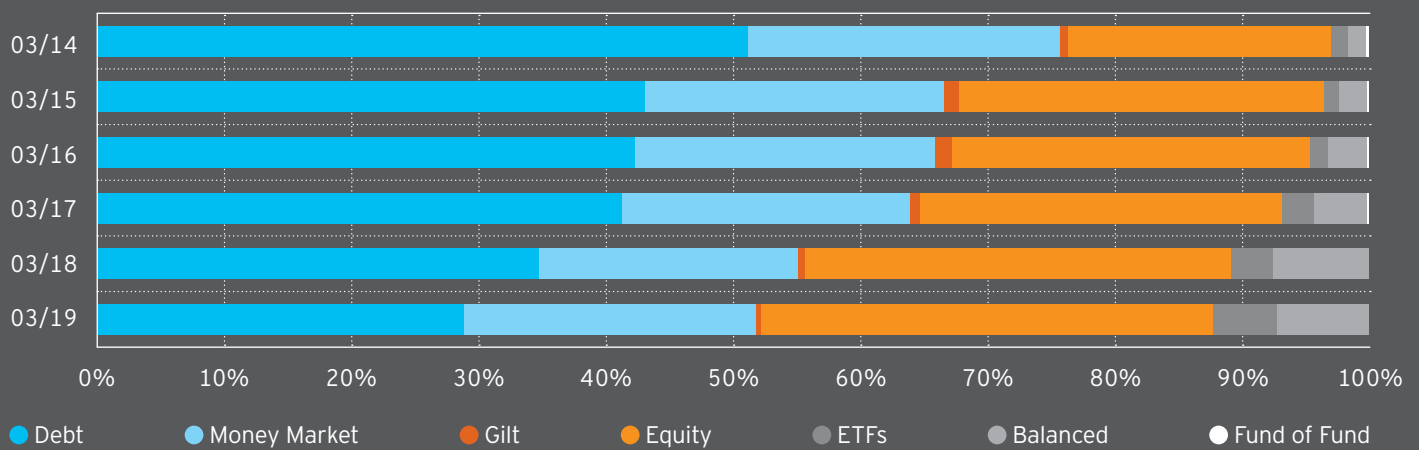
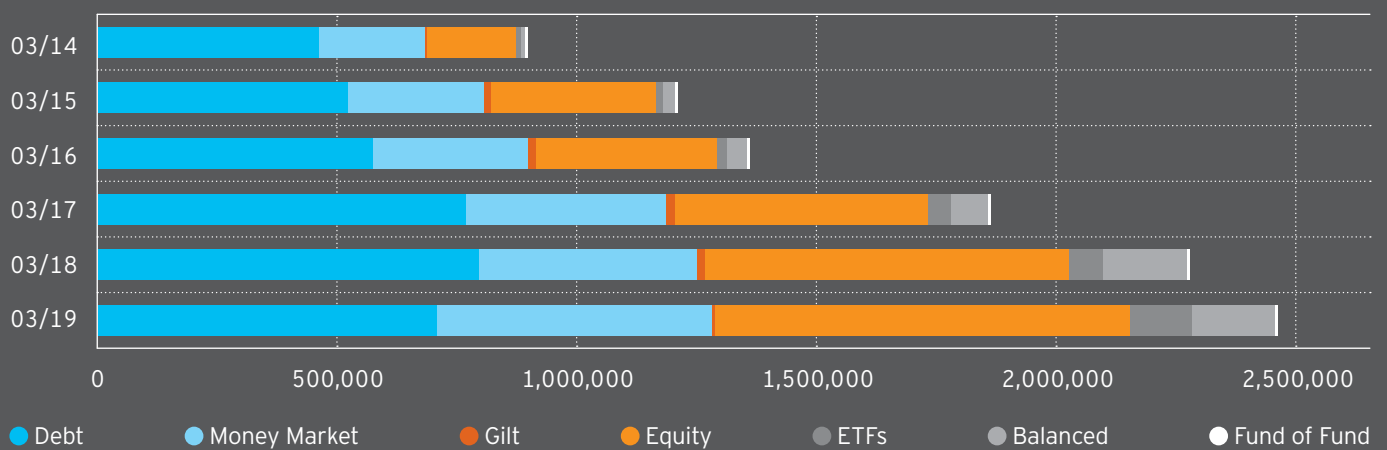
Figure 12. AUM of Indian mutual funds across asset classes by % total³³Figure 13. AUM of Indian mutual funds across asset classes by value³³

Figure 14. Investor split by AUM at March 2019 ³³

Type	AUM (US\$bn)	%
Corporate	136.37	40.12
HNWI	107.38	31.59
Retail	89.98	26.47
Banks/FI	4.31	1.27
FII	1.90	0.56
Total	339.94	100.00

Figure 15. Top 10 largest funds in March 2019 ³³

Fund house	Fund name	AUM (US\$bn)
HDFC Mutual Fund	HDFC Liquid Fund	11.04
ICICI Prudential Mutual Fund	ICICI Prudential Liquid Fund	9.18
Aditya Birla Sun Life Mutual Fund	Aditya BirlaSunLife Liquid Fund	8.31
SBI Mutual Fund	SBI Liquid Fund	7.96
SBI Mutual Fund	SBI ETF Nifty 50	6.59
Reliance Mutual Fund	Reliance Liquid Fund	6.12
UTI Mutual Fund	UTI Liquid Fund	5.77
HDFC Mutual Fund	HDFC Balance Advantage Fund	5.5
ICICI Prudential Mutual Fund	ICICI Prudential Balanced Advantage Fund	4.12
SBI Mutual Fund	SBI Equity Hybrid Fund	4.06



Figure 16. Top 5 largest funds in selected categories ³³

Liquidity funds		
Fund house	Fund	AUM (US\$bn)
HDFC Mutual Fund	HDFC Liquid Fund	11.04
ICICI Prudential Mutual Fund	ICICI Prudential Liquid Fund	9.18
Aditya Birla Sun Life Mutual Fund	Aditya Birla Sun Life Liquid Fund	8.31
SBI Mutual Fund	SBI Liquid Fund	7.96
Reliance Mutual Fund	Reliance Liquid Fund	6.12

Balanced funds		
Fund house	Fund	AUM (US\$bn)
HDFC Mutual Fund	HDFC Balance Advantage Fund	5.50
ICICI Prudential Mutual Fund	ICICI Prudential Balanced Advantage Fund	4.12
SBI Mutual Fund	SBI Equity Hybrid Fund	4.06
HDFC Mutual Fund	ICICI Prudential Equity & Debt Fund	3.70
ICICI Prudential Mutual Fund	HDFC Hybrid Equity Fund	2.62

Equity funds		
Fund house	Fund	AUM (US\$bn)
Kotak Mutual Fund	Kotak Multicap Fund	3.41
Aditya Birla Sun Life Mutual Fund	Aditya Birla Sun Life Frontline Equity Fund	3.01
HDFC Mutual Fund	HDFC Equity Fund	3.00
HDFC Mutual Fund	HDFC MidCap Opportunities Fund	2.99
SBI Mutual Fund	SBI Bluechip Fund	2.96

Debt funds		
Fund house	Fund	AUM (US\$bn)
ICICI Prudential Mutual Fund	ICICI Prudential Savings Fund	2.64
Aditya Birla Sun Life Mutual Fund	Aditya Birla Sun Life Savings Fund	2.37
HDFC Mutual Fund	HDFC Credit Risk Debt Fund	2.37
Franklin Templeton Mutual Fund	Franklin India Ultra Short Bond Fund	2.33
Aditya Birla Sun Life Mutual Fund	Aditya Birla Sun Life Corporate Bond Fund	2.14

Monthly average as at end Q1 2019

ETFs

Exchange-traded funds (ETFs) have been available and listed on the Indian Stock Exchange since 2001. During the initial years, by far the most popular choices were Gold Funds. These represented as much as 90% of the ETF market in India at one stage. However, in recent years, as equity markets have improved (and gold has declined in value), equity ETFs have gained popularity.

As elsewhere in the Asian region, the use of ETFs remains very patchy. On the one hand, banks and financial advisory businesses have yet to embrace the use of ETFs. On the other hand, there remains very positive potential usage by pension, insurance and institutional funds, that has yet to materialise.

Due to foreign exchange restrictions, the number of ETFs that invest outside India is relatively small. There would need to be changes to these restrictions to enable this aspect of the ETF market to develop further.

However, retirement funds (the Employees Provident Fund Organisation or EPFO) and related funds, have started to invest in ETFs and this has led to a significant rise in ETF assets (specifically at fund houses like SBI & UTI). The government has also used ETFs as a tool for divestment of its holdings (CPSE ETF and Bharat 22 ETF), which has also seen investments from retirement funds like EPFO.

Figure 17. AUM of Indian-listed ETFs ³⁴

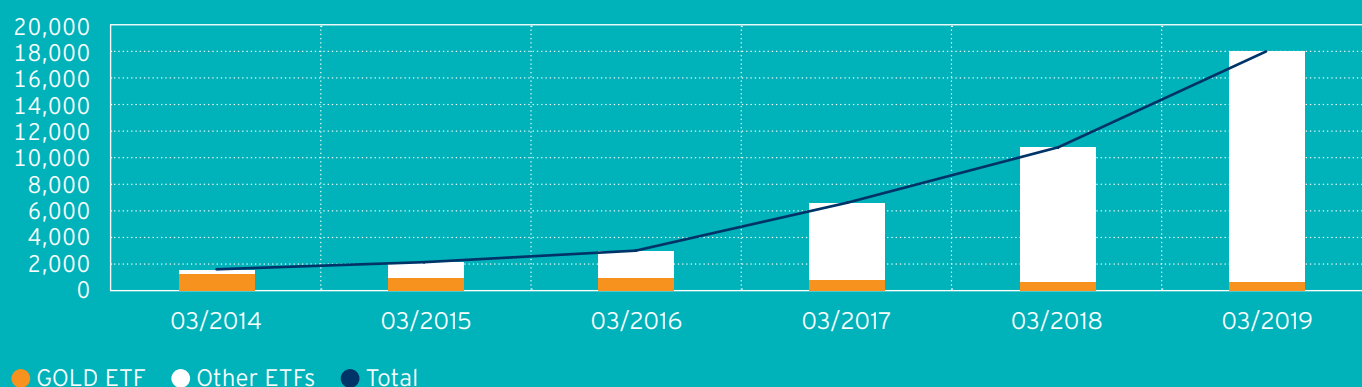


Figure 18. Top ETFs companies, funds, AUM, Indian and non-Indian invested ³⁵

	Name	AUM of ETFs (US\$m)	No. Of ETF	India-invested	Non-India-invested	Market share
1	SBI	10,487.51	9	10,487.51		52.40%
2	Reliance	3,856.48	17	3,855.43	1.05	19.27%
3	UTI	2,584.98	5	2,584.98		12.92%
4	ICICI Prudential	1,390.71	11	1,390.71		6.95%
5	Kotak	1,236.48	6	1,236.48		6.18%
6	LIC	188.39	4	188.39		0.94%
7	HDFC Mutual Fund	116.93	3	116.93		0.58%
8	Aditya Birla Sun Life	49.46	4	49.46		0.25%
9	Motilal Oswal	29.88	3	6.50	23.38	0.15%
10	Axis Mutual Fund	16.68	2	16.68		0.08%
11	DSP	13.75	1	13.75		0.07%
12	Tata Mutual Fund	10.66	1	10.66		0.05%
13	IDBI	8.68	1	8.68		0.04%
14	Quantum	8.44	2	8.44		0.04%
15	Canara Robeco	5.19	1	5.19		0.03%
16	Invesco	4.69	2	4.69		0.02%
17	Mirae	2.62	1	2.62		0.01%
18	Edelweiss	1.97	3	1.97		0.01%
19	Indiabulls	1.34	1	1.34		0.01%
20	IDFC	0.30	2	0.30		0.00%
	Total	20,015.13	79	19,990.70	24.43	100.00%

Note: The AUM is shown as at 31 March 2019.

Alternative investments, private equity, hedge funds

The number and range of alternative investment funds (AIFs) on offer in India is increasing quite quickly, as new opportunities arise. The choice of products offered include hedge funds, private equity funds, real estate investment trusts (REITs), etc. AIFs have been able to be offered to HNWI's for a number of years and, with the rapid rise in wealth generally and also in the provision of specialist banking services for the wealthy, such products become increasingly attractive.

AIFs generally are regulated under SEBI (Mutual Funds) Regulations 1996, together with some amendments introduced in July 2012, called SEBI (Alternative Investment Funds) Regulations, 2012.³⁶ From a regulatory perspective, SEBI has classified AIFs into three categories:

- Category I funds receive incentives from the government or regulators. They include venture funds, social venture funds and infrastructure funds.
- Category II funds include private equity funds, debt funds and similar. They don't receive any government concessions, and can't raise debt for investment purposes.
- Category III funds are typical hedge funds that aim to make investment returns over long- and short-term time periods.

Regulations in India restrict the availability of these AIFs to HNWI's only and generally to no more than 1,000 investors per fund. Such investors are not actually classified, but they can be assumed to mean those having a minimum net worth of approximately US\$1 million, and for these types of investments investors are required to make a minimum investment of INR10 million (US\$143,000) per investment. The minimum fund size is required to be INR200 million (US\$2.9 million).

Another aspect of the development of AIFs has been their ability to pay commissions to distributors in the form of upfront fees, ranging up to 10% of the amount invested. The recent rapid growth in this area and the apparent freedom to pay introductory commissions have begun to lead to calls for SEBI to introduce more restrictive regulations on how they operate, before the collapse of some funds occurs and its consequent impact on the market.

At 30 April 2019, SEBI had 576 AIF registered, offering a wide variety of investment mandates.³⁷ The most popular categories are shown in figure 20.

Figure 19. Categories and split of hedge and alternatives funds

	Commitments raised*	Funds raised*	Investments made*
Category I			
Infrastructure funds	12,082.22	6,450.14	5,464.12
Social venture funds	1,314.64	859.46	797.30
VC funds	19,875.84	6,271.67	4,572.16
SME funds	260.86	208.00	59.42
Category I Total	33,533.56	13,789.27	10,893.00
Category II	205,360.05	83,554.05	68,085.75
Category III	43,254.74	36,865.99	30,801.78
Grand total	282,148.35	134,209.31	109,780.53

*INR million.

Taxation is a key consideration for AIFs, and generally in India they are treated relatively favourably.³⁸

Category I and II AIFs enjoy a special tax regime and are pass-through entities for tax purposes. The special tax regime is not available to Category III AIFs and the taxability of the fund depends on its legal status (company, trust, limited liability partnership and so on). Most funds are set up as trusts and the income accruing to the Category III AIF is chargeable to tax in the hands of the trustee as a representative tax payer for and on behalf of the beneficiaries and in like manner as

the beneficiaries. The Central Board of Direct Taxes (CBDT) issued a circular stating that a position of tax pass-through can be achieved if the Category III AIF is set up as a determinate trust and the income of the Category III AIF does not consist of or include profits and gains of business. A determinate trust is where the names of the investors and their respective beneficial interest are known from the trust deed. If the Category III AIF complies with these conditions, the income is taxed only at the investor level as if it were arising out of investments made directly by the investor.

Dividends declared by Indian companies are exempt from tax in the hands of the shareholders (that is, the hedge fund). However, the Indian company distributing the dividends must pay a dividend distribution tax at the base rate of 15% (excluding applicable surcharge and education).

Interest income accruing to the hedge fund on debt instruments is subject to a withholding tax at rates applicable to resident beneficiaries and non-resident beneficiaries. For business income or speculative or derivatives income, the hedge fund is taxed at the entity level at the maximum marginal rate (MMR).

When the trust is indeterminate (that is, when the beneficiaries or their interests are unknown), the hedge fund will not qualify for the determinate status as clarified by the CBDT and will be taxed at the entity level at MMR.

Systematic Investment Plans

In recent years, Systematic Investment Plans (SIPs) have become a very popular and successful option for mutual fund houses in India. Typically, a SIP is simply a regular savings plan that buys directly into unit trusts or mutual funds, as selected by the investor. In India, the usual minimum investment for monthly contributions is INR500 (US\$7.1). In keeping with the flexibility offered by SIPs, many of the fund houses that offer these products also provide “bolt-on” extras, such as:

- The ability to increase monthly contributions annually or from time to time.
- “Alert SIP”, whereby the fund house issues alerts to the subscriber to buy more when markets are down.
- “Perpetual SIP”, where no end date is selected for the term of contributions allowing subscribers to maintain their SIP for as long or as short as they wish.

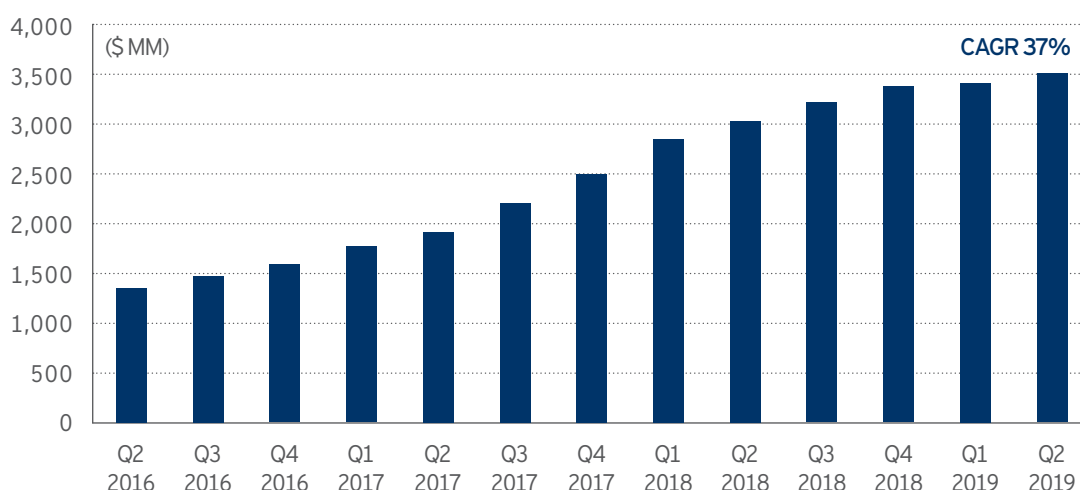
The success of SIPs has been achieved following widespread marketing and support for these products by the mutual funds industry. They have stressed the usual benefits such as rupee cost-averaging, convenience and compounding. All fund houses offer these products and bank distributors are strongly encouraged to use them with customers also. When using SIPs in



conjunction with the Equity Linked Saving Scheme (ELSS), investors can also gain some significant tax advantages. The ELSS is a tax-saving mutual-fund product where individuals can save up to INR46,800 in a financial year.³⁹ The scheme has a three-year lock-in period, and after three years any gains are taxed at 10% only on the excess over INR100,000.

The scale of success of SIPs can also be seen from the numbers. As at April 2019, there were 26.2 million investors who had created a SIP, which has been increasing by an average of 900,000 per month for the last two years.⁴⁰ The monthly inflow to these products have averaged over INR7 billion, and was INR80 billion (US\$1.2 billion) during the 2018-19 financial year.

Figure 20. Quarterly growth of SIPs 2016-19⁴¹



Portfolio management services (PMSs)

In recent years, the development of PMSs has been rapid. Many new firms – over 280 are registered – have started offering such services to HNWI, either directly or via third-party distributors. In India, a PMS is usually operated as an investment portfolio that can comprise equities, debt securities, mutual funds and structured products in any combination. Typically the minimum initial investment required is INR2.5 million (US\$35,000), although to make them more exclusive, many offering such products have raised their minimum to INR5 million (US\$70,000). Not only are these products offered by private banks but also by so-called wealth managers, which have become a fast-growing sector of the personal financial services market.⁴² The scale of the market is now estimated to have reached AUM of INR130 billion (US\$1.85 billion), with client numbers exceeding 130,000. Typically PMSs establish one or more investment objectives from outset, which could be for capital growth, short- or long-term returns, retirement, etc. Fees are charged to the portfolio and can range from around 1% per annum to as much as 3%. Some managers also include profit-sharing fees, which can range between 15% and 20% of excess returns over agreed benchmarks. Unlike the mutual funds industry, PMS operators often pay an introductory commission to third-party providers, which can range between 1% and 3% of assets sourced.

PMSs offer an alternative to traditional mutual funds and so compete in the market for assets. To date there has been little published about the performance track record of PMS providers, which, when it happens more regularly, may provide more meaningful comparisons with the traditional mutual funds sector.

Taxation issues⁴³

Any discussion of the Indian investment markets also needs to include the impact of taxation. Generally, tax in India is applicable to all forms of income and capital gains. There are, however, a number of areas where there are tax benefits or savings that have often been used to stimulate greater investor participation as a result.

The fund

Generally, a mutual fund is allowed to invest and accumulate assets tax free. Thus it is in the hands of the end-investor, where tax is applicable. Nevertheless, there is a Securities Transaction Tax (STT) of 0.001%, which is levied by the fund company itself, when an investor sells units of an equity or balanced fund. There is no STT on the sale of debt fund units.

The investor.

Investors are deemed to earn income on investments in the form of interest, dividends or capital gains. Where there is income, there is income tax. The tax paid on capital gains largely depends on the time for which an investment is held in the respective schemes. This is the holding period for mutual funds, which can be deemed short-term or long-term. For equity mutual funds and balanced mutual funds, a holding period of 12 months or more is regarded as long-term. Long-term capital gains tax or LTCG applies to those investments. A holding period of 36 months or more is regarded as long term for debt funds. A holding period of less than 36 months for debt funds and less than 12 months for equity and balanced funds is defined as short term. Therefore, short-term capital gains tax may apply to gains made from any scheme held for less than 36 months.

Figure 21. Holding period classification for mutual funds

	Short-term	Long-term
Equity funds	Less than 12 months	12 months or more
Balanced funds (min. 65% equity inv.)	Less than 12 months	12 months or more
Debt funds	Less than 36 months	36 months or more

Equity Linked Savings Schemes (ELSSs) are the most efficient tax-saving instruments under Section 80C. As diversified equity funds, they can invest in equity shares of companies across the market. The ELSS has a lock-in period of three years, which means it cannot be redeemed within three years of commencement. After redemption, the long-term capital gains (LTCG) up to INR100,000 is tax-free. LTCG in excess of INR100,000 is taxable at the rate of 10% without the benefit of indexation. There is a 15% tax on short-term gains from equity funds, if the units are redeemed within 12 months of purchase. Balanced funds are regarded as equity-oriented hybrid funds that invest at least 65% of their assets in equities and thus their tax treatment is the same as non-tax saving equity funds.

Long-term capital gains on debt funds are taxed at the rate of 20% after indexation. Indexation is a method of factoring in the rise in inflation between the year when the debt fund units were bought and the year when they are sold. Indexation allows the investor to inflate the purchase price of debt funds to bring down the amount of capital gains. Investors add short-term gains from debt funds to their overall income for tax purposes, and are subject to short-term capital gains tax (SCGT) as per the income tax rate applicable to their income.

To conclude here, the longer an investor holds mutual fund units, the more tax-efficient they become. This is because the tax on long-term gains is much less than the tax on short-term gains.

³² See Master Circular for Mutual Funds at www.sebi.gov.in.

³³ From www.amfi.com. As at 31 March 2019, in INR.

³⁴ From www.amfi.com.

³⁵ From www.amfiindia.com.

³⁶ From www.sebi.gov.in.

³⁷ From www.sebi.gov.in.

³⁸ From "Hedge Funds in India: Regulatory Overview" at uk.practicallaw.thomsonreuters.com.

³⁹ From www.clearfax.in/s/elss.

⁴⁰ From www.amfiindia.com/mutual-fund.

⁴¹ From www.amfiindia.com.

⁴² From PMS Investing at www.economictimes.indiatimes.com.

⁴³ From "Mutual Fund Taxation - How Mutual Funds Are Taxed?" at www.clearfax.in.

RETAIL FUND DISTRIBUTION

Mutual funds in India have a very wide distribution network. It is estimated there are more than 124,000 mutual funds distributors working at over 1,130 registered investment advisers, more than 280 firms offering PMS services and more than 150 banks with 110,000 branches throughout the country, all willing and able to distribute mutual funds. Indian investors have many choices available to compete for their savings. These range from state-owned to private sector-owned banks. In addition, there are many of the global banks that have a presence in India, some with extensive branch networks, others with a limited presence, usually in Mumbai.

India has also developed a number of special-purpose banks, such as payments banks (which have a restriction on the volume of deposits per customer they can accept) and small finance banks (to cater for those people who previously had not used traditional banks).

Figure 23 below provides a snapshot of the typical array of products on offer, quite apart from regular bank savings accounts.⁴⁴

Figure 22. Variety of investment options in India

	Risk	Tenure	Liquidity	Returns	Taxation
Direct Equity	High	Can be sold anytime	High	Market-linked	STCG - 15%, LTCG-10%* (Long term 1 year)
Equity mutual fund	Moderate-High	Open end^	High	Market-linked	STCG - 15%, LTCG-10%* (Long term 1 year)
Real estate	High	Can be sold anytime	Low	Market-linked	STCG- Added to income, LTCG-20%**
Gold	Low-moderate	Can be sold anytime	Varies	Market-linked	STCG- Added to income, LTCG-20%**
PPF	No risk	15 years	Partial withdrawals^^	7.9 percent	Interest tax free (EEE status)
Bank fixed deposit	Low	7 days to 10 years	Premature exit	Varies	Interest taxable as per tax slab
Debt funds	Low-high	Open end	High	Market-linked	STCG- Added to income, LTCG-20%**
RBI taxable bonds	No risk	7 years	Low	7.75 percent	Interest taxable as per tax slab
NPS	Low-high	60 minus entry age	Limited	Market-linked	60% of corpus tax exempt, Annuity taxable
Senior Citizens' Saving Scheme	No risk	5 years	Low	8.3 percent	Interest taxable

* Gains up to Rs 1 lakh exempted. ** Post indexation. ^ ELSS comes with 3-year lock-in. ^^ Subject to conditions.
For physical gold, paper gold and debt funds long term is three years; real estate long term is two years.



HNWIs are well provided for by private banking. Most of the major Indian-owned banking groups have their own private banking subsidiary. Many of the largest global banking groups are also present in India and offer extensive private banking services in key wealth centres.

Figure 23. Top 20 private banks/wealth managers by AUM at 31 December 2018 ⁴⁵

	Name	Type	AUM (US\$bn)
1	Kotak Wealth Management	Domestic	33.63
2	ICICI Bank PB	Domestic	25.61
3	IIFL Wealth & AM	Domestic	21.38
4	Edelweiss WM	Domestic	14.70
5	BNP Paribas WM	Foreign	13.79
6	Axis Bank WM	Domestic	12.78
7	Standard Chartered PB	Foreign	9.70
8	HDFC PB	Domestic	9.10
9	Julius Baer PB	Foreign	9.00
10	JM Financial WM	Domestic	6.14
11	ASK Asset & WM	Domestic	6.04
12	Barclays Wealth	Foreign	4.91
13	Aventus WM	Domestic	3.90
14	Centrum WM	Domestic	3.60
15	Client Associates	Domestic	3.40
16	Karvy Private Wealth	Domestic	3.36
17	L&T Capital Markets	Domestic	3.27
18	Deutsche Bank WM	Foreign	3.20
19	Credit Suisse PB	Foreign	2.77
20	Anand Rath Private WM	Domestic	2.75

Note Excludes a number of global firms including Citi, HSBC and UBS, which did not provide statistics to the publication. As at the date of this figure, Citi Private Bank had approximately US\$20bn in AUM.

Figure 24. Top 12 Banks in India by branch, size and type ⁴⁶

	Name	Branches	HO location	Private or public/state	Est.
1	HDFC Bank	4,963	Mumbai	Private	1994
2	State Bank of India	85,356	Mumbai	Public/state	1955
3	ICICI Bank	4,867	Mumbai	Private	1994
4	Kotak Mahindra Bank	1,369	Mumbai	Private	2003
5	Axis Bank	4,000	Mumbai	Private	1993
6	IndusInd Bank	1,558	Mumbai	Private	1994
7	Yes Bank	1,150	Mumbai	Private	2004
8	Punjab National Bank	7,000	New Delhi	Public/state	1908
9	Bank of Baroda	9,500	Gujarat	Public/state	1908
10	Bank of India	5,100	Mumbai	Public/state	1906
11	Canara Bank	6,639	Bengaluru	Public/state	1906
12	IDBI Bank	2,896	Mumbai	Private	1964



Given India's strength in technological development, to date it is notable that online mutual funds distribution has not yet succeeded. This is likely to occur sooner or later, though, as investors become more comfortable with the concept of mutual funds investing. As tax continues to be a significant factor in India, especially for high-income earners, many firms have developed businesses that aim to offer comprehensive tax advice and incorporate investment advice and guidance. As in some other parts of the world, this appears to be a relatively winning combination from an individual's perspective.

Retail investor attitudes⁴⁷

A recent survey carried out in India on behalf of DSP Mutual Fund to gauge investor attitudes has revealed some surprising results, which will have the mutual funds industry paying more attention to its future marketing efforts. While much of the survey focuses on women's attitudes, the results reflect views of more than 4,000 people interviewed in eight cities. Of particular note were that:

- 33% of women take independent investment decisions, compared to 64% of men.
- 65% of respondents began investing before reaching 25, but 76% felt they should have started even younger.
- 42% of women and 46% of men consulted an investment adviser to make investments.
- 40% of women were introduced to investing by their husbands compared to 27% by their fathers.
- Both men and women had similar investment goals, i.e. children's education, dream home, children's marriage, debt-free life and higher standard of living.
- Surprisingly, retirement didn't figure as highly in the objectives as other choices.

⁴⁴ From "Top 10 Investment Options" at www.economicstimes.indiatimes.com.

⁴⁵ Asian Private Banker, June 2019.

⁴⁶ From <https://www.mapsofindia.com/my-india/business/top-10-banks-in-india-by-size-and-market-capital#>.

⁴⁷ From DSP Winvestor Pulse 2019 survey, published 30 May 2019.

PENSION AND RETIREMENT FUNDS AND INSTITUTIONAL FUND MANAGEMENT

National Pension System⁴⁸

The National Pension System (NPS) is a voluntary defined contribution (DC) pension system in India. The NPS is a tax-exempt system where all assets escape tax at maturity and the entire pension withdrawal amount is tax-free. NPS started with the government's decision to cease defined benefit (DB) pensions for all its employees who joined after 1 January 2004. While the scheme was initially designed for government employees only, it was opened up to all citizens between the age of 18 and 60 in 2009. In its overall structure, the NPS is similar to US 401(k) plans. The NPS is administered and regulated by the Pension Fund Regulatory and Development Authority (PFRDA). Under the NPS, an individual can contribute to their retirement account. Also, their employer can contribute to their welfare and social security.

On 10 December 2018, the government made NPS entirely tax-free, whereby the entire assets escape tax at maturity. The 40% annuity also became tax-free. The contribution under Tier II of NPS is covered under Section 80C of the Income Tax Act for deduction of up to INR1.50 lakh for income tax benefits, provided there is a lock-in period of three years. The tax changes to NPS were notified through changes in The Income Tax Act 1961, which is expected to happen through the Finance Bill in 2019 Union Budget of India. The NPS has limitations to the extent that a proportion (40%) has to be compulsorily used to purchase an annuity on retirement.

NPS contributions receive tax exemptions under Sections 80C, 80CCC and 80CCD(1) of the Income Tax Act. Starting from 2016, an additional tax benefit of INR50,000 under Section 80CCD(1b) is provided under the NPS, which is over the INR1.5 lakh exemption of Section 80C. Private fund managers are important parts of the NPS. The NPS is considered one of the best tax-saving instruments after 40% of the accumulated assets were made tax-free at the time of maturity, and it is ranked just below equity-linked savings schemes in terms of popularity.

Unlike traditional financial products where all the functions (sales, operations, service, fund management, depository) are done by one company, the NPS follows an unbundled architecture where each step of the value chain is made separate from the other. This unbundling not only allows the customer to mix and match their providers of service through the value chain, picking the best-suited option, but also curbs the incidence of mis-selling.

NPS architecture consists of the NPS Trust, which is entrusted with safeguarding subscribers' interests; Central Recordkeeping Agencies (CRAs), which maintain data and records; point of presence (PoP) collection, distribution and servicing arms; pension fund managers (PFMs) for managing the investments of subscribers; a custodian to take care of the assets purchased by the fund managers; and a trustee bank to manage the banking operations. At age 60, the customer can choose to purchase a pension from an Annuity Service Provider (ASP). NPS investors can't opt for two pension fund managers, nor can they switch to another pension fund before a year has elapsed. In 2017, PFRDA increased the maximum entry age in the NPS to 65 years.

Figure 25. Top pension fund managers in India⁴⁹

The number of PFM's has increased to eight in the NPS and they are:⁵⁰

	AUM (US\$m)	Date included
SBI Pension Funds	17,612	May 2009
UTI Retirement Solutions	13,530	May 2009
LIC Pension Fund	13,395	July 2013
HDFC Pension Fund	765	August 2013
ICICI Prudential Pension Fund	505	May 2009
Kotak Pension Fund	114	May 2009
Reliance Capital Pension Fund	42	May 2009
Birla Sun Life Pension Management	16	May 2017

At present, central government employees have no say in the matter of choice of fund manager or investment allocation in the NPS, as both are decided by the government. All the NPS contributions of central government employees are being distributed evenly across three public sector fund managers: LIC Pension Fund, SBI Pension Fund and UTI Retirement Solutions.

The current CRAs are the NSDL e-Governance Infrastructure Limited (NCRA) and Karvy Computer Shares Pvt Ltd (KCRA). All the major commercial banks, brokers and Stock Holding Corporation Ltd perform the role of PoPs. The subscriber can choose any one of them. There are eight fund managers and five annuity service providers for subscribers to choose from. The subscriber can choose to invest either wholly or in combination, in four types of investment schemes offered by the pension fund managers, namely:

- **Scheme E (Equity)**, which allows up to 75% equity participation and is invested in stocks.
- **Scheme C (Corporate Debt)**, which invests only in high-quality corporate bonds.
- **Scheme G (Government/Gilt Bonds)**, which invests only in government bonds.
- **Scheme A (Alternative Investment)**, which allows up to 5% in alternative investments.⁵¹

Alternatively, the subscriber can opt for a default scheme, wherein their portfolio is rebalanced each year for the proportion of equity, corporate bonds and government bonds according to the time left to retirement.

NPS offers two types of accounts to its subscribers:

- **Tier I**, the primary account, which is a pension account that has restrictions on withdrawals and on the utilisation of accumulated assets, where all the tax breaks that NPS offers are applicable.
- **Tier II**, where, in order to introduce some liquidity to the scheme, the PFRDA allows subscribers with pre-existing Tier I accounts to deposit and withdraw monies as and when they want. NPS Tier II is an investment account, similar to a mutual fund in characteristics.⁵²

Investment in NPS is eligible for tax benefits as follows.

Up to INR150,000 under Section 80CCD(1). The benefit is additionally capped at 10% of basic salary. The benefit under Section 80C, Section 80CCC and Section 80CCD(1) is capped at INR150,000. Contribution Up to INR50,000 under Section 80CCD(1B). This is over and above tax benefit under Section 80CCD(1b). Employer co-contribution up to 10% of basic and Dearness Allowance without any upper cap in terms of amount is tax-free income in the hands of employees under Section 80CCD(2).

Employees' Provident Fund Organization (EPFO)⁵³

The EPFO is one of the world's largest social security organisations in terms of members and in volume of financial transactions undertaken. At present, it maintains 171.4 million accounts.

The EPFO came into existence with the promulgation of the Employees' Provident Funds Ordinance on 15 November 1951. It was replaced by the Employees' Provident Funds Act, 1952. The Employees' Provident Funds Bill was introduced in parliament as Bill Number 15 of the year 1952 as a bill to provide for the institution of provident funds for employees in factories and other establishments. The act is now referred to as the Employees' Provident Funds and Miscellaneous Provisions Act, 1952, which extends to the whole of India except Jammu and Kashmir. The act and schemes it frames are administered by a tri-partite board known as the Central Board of Trustees, Employees' Provident Fund, consisting of representatives of government (both central and state), employers and employees.

The Central Board of Trustees administers a contributory provident fund, a pension scheme and an insurance scheme for the workforce engaged in the organised sector in India. The board is assisted by the EPFO, which has offices in 135 locations across India. The EPFO is under the administrative control of India's Ministry of Labour and Employment.

The board operates three schemes: the EPF Scheme 1952 (EPF), the Pension Scheme 1995 (EPS) and the Insurance Scheme 1976 (EDLI). EPFO assists the central board in administering a compulsory contributory Provident Fund Scheme, a Pension Scheme and an Insurance Scheme for the workforce engaged in the organised sector in India. It is also the nodal agency for implementing bilateral social security agreements with other countries on a reciprocal basis.

The schemes cover Indian and international workers (for countries with which bilateral agreements have been signed). Currently there are 19 operational social security agreements. It is one of the largest social security organisations in India in terms of the number of covered beneficiaries and the volume of financial transactions undertaken. The EPFO's apex decision-making body is the Central Board of Trustees. On 1 October 2014, Prime Minister Narendra Modi launched a Universal Account Number for employees covered by EPFO to enable pension fund number portability. The total AUM are more than INR11 lakh crore (US\$157.8 billion) as at end of 2018.

The EPFO and related funds have started to invest in ETFs and this has led to a significant rise in ETF assets (specifically at fund houses like SBI & UTI) to which the government divested some of its holdings (CPSE ETF and Bharat 22 ETF), which has also seen support and investments from retirement funds like the EPFO.



Figure 26. Indian life insurance companies by formation date⁵⁴

	Name	Date of reg. or form.	JV	Ownership (where public)
1	Life Insurance Corporation of India (LIC)	1956	No.	State-owned
2	HDFC Standard Life Insurance	2000	Yes	61% HDFC, 35% Aberdeen Standard Life, 4% others
3	Max Life Insurance	2000	Yes	68% Max FS, 26% Mitsui Sumitomo Ins.
4	ICICI Prudential Life Insurance	2000	Yes	ICICI, Prudential (UK)
5	Kotak Mahindra Life	2001	No	
6	Birla Sun Life Insurance	2000	Yes	Aditia Birla, Sun Life of Canada
7	TATA AIA Life	2001	Yes	TATA, AIA
8	SBI Life Insurance	2001	Yes	62.1% SBI, 22% BNP Paribas, 16% others
9	Exide Life Insurance	2001	No	
10	Bajaj Allianz Life Insurance	2001	Yes	Bajaj, Allianz
11	PNB MetLife	2001	Yes	30% PNB, 70% MetLife
12	Reliance Nippon Life Insurance	2001	Yes	51% Reliance, 49% Nippon Life
13	Aviva Life Insurance	2002	Yes	Dabar, Aviva
14	Sahara India Life	1978	No	
15	Shriram Life	2005	No	
16	Bharti AXA Life	2005	Yes	Bharti, AXA Group
17	Future Generali India Life	2007	Yes	Future Group, IITL, Generali
18	IDBI Federal Life	2008	Yes	IDBI, Federal, Ageas
19	Canara HSBC Oriental Bank of Commerce Life	2008	Yes	Canara, HSBC
20	Aegon Life	2008	Yes	Times Group, Aegon
21	DHFL Pramerica Life	2008	Yes	DHFL, Prudential (US)
22	Star Union Dai-ichi Life		Yes	Star Union, Dai-ichi
23	IndiaFirst Life	2009	Yes	44% BoB, 30% Andhra Bank, 26% Warburg Pincus
24	Edelweiss Tokio Life	2011	Yes	Edelweiss, Tokio Life

Figure 27. India's top national provident and pension funds⁵⁵

Fund	Fund size (crore)
Employee Provident Fund	INR1,140,000
Postal Life Insurance	INR67,000
State Railway Provident & Pension Fund	INR70,000
Indian Oil Corporation Provident Fund	INR36,000
ONGC Provident Fund	INR28,000
National Pension Scheme	INR245,999
NTFC Provident Fund	INR16,800
Seamen's Provident Fund	INR1,670

⁴⁸ From Wikipedia.⁴⁹ From Economic Times of India.⁵⁰ From <https://www.pfrda.org.in/index1.cshhtml?lslid=226>.⁵¹ Newly added asset class only for private sector subscriber with active choice.⁵² Contributions to the voluntary savings (Tier-II) account can only be made by the subscriber, not by any third party.⁵³ EPFO Annual Report 2015-16.⁵⁴ Insurance Regulatory and Development Authority of India.⁵⁵ From Wikipedia.

HOW CAN FOREIGN MANAGERS ENTER THE MARKET?

Impact of capital controls

The RBI maintains a comprehensive set of regulations regarding exchange controls. The effect of these is to reduce the flows of money out of the country while not restricting inward investments. The Foreign Exchange Management Act (FEMA) was passed in 1999 and replaced a previous act that also sought to control foreign exchange activities. The main features of FEMA include the following:⁵⁶

- FEMA gives power to the government to impose restrictions on financial activities such as making payments to a person situated outside of the country or receiving money through them. FEMA also restricts foreign exchange and foreign security deals.
- Transactions involving foreign securities or foreign exchange, and payments made from any foreign country to India, cannot be made without FEMA's specific or general permission. All transactions must be carried out via an authorised individual or institution.
- The government can restrict an authorised individual from carrying out foreign exchange deals within the current account on the basis of the general interest of the public.
- Even though drawing or selling foreign exchange is carried out via an authorised individual, FEMA empowers the RBI to place a number of restrictions on the transactions of the capital account.
- Indian residents have permission to conduct foreign exchange and foreign securities transactions or the right to hold or own immovable property in a foreign country in case the security, property or currency was acquired or owned when the individual was based outside the country or when they inherited the property from another individual staying outside the country.

Regulations applicable to overseas investment

Under the SEBI Circular issued in July 2018, mutual funds are allowed to invest in overseas assets provided they stay within limits set by the government.⁵⁷ The key details follow.

Figure 28. Overseas investment limits summary

Applicable limits	<ul style="list-style-type: none"> • Aggregate ceiling for overseas investments of US\$7bn. • Maximum per mutual fund company US\$300m. • Aggregate ceiling for use of overseas ETFs of US\$1bn. • Maximum per ETF issuer of US\$50m.
Permissible investments	<ul style="list-style-type: none"> • Securities issued on recognised stock exchanges. • IPOs on recognised stock exchanges. • Debt securities in fully convertible currencies not below investment grade. • Money market or repo instruments, not below investment grade. • Government securities rated not below investment grade. • Derivatives on recognised stock exchanges, used for hedging and portfolio balancing only. • Units/shares of overseas mutual funds investing within the above parameters, including REITS.
Other conditions	<ul style="list-style-type: none"> • Dedicated fund manager required to oversee overseas investments. • Proper, clearly defined due diligence on selection processes required • Mandatory disclosure in scheme documents required.

⁵⁶ From www.archive.india.gov.in/business/doing_business/fema.php.

⁵⁷ From Master Circular for Mutual Funds 10 July 2018 (pp 161-163) in Legal at www.sebi.gov.in.

SHOULD INDIA JOIN THE ASIA REGION FUNDS PASSPORT SCHEME?

India has built one of the larger mutual funds markets in the Asia-Pacific region. However, any examination of it reveals that it is largely an insular market and that active foreign participation is relatively small given the scale of the opportunity that might exist were India to consider joining the Asia Region Funds Passport (ARFP) scheme.

The ARFP was developed for a number of Asia-Pacific economies by the Asia-Pacific Economic Cooperation Joint Committee, a part of the Asian Development Bank. Its objective is to enlarge the scale of domestic mutual funds management within the region and bring a number of economic benefits to investors in such funds, which, in turn, could lead to improved returns.

What is the ARFP?

The ARFP was designed to enable mutual funds domiciled in one jurisdiction to be marketed and sold in another within the framework of the scheme's limitations. The ARFP formally commenced in early 2019. The following countries have indicated their intent to participate: Australia, Japan, South Korea, New Zealand and Thailand. Others, including Singapore and the Philippines, have been observers and may consider joining at some later date.

ARFP rules set out some detailed requirements for eligibility, both for the CIS operators, i.e. fund managers, and for the funds themselves, a brief summary of which follows.

CIS operators (fund managers)

- Operators need to be of "good standing", i.e. both the company along with the directors and the senior management would need to demonstrate they have not faced any prosecution or convictions.
- The minimum AUM at the time of seeking to offer a fund under the ARFP would need to be not less than US\$500 million and at least 50% of the AUM must be in permissible investments (i.e. are not derivatives).
- The operator, the directors and the senior management would need to demonstrate at least five years' relevant experience in managing and offering funds. The CEO would be required to have 10 years' experience.

The Collective Investment Scheme (mutual fund)

- The fund would need to have previously been authorised by its home regulator and currently be offered for sale in its home jurisdiction.
- The fund would need to comply with a number of basic requirements, including the use of a custodian and/or

trustee, independence and separation of assets. There also needs to be independent oversight of the operator's duties and an annual audit of compliance with ARFP rules.

- A number of investment restrictions would apply to the portfolio of a fund to be eligible for the ARFP, with specific limitations on use of financial derivative instruments (securities lending is prohibited).
- The fund would be expected to comply with the "home" jurisdictions regulatory requirements and be managed accordingly.

The primary objective of the ARFP is to make available to retail investors those funds from other jurisdictions that might appeal to cross-border investors. Typically, most funds likely to qualify initially will be somewhat plain vanilla, low risk, regional or local equity and/or bond funds.

It would be expected that distribution of funds in the "host" jurisdiction would be carried out by professional investment advisers, banks and securities companies, licensed and eligible to do so. It is not a requirement of the ARFP for the CIS operator to establish a local office in the "host" jurisdiction.

Why is "fund passporting" attractive?

As investors become more sophisticated, often after having gained experience from their local securities markets, they recognise there can be a number of attractive investment opportunities beyond the borders of their home country. Similarly, domestic fund managers invariably seek to offer their services to markets outside their home base, especially if they can demonstrate above-average returns. Thus cross-border fund distribution developed many years ago.

The European Undertakings for Collective Investment in Transferable Securities (UCITS) are an internationally recognised "gold standard" for regulated investment funds, first established over 30 years ago and now freely available in more than 50 jurisdictions globally. UCITS primarily operate out of either Luxembourg or Dublin, and in Asia they are authorised for sale locally in Hong Kong, Singapore and Taiwan. They now exceed US\$7 trillion in AUM, and are used by retail and institutional investors. UCITS funds can invest into virtually all stock and bond markets worldwide and provide a multitude of pricing options to suit all investment requirements.

The ARFP is designed to replicate a number of the criteria that have made UCITS successful, with a view to eventually becoming the Asian equivalent of UCITS. This may be a big

ambition, but it should be remembered that it has taken UCITS almost 30 years to become so widely accepted, after a slow start in the late 1980s.

A review of the benefits of creating the ARFP, provided to the APEC, showed that, in time and with enlargement of the industry in Asia, significant cost savings could be achieved when compared to products managed under existing arrangements via UCITS. Furthermore, as the assets of these funds would be required to be managed and operated within the Asia-Pacific region, it was anticipated considerable employment opportunities would exist, especially in those locations that could successfully develop the requisite skills to manage such funds. It was also anticipated that through the active management of such funds within the Asia-Pacific region, a greater proportion of the assets would likely be invested in the region, leading to greater support for local stock markets.

Why should India be interested?

The Indian mutual funds business has been a domestic industry with limited access for domestic retail investors to invest in global or even Asian regional stock markets. Similarly, the range and choice of Indian equity funds offered outside India is very limited. As markets develop and open up, investors become interested in seeking out new opportunities in the belief that better returns for their assets might be achievable. The objective of all fund-passporting schemes is to provide better access to make available to domestic investors these global opportunities while allowing local regulators some degree of control over the choice made available and over who takes them up. A consequence of this type of approach is that it enlarges the entire mutual funds business in each market where open choices are available, benefiting the domestic operators who have both the local presence and the brand awareness to better succeed.

Fund-passporting schemes don't put at risk the local established providers by allowing the global fund manager titans to enter markets. Instead, they enable greater local and regional cooperation, particularly among the medium- and smaller-sized fund managers.

In a number of countries, and while the size and scale of domestic mutual funds business grows, there are concerns that local (retail) investors are taking on higher levels of risk, especially for savings accumulation designed to meet retirement income needs, if too large a proportion of their assets is invested into just a single (their domestic) market. The spreading of risks across multiple markets is both prudent and likely to be more rewarding over the longer term.

What would India bring to the table?

It is expected that the growth of wealth in the Asia-Pacific region will far outstrip that of other major regions, including the US and Europe, over the next few decades. Asian wealth is being sourced from the faster pace of local and regional economic growth, the increasing desire to trade within the region and the generally higher saving rates of families. Furthermore, Asia is only now beginning to recognise a need to build sustainable retirement schemes that will relieve the state of the burden of retirement income provision. Using mutual funds has been identified as one of the most efficient routes for most individuals to save and invest.

Participation in the ARFP would enable India to be seen as an Asia-Pacific regional partner in the rapidly growing financial services and wealth management field.



CAN YOU MOBILISE A BILLION INVESTORS?

There can be no doubt that the Indian mutual funds market presents many complex challenges for all participants. At the same time, it offers outstanding opportunities. Where else in the world is there such a well developed market for investors with so small a level of actual participation by retail investors? Only in the last couple of years have retail investors begun to realise the benefits of mutual funds investing, especially using regular savings plans to accumulate assets and wealth. This aspect alone can only bode well for the future of the market, as investors become less susceptible to market volatility.

In March 2017, the Association of Mutual Funds in India (AMFI), on behalf of the industry as a whole, launched the Mutual Funds Sahi Hai investor education and awareness initiative. The initiative was designed to reach out to Indians across all states and languages through TV, digital, print and other media to allow them to self-educate on mutual funds through a website. The website offers simple content with articles and videos that prospective investors should find easy to understand. It also offers tools and calculators to help plan for life goals. The primary objective of the campaign was to increase the numbers of investors in mutual funds by more than 5 million per annum. Based on feedback to date, it appears to have been successful in achieving this goal. The campaign, in its second year, focused on using debt funds, attempting to increase the proportion held in such funds from a relatively low 10% of all investors. The Mutual Funds Sahi Hai campaign has been well supported with a budget of over INR1 billion (US\$14 million) spent to date.

Just by considering the size and scale of the Indian mutual funds market, an observer can quickly come to realise there has been extraordinary growth in the last 10 years or so. Yet, unlike many other markets in the Asia-Pacific region, the Indian market has been open for foreign participation, albeit in a more passive manner than many perhaps have been expecting. Of the top 10 largest mutual funds companies, only two are 100% Indian owned. Some key statistics captured in figure 30 can help us understand the position a little better.

Figure 29. Key statistics for India

>1.36 billion



Population
of India

US\$2.2tr



Size of the
securities market

7.3%



GDP growth
in 2019

US\$342b



Size of the mutual
funds market

30m



Estimated
number of retail
investors

26.2m



Number of
SIP investors

150,000



Number of
HNWI families

124,000



Number of mutual
funds distributors

44



Number of mutual
funds companies

19



Number of
ETF providers



But it has not been so easy for foreign firms to enter the market and achieve success. Many have learned the hard way that they have needed to allow their business to develop domestically, rather than follow practices adopted in other substantial markets. Manufacturing local Indian-invested funds to be sold via banks and financial and wealth managers has proved the correct recipe.

With maybe more than 99% of all assets in the mutual funds business invested domestically, however, risk diversification becomes important – hence the interest of foreign firms to be able to sell their global expertise. This, though, is greatly restricted by India's strong foreign-exchange controls. While they do allow a proportion of assets to be invested in international markets, the total aggregate they allow is less than 2% of the size of the market, a figure that has by far yet to be reached. This is perhaps in part due to the strong returns that the Indian securities markets have achieved over the last few years, together with the higher rates of interest that bank deposits earn. But the continued weakness of the Indian rupee will undermine this to some extent, and thus, as and when global markets achieve a more sustained period of growth, this might be a time when Indian investors become more interested to invest globally also.

Of course, it will not always stay like this. There will be a time when market conditions change and that is when many of the global fund managers operating in the market hope their positioning will enable their Indian businesses to capture a significant inflow. Already, domestic mutual funds are able to access UCITS products from Luxembourg or Dublin within feeder or fund-of-fund routes. But these UCITS are not allowed direct entry to the Indian market at this stage and form a part of the exchange controls referred to above.

Unlike most other major markets around the world, India does not offer much opportunity for global fund managers to participate in the institutional fund management market. The major Indian retirement funds have restricted opportunity to outsource their assets for management. Where they do, it is usually to the same eight managers that have been approved for use within the NPS. And getting added to that list has proven to be both time-consuming and problematic for most who have applied.

Similar to the mutual funds industry, the life insurance industry is also growing very fast. Many of the major life companies are also part-owned by global firms but conduct their business in a very domestic Indian fashion. As with the retirement industry, life companies are restricted on their ability to outsource assets for management by third-party fund managers.

Should global fund managers consider entering the market?

This is the key question being asked by many global managers today. They look at the conflicting information, failures by some and success by others, and wonder which will be their fate. The reasons for participating are very compelling, but the willingness of global firms to allow a subsidiary to develop and grow on its own is still a rare occurrence. It is just not possible, nor have there been any examples of success, to parachute top international managers into India and grow a business from scratch. The size of investment required to participate, and the timeframe over which that success may be achieved, are such that only the most committed global firms have, until now, been able to enter the Indian mutual funds market.

The best route, and the one that has some degree of proven success, has been to partner up with a leading local enterprise to develop that business. This can be done either by acquiring one of the existing small mutual fund companies or more likely by working with one of India's many conglomerates wishing to add financial services to their portfolios. To some extent, the foreign partner would need to provide expertise in managing a mutual funds business, but they would also need to be prepared to recruit talented staff locally within India. Fortunately, there are plenty of such individuals, although, as elsewhere in the world, the top people are commanding top pay as well.

With the Indian population likely to grow to become the largest in the world within the next five to six years, and with GDP growth leading the economy to place between top three and five in terms of size within the next 10 years, India is certainly a most appealing market. Stable and supportive government has been a massive assistance here and can be expected to continue to be supportive for the coming five years or more.

GIFT City⁵⁸

Gujarat International Finance Tec-City (GIFT City) is a business district promoted by the Gujarat government through a joint venture company, to be India's first operational smart city and international financial services centre. It is being developed in the Ahmedabad metropolitan region as a greenfield development. The project is located in the north west of India.

The idea for GIFT City was started by Indian Prime Minister Narendra Modi, when he was chief minister of Gujarat in 2011, when he kicked off an ambitious project to develop a financial hub in the style of Singapore or Dubai. It is being planned by East China Architectural Design & Research Institute (ECADI), which was responsible for planning much of modern-day Shanghai, and Fairwood Consultants India. The developers were tasked with transforming an expanse larger than New York's Central Park into a city with more than 100 skyscrapers supporting more than 1 million jobs. The city has an integrated development model which will be spread out in three phases. Each phase is designed as integrated sustainable development, for example the first phase itself includes development of office space, residential, school, hotel, club etc.

Of most interest to the mutual fund industry will be how GIFT City develops as an International Financial Services Centre, where offshore banks and bank accounts can be established and where there may be taxation advantages to be gained. Whilst it is still early days, the development has been slower than forecast.

Can India become a global financial and fund management hub?

One of the long-held ambitions, not just of India but of many governments in the Asian region, is how can they become a global financial hub or a fund management centre. This is seen as providing significant employment opportunities and thus economic growth. Often, there is a desire to emulate Hong Kong, Singapore or even Dubai, each of which has achieved this status.

For India, it does have many of the attributes necessary, such as scale, highly talented and well educated people, and financial markets. But it also has some inherent restrictions, such as exchange control, volatile currency and a lack of substantial foreign companies active in the local market. All these can change should the government be willing and market conditions allow, but in the short term, it is unlikely to be achieved.

How can India compete with China for more of the world's investment monies?

India very obviously is frequently compared to China, as both a place to invest and also a place to establish businesses. Both have more than 1 billion in population, have strong 6%+ economic growth over many years and are relatively under-represented in international investment portfolios. In recent years, China has begun to open up its financial markets to allow foreign investors and foreign companies to participate. India has been doing the same for far longer than China.

As economic growth occurs, personal wealth usually follows, and as has been seen in China, many new millionaires and billionaires have been created over the last 15 to 20 years. This has also occurred in India (see page 10 for more details). These new wealthy HNWI's also dislike facing restrictions on how and where they invest their assets. Thus, many have been seen to be active in most of the world's expensive property markets. Many global private banks have benefited greatly from offering their services to this new wealth. India will need to be able to embrace this opening-up. This can be achieved through a gradual reduction in the enforcement of exchange controls. Enabling local investors to have more access to global stock markets, especially via the mutual fund route, possibly through use of UCITS products, and under regulatory supervision, might help.

This is a challenge that India will need to take on if it wishes to become more integrated with the world's financial community.

⁵⁸ Sources: www.giftgujarat.in and www.giftsez.com and www.business-standard.com 24 May 2019



APPENDIX

As can be seen in figure 31, India's exchange rate against other currencies can be very volatile.

Figure 30. Historic exchange rates ⁵⁹

Fiscal year		Calendar year	
Year INR	INR/US\$1	Year	INR/US\$1
2004/5	44.95	2005	44.11
2005/6	44.28	2006	45.33
2006/7	45.29	2007	41.29
2007/8	40.24	2008	43.42
2008/9	45.91	2009	48.35
2009/10	47.42	2010	45.74
2010/11	45.58	2011	46.67
2011/12	47.95	2012	53.49
2012/13	54.45	2013	58.63
2013/14	60.50	2014	61.03
2014/15	61.15	2015	64.15
2015/16	65.46	2016	67.21
2016/17	67.09	2017	65.12
2017/18	64.45	2018	68.36
2018/19	69.89	2019	70.90*

⁵⁹ Reserve Bank of India. Average rate for the year shown.

* As at 12 August 2019.



GLOSSARY

80CCD	Section of India's Income Tax Act 1961 that allows tax deductions
AIF	Alternative investment funds (including hedge, alts, REITS, etc.)
AMFI	Association of Mutual Funds in India
ARFP	Asia Region Funds Passport
ASP	Annuity Service Providers
AUM	Assets under management
BRICS	Brazil, Russia, India, China, South Africa
BSE	Bombay Stock Exchange
CAGR	Compound annual growth rate
CIS	Collective Investment Scheme
CRA	Central Recordkeeping Agencies
Crore	10 million, 10 crore = 100m, 100 crore = 1bn
DB/DC	Defined benefit/defined contribution (pension)
ELSS	Equity-Linked Savings Scheme
EPFO	Employees Provident Fund Organisation
ETF	Exchange-traded funds
FDI	Foreign direct investment
FEMA	Foreign Exchange Management Act
FERA	Foreign Exchange Regulation Act
FII	Foreign institutional investors
HNWI	High-net-worth individuals/investors
IBEF	India Brand Equity Foundation
IDBI	Industrial Development Bank of India
INR/Rs/	Indian rupee (currency)
Lakh	100,000, 10 lakh = 1m, 100 lakh = 1bn
LICI	Life Insurance Corporation of India
LTCG	Long-term capital gains
MF	Mutual fund
NPS	National Pension System
NRI	Non-Resident Indian
NSE	National Stock Exchange
PAN	Permanent account number (for financial transactions)
PFRDA	Pension Fund Regulatory and Development Authority
RBI	Reserve Bank of India
REITS	Real Estate Investment Trusts
SBI	State Bank of India
SEBI	Securities and Exchange Board of India
SIP	Systematic Investment Plan
STCG	Short-term capital gains
STT	Securities Transaction Tax
SWF	Sovereign wealth fund
UCITS	Undertakings for Collective Investment in Transferable Securities
ULIP	Unit Linked Investment Plan
US-64	Unit Scheme 1964
UTI	Unit Trust of India

LINKS

Association of Mutual Funds in India	www.amfiindia.com
Citibank India	www.online.citibank.co.in
Cleartax	www.cleartax.in
India Brand Equity Foundation	www.ibef.org
Live Mint	www.livemint.com
Mutual Fund India	www.mutualfundindia.com
Reserve Bank of India	www.rbi.org.in
Securities and Exchange Board of India	www.sebi.gov.in
The Economic Times of India	www.economictimes.indiatimes.com
The Times of India	www.timesofindia.indiatimes.com

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The author would like to thank a number of people and organisations for their assistance in compiling this document. All references and sources have been noted. The Indian mutual funds market is well served by many online and print publications from which some information has been drawn. Many of the fund managers have comprehensive websites and the Association of Mutual Funds in India's own website is particularly comprehensive. Another standout is The Economic Times of India, which has an excellent website providing detailed information about mutual funds, allowing meaningful comparisons to be made.



ABOUT THE AUTHOR...

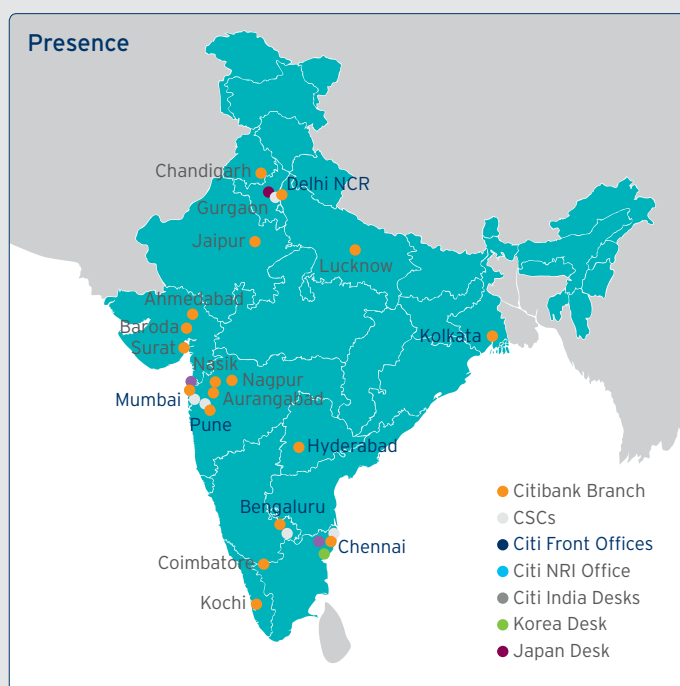
Stewart Aldcroft is a managing director and senior adviser in Citi's Markets and Securities Services business, based in Hong Kong. He is also the chairman of Cititrust Limited, which provides trustee and fund administration services for unit trusts, ETFs and approved pooled investment funds in Hong Kong. He has been based in Hong Kong since 1985, and has held a number of senior leadership roles in various leading fund management companies.



CITI IN INDIA

Highlights

Balance sheet	~US\$25 bn
Cities	18
Branches	35
Multinational clients and large local corporate clients	>1,500
SME clients	>30,000
Retail clients	>1 million
Employees	~20,000+
Share of India's payment flows	~5.9%
Share of India's FX flows	~13%
Share of India's trade-linked flows	~7%



Leadership

- Over 116 years
- No.1 foreign bank in terms of total balance sheet (US\$25 billion), deposits (US\$17 billion) and profits (PBT of US\$945 million)*
- One of the largest foreign investments in financial services (over \$3.5bn of capital and retained earnings)*
- Leading consumer bank: Citi has 540+ ATMs with 1.2 million retail customers, 2.1 million credit-card customers
- No.1 custodian bank with >25% share of flows in both foreign portfolio investors and local AMCs
- No.1 foreign bank with largest (~13%) market share of INR/USD flows
- Citi moves 5.9% of India's payment flows and 7.1% of trade flows
- No.1 bookrunner for equity and equity linked issuances
- Citi helped clients raise over \$25 billion of equity and debt capital in 2018

Services

Institutional Clients Group	Transaction services	Treasury	Corporate finance and lending	Investment bank	Consumer Banking	Banking	Cards
	Account services	FX	FCY lending	Advisory		Current accounts	Credit cards
	Cash management	Derivatives	LCY lending	Equity capital markets		Deposits	Equal payments
	Collections	Hedging	Debt Capital markets	M&A		Savings plans	CWA
	Trade	Time deposits	Structured finance			Fixed income	
	Working capital	Investments in the local securities	Securitisation			Mutual funds	
	Securities services		Project finance			Insurance	
						Personal loans	

SECURITIES SERVICES

30%

Share of FPI
trade flows

No.1

Assets under custody
(~US\$245 billion)

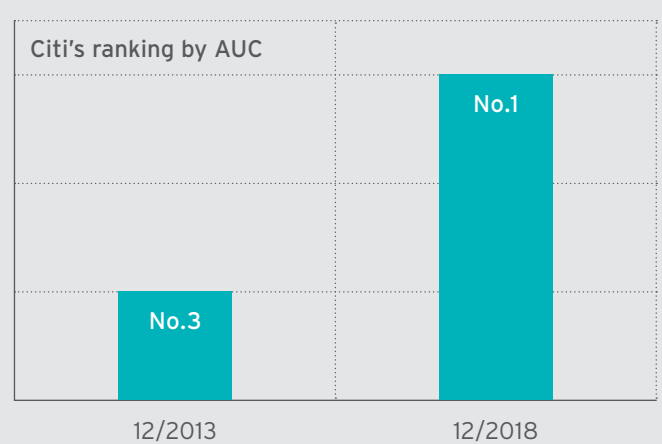
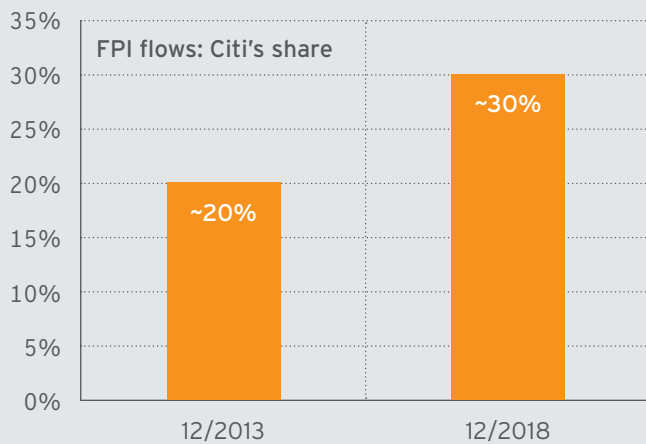
US\$60bn

AUM under fund
administration

14 years running

"Top-rated"
by Global Custodian

Growth driven by client acquisition



Key fund accounting statistics	Volume
Clients	13
AUM	US\$60bn
Daily Navs	1428
Monthly transactions	292m
Portfolios serviced	326

Strongest people-platform

- Largest team split across two cities
- Only custodian with two ex-regulators in its custody business team

Client-focused innovation

- Most flexible funding and margining solutions and first to enable margin netting and non-cash collateral for equities
- First-to-market FX benchmarking, quasi-netting and third-party FX
- First custodian DDP to register the first FPI
- First custodian to provide securities-lending solution (agency model)

Market advocacy

- Strongest regulatory interface with engagement at all levels, often the only bank looking at areas of importance for our clients

Robust contingency and capacity planning

- Only custodian with live processing from two cities with independent linkages to the depositories and clearing corporations
- Proactive capacity planning with units operating at ~70% level of capacity utilisation

Awards and recognition

- 2018 Best Asset Service Provider of the Year by AsianInvestor
- 2018 Best Subcustodian in India by Global Investor/ISF
- 2017 Best Custodian Overall by Triple A Asset Servicing Awards

www.citibank.com/mss

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