Participatory Notes

Why in News?

Investment in the Indian capital markets through **Participatory notes (P-notes)** dropped to Rs 86,706 crore till May-end, 2022.

- However, according to experts, foreign investors will reverse their selling stance and return to the country's equities in the coming 1-2 quarters.
- In line with a decline in P-note investment, the assets under the custody of **Foreign Portfolio Investors (FPIs)** dropped 5% to Rs 48.23 trillion end-May, 2022 from Rs 50.74 trillion end-April,2022.
    - This was the eighth consecutive month of net pull-out by FPIs from **equities.**

What are the Participatory Notes?

- P-notes are **Offshore Derivative Instruments (ODIs)** issued by registered **Foreign Portfolio Investors (FPIs)** to overseas investors who wish to be a part of the Indian **stock markets without registering themselves directly.**
    - P-notes have **Indian stocks as their underlying assets.**
    - FPIs are **non-residents who invest in Indian securities like shares, government bonds, corporate bonds, etc.**
- Though P-note holders have less stringent registration requirements, **they have to go through a proper due diligence process** of the **Security and Exchange Board of India (SEBI).**

What are the reasons for Declining P- Notes?

- **Uncertainty around Inflation Levels:**
    - There is still uncertainty around inflation levels and the US Federal Reserve's (Fed's) actions.
    - Decline in P-Notes is being attributed due to the tightening of monetary policy by the US Fed which has been on a rate hiking spree to control inflation.
        - Other central banks, including in Britain and the Eurozone, are following suit.
- **Currency correction:**
    - Currency correction has happened to a large extent.
        - A correction is **a price rebound which can be observed after every trend impulse.** After a correction takes place, the price returns to the trend. A correction on the currency market takes place due to the overselling or overbuying of instruments at the current moment in time.
        - A large part of this reduction to **market correction in equity and debt portfolios.**

What are the Expectations for P-Notes in the Future?

- Equity markets are offering some attractive valuations at these levels.
- **Supply-chain and** inflation issues should begin to **subside in the months to come.**
- Markets usually move ahead of the economic cycle.
    - It is believed that the next one/two quarters, FPIs should be coming back to allocating

capital towards Indian equities.

UPSC Civil Services Examination, Previous Year Question (PYQ)

Q. Which of the following would include Foreign Direct Investment in India? (2012)

1. Subsidiaries of foreign companies in India.
2. Majority foreign equity holding in Indian companies.
3. Companies exclusively financed by foreign companies.
4. Portfolio investment.

Select the correct answer using the codes given below:

(a) 1, 2, 3 and 4
(b) 2 and 4 only
(c) 1 and 3 only
(d) 1, 2 and 3 only

Ans: (d)

Exp:

- Funds from a foreign country could be invested in shares, properties, ownership/management or collaboration. Based on this, Foreign Investments are classified as below:
  - Foreign Direct Investment (FDI)
  - Foreign Portfolio Investment (FPI)
  - Foreign Institutional Investment (FII)
- Foreign Direct Investment (FDI) is an investment made by a firm or individual in one country in business interests located in another country. Generally, FDI takes place when an investor establishes foreign business operations or acquires foreign business assets, including establishing ownership or controlling interest in a foreign company. FDIs are distinguished from portfolio investments in which an investor merely purchases equities of foreign-based companies.
- FDI Includes
  - **Opening of a subsidiary or associate company in a foreign country**, Hence, 1 is correct.
  - **Acquiring a controlling interest in an existing foreign company**, Hence, 2 is correct.
  - By means of a **merger or joint venture with a foreign company**. Hence, 3 is correct.
- **Foreign Portfolio Investment (FPI)** is an investment by **foreign entities and non-residents in Indian securities,** including shares, government bonds, corporate bonds, convertible securities, infrastructure securities, etc. The intention is to ensure a controlling interest in India at an investment that is lower than FDI, with flexibility for entry and exit. Hence, 4 is not correct.
- **Therefore, option (d) is the correct answer.**

Source: ET