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FOREWORD

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In these choppy waters of spiraling interest rates and regulatory scrutiny, the astute asset manager must be lean, agile and clued in to stay ahead, eager to blaze trails and scout fertile pastures while sidestepping pitfalls. In the latest edition of *Performance*, our global thought leaders have mapped the industry's ever-changing face, helping you break away from the competition and forge a pioneering path.

The **EU's Anti-Money Laundering Authority (AMLA)** is set to be an industry game changer with far-reaching supervisory powers over financial sector entities. Nicolas Marinier, and Maxime Heckel share what to expect from AMLA's stricter standards and heightened supervision to combat cross-border financial crime.

While **impact measurement** is a must for investment managers to meet their sustainability goals and requirements, it can be difficult to know where to start. Don Gerritsen, Bas van't Hooft and Jonathan Wiedeman are here to help with five-step investor impact cycle, a clear blueprint for forward-thinking players.

A spike in high-profile market abuse cases has attracted growing regulatory attention, driving institutions to step up their dealing room controls. Bimal Modi and Soniya Mahajan set out how **holistic conduct risk management with a tech-rich approach can help financial service firms** uphold investor and regulator trust.
India's asset management industry is booming, as foreign investors flock to capitalize on the country's exceptional economic ascent. Sharing their invaluable insights into India's foreign investment landscape are Mr. Shiv Sehgal, President and Head of Nuvama Capital Markets and Mr. Ankit Jain, Senior Fund Manager of Mirae Asset Investment Managers India Private Limited.

A comprehensive grasp of **India's tax landscape** is essential for foreign investors to unlock its full potential and clear regulatory hurdles. Rajesh H. Gandhi, Vijay Morarka, Nikki Mutreja and Krisha Shah succinctly explain India's tax rules to help investors leverage exemptions and optimize their strategies.

A new frontier in digitalization, generative artificial intelligence's (GenAI) powerful ability to create new data is set to transform the fund servicing industry's entire value chain. Dimitri Tsopanakos and Simon Ramos and Cécilia Tondini dig into how GenAI can help firms tackle the market's myriad challenges while mitigating this emerging technology's risks.

BlackRock's USD47 million investment in Securitize is spearheading the fund industry's revolutionary **tokenization of real-world assets**. Pascal Koenig,President Insight AM demonstrates how tokenization and fragmentation can open advised management to an untapped saver demographic.

From India's dynamic foreign investment opportunities to cutting-edge tech trends, this 44th issue of *Performance* charts the industry's untapped terrains and shifting borders for the curious explorers at asset management's frontier. We wish you an insightful read.

EDITORIAL

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India's economic landscape shows resilience and promise, buoyed by robust foreign investments and rising competitiveness. Positioned to become the world's fourth-largest economy in the near future, the government has focused on boosting the ease of doing business and structural reforms to attract foreign investments.

This commitment is yielding tangible results, as evidenced by the steady influx of Foreign Portfolio Investment (FPI) and Foreign Direct Investment (FDI) into pivotal sectors of the economy. These investments are a testament to the global confidence in India's trajectory, robust foundations and potential for sustained and substantial growth in the medium to long term.

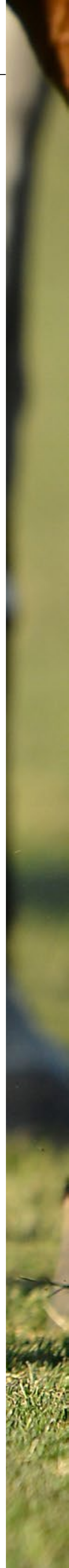
India's asset management industry has also flourished in recent years, playing a vital role in directing investments, fueling wealth creation, and fostering sustainable development—heralding a prosperous era of opportunity. The profound and multifaceted influence of artificial intelligence (AI), including machine learning, natural language processing and predictive analytics, is revolutionizing how India's asset managers analyze data, make investment decisions, and manage portfolios.

As governmental initiatives increasingly prioritize sustainability, responsible investing has witnessed a remarkable surge, doubling its influence over the past three years. This shift toward responsible investment practices underscores a collective commitment to fostering both long-term wealth generation and positive societal impact. Investors are increasingly recognizing the importance of aligning their financial objectives with environmental, social and governance (ESG) considerations, embracing a holistic approach to wealth creation.

In this *Performance* edition, we highlight some of India's key regulatory and taxation considerations for foreign investors. There is also an exclusive interview with the President of Nuvama Capital Markets, Mr. Shiv Sehgal and the Fund Manager of Mirae Asset Investment Managers India Pvt Ltd, Mr. Ankit Jain, who share their insights on the factors shaping India's economic future, global competitiveness, and primary market drivers.

We also delve into the sectors expected to thrive over the next decade, along with the rising trend in alternate investments in India. While India's investments are at an all-time high, the Securities and Exchange Board of India (SEBI), India's securities market regulator, continues to play a vital role in safeguarding investors' interests. This issue also discusses the holistic measures financial institutions can adopt for conduct risk management and dealing room controls.

I hope this edition's insights stand you in good stead.



The Anti-Money Laundering Authority's fight against financial crime

INCREASED POWER AND REACH PROMISE IMPROVED ML/TF CONTROLS

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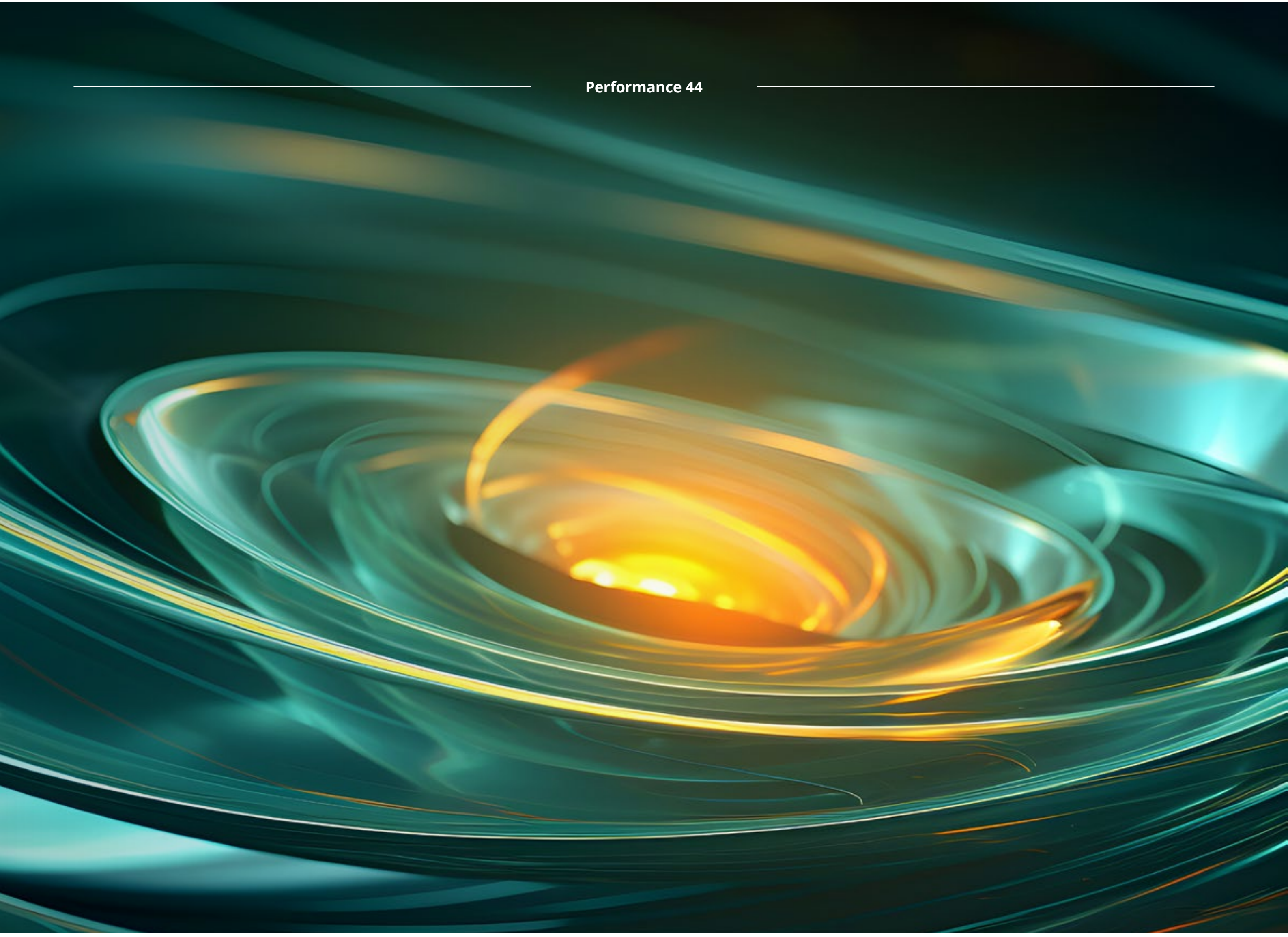
INTRODUCTION

In December 2023, the European Council and the European Union (EU) Parliament announced a provisional agreement for the establishment of the Anti-Money Laundering Authority (AMLA), a new EU authority to combat money laundering and terrorist financing (ML/TF). This authority aims to combat these financial crimes more effectively across EU borders through direct supervision of selected high-risk financial institutions and through indirect supervision from national AML/CTF financial supervisors. While the EU Commission's legislative proposal dated 20 July 2021 laid the foundation for the AMLA and its purpose, the recent decision announced on 13 December 2023 constitutes a significant milestone in solidifying the framework, including the scope of its supervisory powers. The recent announcement on 22 February 2024 that Frankfurt will be the home of AMLA is one more step toward the "go-live" of the AMLA.



The challenge with the current AML/CTF framework

It is glaringly apparent that when it comes to cross-border combat of financial crime, the approach in place today falls short.

Consider the recent case of the Latvian bank, ABLV; it serves as a stark reminder that the existing practices are **outdated and ill-equipped** to deal with the complexities of modern financial crime. ABLV stands accused of involvement in money laundering schemes tied to Russian and Ukrainian clients, exposing loopholes in our system. One obvious issue is the ease with which many financial institutions accept funds from foreign clients without adequately verifying their identities, the ownership and control structure involved, or the source of funds. In this specific example, the lack of due diligence allowed illicit funds to flow through Latvia before being funneled into western Europe, laying bare serious deficiencies in cross-border ML controls that demand immediate attention.

The difficult and insufficient pace of investigations into **cross-border money laundering scandals exacerbate the problem**. Lengthy probes and the inherent difficulties in coordinating efforts among various authorities not only delay the fight against financial crime but also increase the likelihood of perpetrators slipping through the cracks or continuing their illicit activities.

To meet these challenges, **revising and modernizing the existing AML/CTF framework is critical**. This will require not only the implementation of new legislation but also closer cooperation at both national and international levels.

Although the AMLA is in its initial phase of establishment, its proposed power, enhancements, reach, and operational obligations promise great hope—but also significant impact—for the financial sector and its fight against financial crime.

Empowered by the EU: Understanding the AMLA's multiple competencies

Extended direct supervisory powers

The EU is preparing to give the AMLA far-reaching supervisory powers over companies in the financial sector. Under the provisional agreement, the AMLA will be empowered to directly supervise certain types of financial institutions with enhanced risks, such as crypto-assets providers deemed "high-risk" and have cross-border activities and a presence in at least six Member States.

In an initial selection process, which will be renewed every three years, the AMLA will oversee up to 40 groups and organizations and will have the authority to impose sanctions to ensure compliance. Companies that have not been selected during the initial selection process will continue to be subject to supervision at the national level with regard to anti-money laundering and countering terrorist financing (AML/CTF). In the event of insufficient measures, the Authority may temporarily take over the national supervision of non-selected financial institutions.

Supreme authority

In addition to the direct supervision of high-risk financial institutions, the AMLA will also take on the task of coordinating the supervision of other financial entities by national authorities. Furthermore, AMLA will be empowered to judge and enforce binding rules in the event of disagreements between national supervisory authorities. This includes situations where disagreements would arise between authorities of different Member States. Currently national authorities are autonomous; disputes between them could trigger significant tensions among those authorities and risk undermining the effectiveness of AMLA. Here, however, the AMLA could then use its supreme authority and demonstrate its strength by enforcing binding rules in the case of disagreements.

Improved whistleblowing mechanism

The provisional agreement also marks a significant step toward strengthening whistleblowing mechanisms in the fight against financial crime—an issue that was brought into focus with the Whistleblower Directive (EU) 2019/1937. The AMLA will process reports from the financial sector and will also be authorized to review whistleblowing reports from staff of national authorities, providing an overview that combines granularity and cross-jurisdiction. By tasking the AMLA with this responsibility, identifying and investigating potential ML/TF activities could become significantly more efficient, amplifying the impact of whistleblower protection overall.

Unified IT systems

The AMLA will also manage FIU.Net, the information exchange platform used by different national financial intelligence units (FIUs). This additional measure enhances the fight against financial crime in a cross-border context by enabling the investigation of suspicious activities and transactions. Moreover, the initially determined scope and content of AMLA's supervisory database will be expanded as the Authority is tasked with establishing and maintaining a central database that will contain information relevant to AML/CTF supervisory authorities; this includes data on suspicious transactions, high-risk individuals or entities, and any other pertinent information necessary for effective AML/CTF supervision. The AMLA will use this database to support other authorities in their efforts to combat ML/TF by providing them with access to relevant information and analysis.

It is clear that the AMLA has been granted **extensive powers** to **demonstrate its strength and its ability to sanction professionals**. This emphasizes that not only is the AMLA serious about AML/CTF, but by effectively exercising these powers, it can establish itself as a formidable force amid the AML/CTF landscape. But with more power, comes increased responsibility.

Four Key obligations of the AMLA

As it launches its operations, the AMLA must prioritize the following in order to effectively fulfill its mandate:

Develop implementing and regulatory technical standards (ITS/RTS)

The AMLA is tasked to play a crucial role in developing a comprehensive set of ITS/RTS as identified by the EU AML Coordination Group. To date, 80 ITS/RTS have been identified, which are critical to defining the complex details of the new unified AML/CTF rulebook. By advancing the formulation and implementation of these standards, the AMLA aims to ensure consistency and effectiveness in AML practices throughout the EU.

Establish supervisory policies and procedures

Central to the AMLA's mission is building robust oversight structures; this includes establishing Joint Supervisory Teams and fostering close channels of cooperation with national supervisory authorities. Moreover, the AMLA must conclude agreements to facilitate smooth cooperation with other EU institutions and authorities from third countries. These efforts are crucial to streamlining surveillance procedures and promoting a coherent approach to combat financial crime.

Strengthen information exchange mechanisms

Another key area for the AMLA is to improve the mechanisms for exchanging information between national authorities and other EU agencies. This includes developing capable data transmission protocols, building databases to store and analyze AML/CTF-relevant information, and promoting training and skill building to support effective use of these information sources. By strengthening these exchange mechanisms, the AMLA seeks to be faster and more efficient than the criminal organizations it is fighting, helping to improve early detection and accelerate the fight against ML/TF across the EU.

Promote good practice and innovation

The AMLA is also expected to play a key role in promoting best practices and innovation in the field of AML/CTF. This includes identifying and disseminating best practices for preventing and detecting ML/TF activities, as well as supporting the research and development of new technologies and approaches that combat financial crime.

CONCLUSION

The Anti-Money Laundering Authority is optimally positioned to strengthen the fight against money laundering and terrorist financing. In addition to having the EU's backing and the operational obligations detailed above, its ability to assume control over the FIU.Net platform will provide a unique opportunity to interact directly with reporters and to gain the related data needed to refine its analyses and respond quickly to emerging risks. This direct interaction opens **new avenues for more efficient and effective monitoring of ML/TF activities within the EU**, ultimately enhancing the fight against financial crime across its Member States. Of course, in order to address any new trend or weakness adequately, the European Commission will need to continuously adapt the resources and powers granted to the Authority.

While it will take time for it to become fully operational and subject to a fair evaluation of its success, we can consider the establishment of the AMLA as an **important step in cross-border collaboration** where all authorities, institutions, and stakeholders share a common goal: combating ML/TF in the long term.

TO THE POINT

- The EU is poised to grant the Anti-Money Laundering Authority (AMLA) extensive supervisory authority over entities of the financial sector. According to the provisional agreement, the AMLA will directly oversee specific types of high-risk financial institutions, including crypto-asset providers with cross-border operations and a presence in at least six Member States.

- One of the key obligations of the AMLA is to develop implementing and regulatory technical standards (ITS/RTS) identified by the EU AML Coordination Group, which will be crucial in establishing shared comprehension among professionals from various Member States.

- The establishment of the AMLA holds the potential to bolster cross-border collaboration, marking a significant stride toward the shared objective of combating money laundering (ML) and terrorist financing (TF) in the long term. This is not only endorsed because of their role as coordinator between national supervisory authorities but also due to their responsibility of managing the Financial Intelligence Unit Network (FIU.Net).

Impact measurement: a five-step guide for investment managers

DEFINE AND MEET YOUR SUSTAINABILITY GOALS WHILE COMPLYING WITH REGULATORY REQUIREMENTS

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INTRODUCTION

Impact measurement allows financial institutions to boost their sustainable investing maturity by quantifying a given investment's positive and negative sustainability impacts. Investors use impact measurement to assess realized versus intended impacts, enabling informed decision-making, risk mitigation, and potentially more stable returns.

A sound impact measurement system helps investment managers effectively communicate with stakeholders, attract clients prioritizing value-aligned investments, enhance their reputation, and foster loyalty. It also allows firms to comply with sustainability regulations, such as the Corporate Sustainability Reporting Directive (CSRD) and the Sustainable Finance Disclosure Regulation (SFDR).

The processes for quantifying the positive and negative sustainability impacts of investment decisions differ from the traditional quantification of financial returns. One significant challenge is determining which areas to focus on, which is where Deloitte's five step investor impact cycle comes in.

The five-step investor impact cycle

Deloitte's strategic process allows investment managers to determine their ambitions, measure their impact, and adapt in line with pre-determined sustainability goals by strategizing, planning, acting, reporting, and evaluating and iterating.

Strategize

1

- Define scope
- Determine the desired impact
- Ensure alignment with regulation

Evaluate & iterate

5

- Compare outcomes with set ambitions
- Determine improvement points
- Iterate the process

Report

4

- Determine material impacts
- Define relevant KPIs
- Integrate impact in reporting process

2 Plan

- Conduct a baseline analysis
- For each asset class and/ or impact theme, outline a specific approach
- Review current data availability and set-up data models

3 Act

- Determine appropriate actions
- Adjust the investment process
- Mobilise the organisation to take action

1. Strategize

What impact measurement ambitions suit my strategy?

The first step for investment managers is to strategize their sustainability ambitions. This involves aligning their financial goals with positive environmental and social impacts, and setting clear criteria and metrics aligned with regulatory standards like the EU Taxonomy, SFDR, and CSRD. There are several approaches to determining impact, including mandate-based, regulatory-based, strategy-based, or a combination of these.

For example, Deloitte recently helped a financial institution navigate upcoming regulatory updates regarding climate change, while investigating the impact of an external net-zero commitment. High-level estimates of the portfolio's greenhouse gas (GHG) intensity helped strategize potential transition paths. The client decided to accelerate the growth of the portfolio's "green" parts to reduce the average GHG, while monitoring additional opportunities to move towards net-zero.

2. Plan

How can I improve my impact as an investor?

Once the sustainability ambitions are determined, the next step is to create a plan. This includes performing a baseline analysis, setting impact ambitions for each asset class, and creating data models.

In today's environment, many organizations struggle to determine how sustainable they currently are. Although global standards and regulations provide some guidance, there isn't a single approach to this issue. Therefore, managers must establish their own baseline, identify relevant impact areas, set success measurement criteria, and formulate a specific plan for each area. Then, they should develop plans for each desired impact area, using the determined baseline to categorize assets.

It is essential to understand the data available and its sufficiency for guiding the business and performing external reporting. In some cases, qualitative or proxy data may be used internally. Once understood, managers should create their data model, data management plan, and investment principles.

For example, a European investment manager has developed a tool to understand the impact of assets on people and the planet, so they can quantify and price the negative and positive impacts of different investments. This allows them to show their clients the impact of their investments and align this impact with their clients' ambitions. They can also use the tool to steer investment decisions and construct portfolios per their strategy and ambitions.

3. Act

What actions must I take to reach my sustainability goals?

In the third step, investment managers need to act on the plan developed in step 2. Depending on their strategies and goals, this may include stewardship, integrating environmental, social and governance (ESG) key performance indicators (KPIs) into the investment decision-making, and exclusions.

For example, one international asset manager practices active ownership through engagement, voting and stewardship. This involves exercising voting rights on stocks, maintaining a dialogue with the companies invested in the portfolio, and filing resolutions at investee companies. The asset manager also engages with portfolio companies on different levels, including value creation, minimal standards and sustainable development goals engagement. The outcomes of its active ownership are measured using the KPIs set in the plan phase.

4. Report

How can I incorporate my sustainability impact in my organizational reporting?

After incorporating new objectives into the firm's strategy, data collection methods and impact goals, investment managers should include them in their reports in line with SFDR and CSRD requirements. Given the evolving regulatory environment, early and frequent discussions with non-financial assurance providers are necessary to clarify reporting expectations and data quality standards. It's also beneficial for organizations to develop internal capabilities to help them understand the legal interpretations.

For example, a leading European impact investor publishes an impact report for their investment funds and provides an overview of the progress achieved. The report considers the fund's impact regarding GHG emissions, water consumed and landfill waste. It also explains the reasons for including and excluding certain companies from the portfolio based on the "do no significant harm" principle. Finally, the report details the portfolio's impact broken down by SDG and sustainable transition themes it supports.

5. Evaluate and iterate

Did I reach my sustainability goals, and how can I improve?

Once the four steps are concluded, the ever-changing investment landscape requires managers to regularly review their progress. By comparing their outcomes with their set goals, they can identify areas of improvement and realign their impact measurement approach as needed.

CONCLUSION

Impact measurement is essential to boost investment managers' sustainability and transparency, while complying with regulations like the CSRD and the SFDR. Deloitte's five-step impact cycle helps investors successfully navigate their impact measurement transformation journey and meet their sustainability ambitions. This leads to better strategy alignment, informed investment decisions, improved stakeholder communication, and easier regulatory compliance.

To find out more about how Deloitte's Sustainable Investor Framework can help you, please get in touch.

TO THE POINT

- Impact measurement plays a crucial role in investment managers' transparency, accountability, stakeholder communication, and regulatory compliance.
- The processes for quantifying investment decisions' positive and negative sustainability impacts differ from traditional approaches, making it challenging to know where to start.
- Deloitte's five-step investor impact cycle provides managers with a clear blueprint for determining their ambitions, measuring their impact, and meeting their sustainability goals.
- This involves managers creating a strategy, designing a plan to improve their sustainability impact, taking action to meet their sustainability ambitions, and incorporating their impact in their reporting.
- Finally, as the investment landscape is constantly evolving, managers must adapt their processes and approaches as needed.

Holistic conduct risk management for dealing room controls

FAIR PLAY IN THE SECURITIES MARKET KEY TO BALANCING SUPPLY-AND-DEMAND DYNAMICS

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INTRODUCTION

The increase in high-profile front running, insider trading and other market abuse cases by financial services professionals has raised serious concerns for regulators and the market's institutions alike. Misusing privileged information of institutions' big orders is not only unethical on the part of the employee; it also has a high probability of deceiving unwary investors and impacting markets at large.

For example, in the case of a front-running scheme, orders placed by front runners (either by the employee themselves or to whom this privileged information was shared) may trigger artificial supply and demand in the market. This impacts the investors' sentiments, as they may follow the buy/sell market trend and end up losing out after the stock prices are corrected upon the big order's execution.

As a result, front-running schemes are not just limited to illegal gains by the front runner, but also pose operational, reputational and regulatory risks to the institution and damage regulators' and institutions' efforts to protect investors' interests.

Given the growing regulatory focus, institutions are seeking a proactive methodology to monitor investment professionals' conduct and prevent potential unethical practices.

Market abuse cases on the rise

Amid the growing number of market abuses, several high-profile cases stand out. On 27 April 2023, India's securities market regulator raised an interim order against the country's largest life insurance undertaking, which debarred suspected individuals and entities from securities market trading, froze bank accounts and impounded wrongful gains amounting to INR2.44 crores.[1] One of the company's investment professionals was alleged to have misused information regarding large buy or sell orders for personal gain, impacting supply-and-demand dynamics and manipulating the trading price in the front-runner's favor.

In another front-running case in February 2023, India's securities market regulator debarred around 21 entities, and impounded INR30.55 crores gained from a front-running scheme run by a fund manager of a large asset management company.[2]

These front-running schemes are witnessed across the globe. For example, a recent order was issued by the US Securities and Exchange Commission (SEC) for multi-year front-running schemes by employees of major asset management firms and investment banks, with one institution penalized USD249.4 million in a recent case.[3]

These cases of foul play and privileged information misuse are highly unethical and are likely to deceive investors and impact markets at large. For example, orders placed by front runners trigger artificial supply and demand in the market, manipulating unwary investors and leaving them feeling cheated.

Current anti-market abuse processes

To comply with regulatory requirements, institutions have defined and identified individuals who handle price-sensitive or privileged information. Many organizations have also implemented rigorous controls for monitoring trades in these identified individuals' trading accounts, and even their immediate relatives' accounts, by requiring them to pre-clear their trades with compliance officers and promptly disclose trades in their personal accounts to the organization.

Several jurisdictions, including India, mandate that the conversations of fund managers and dealers are recorded during market hours to detect the disclosure of privileged information. Some institutions have gone further and set up dedicated

1. Aathira Varier, "Front running case: LIC fires employee banned by Sebi from stock market," *Business Standard*, 20 March 2024.
2. Palak Shah, "SEBI impounds ₹30.55-crore ill-gotten gains in Axis Mutual front-running case," *The Hindu Business Line*, 28 February 2023.
3. KS Badri Narayanan, "SEC charges Morgan Stanley, Pawan Passi in front-running case," *The Hindu Business Line*, 12 January 2024.

and secured dealing rooms for equity and fixed income, access-controlled dealing rooms, and restrictions on carrying and using personal phones inside dealing rooms and during market hours. Some have also installed video cameras inside dealing rooms to monitor and detect unauthorized access and abnormal activities.

In addition to these controls, investment back-office or compliance teams perform periodic reviews to identify trades with distorted volume weighted average prices (VWAPs), especially significant market trades that are susceptible to front-running schemes.

However, despite all these efforts, some institutions are still failing to prevent and detect unethical conduct by investment professionals, and are struggling to demonstrate their implemented controls to regulators.

Holistic conduct risk management frameworks

The reason for these challenges may lie in institutions' fragmented approach and insufficient use of technology, which monitor individuals' trading accounts, the institution's accounts and calls in isolation. Consequently, institutions are moving from reactive analysis to proactive, holistic monitoring through designing conduct risk management frameworks.

These frameworks consist of four primary pillars:

01. Clearly defined policy and processes;
02. People with appropriate skill sets;
03. Tools and technology to aid the institution's prevention and detection strategy; and
04. Governance to oversee the conduct risk management process.

While many institutions have the first two pillars in place, deploying the right tools and setting up governance will bolster their monitoring of dealing room transactions and behavioral patterns. Tech-enabled tools can perform a 360-degree assessment and identify abnormal patterns and red flags, including large trade data analytics platforms, voice analytics, data leakage prevention (DLP) systems, and electronically stored information (ESI) review platforms.

These tools can raise red flags by comparing identified personnel's unusual trading patterns with the institution's patterns, and comparing trade confirmations from brokers with the institution's trade data. They can also profile behavioral patterns by analyzing big orders, call recordings, chats, business allocations to brokers, dealer commission concentrations, violations of roles and responsibilities, and dealing room access logs.

This technology-enabled framework can help institutions analyze this data in "near-real time", providing an intelligent dashboard that summarizes outliers for compliance teams to investigate further. These outliers are based on various pre-defined scenarios around residual risks, identified through an iterative control risk assessment process.

Additionally, institutions may also consider using tools that perform social media and lifestyle checks on identified personnel to flag any undisclosed sources of income. These tools could also strengthen senior management's governance and oversight by automating periodic management information system (MIS) reports.

CONCLUSION

The rise of front running, insider trading and other market abuse cases indicates that many institutions' market controls are falling short. To mitigate operational, reputational and regulatory risk and create a fair marketplace for investors, financial services institutions should consider deploying a holistic conduct risk management framework for their dealing rooms.

Tech-enabled tools can help institutions implement strong and effective controls to proactively monitor the trades and behavioral patterns of dealing-room personnel. And given the dynamic nature of risks, a 360-degree periodic assessment can allow institutions to align their residual risks with the corresponding monitoring mechanisms.

These holistic monitoring systems will help deter unethical practices and streamline efforts to create a safe and fair marketplace for investors at large.

TO THE POINT

- A rise in market abuse cases has catalyzed a paradigm shift in conduct risk management, moving from reactive analysis to proactive monitoring.

- Holistic conduct risk management for dealing room controls is essential for financial services institutions to prevent and detect employees' unethical practices.

- A robust and effective framework with a technology-rich approach helps uphold investors' and regulators' trust.

- Institutions can easily demonstrate to regulators their efforts in preventing and detecting unethical practices, thereby supporting the regulators' mission of creating a fair securities market environment.

Deciphering India’s tax landscape: An insight for foreign investors

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INTRODUCTION

The Indian Finance Minister, Ms. Nirmala Sitharaman, emphasized India's enduring economic growth in her recent Union Budget speech, highlighting the importance of fiscal discipline and revitalization. With ongoing reforms and digitalization initiatives shaping the economic landscape, India's tax regime continues to evolve, offering a range of challenges and opportunities for both domestic and foreign investors. A thorough understanding of these dynamics is crucial for foreign investors seeking to navigate the Indian market effectively and make informed investment decisions.

India operates under a dual taxation regime, encompassing both source and residency-based taxation principles. While resident Indians are required to pay taxes on their global income, non-residents are taxed solely on income sourced from India. According to Indian tax law, an entity is classified as non-resident only if its Place of Effective Management (PoEM) (for corporations) is located outside India, or if its control or management (for entities other than corporations) is situated wholly outside India.

A foreign investor seeking to invest in the Indian securities may generate diverse income streams from such investments, including gains from the transfer of securities, dividend, interest and more. Taxability of gains arising from the transfer of securities depends on several factors, such as the nature of investment, type of security, duration of holding, investment route and other relevant considerations.

Characterization of income on transfer of Indian investments

Understanding the taxation of gains from the transfer of Indian securities is indeed crucial for foreign investors. In India, these gains can be categorized as either "capital gains" or "business income," depending on various factors, such as the investor's intent, holding period, frequency of transactions, and the type of security involved.

Characterization of gains arising from transfer of Indian securities has been a vexed issue. To provide clarity on this matter, Indian tax laws stipulate certain rules. For instance, listed shares or securities held for a period exceeding 12 months immediately preceding the date of transfer are deemed to be treated as "capital gains," unless the investor explicitly treats them as "business income." Similarly, for unlisted shares, they are also treated as "capital gains" unless certain conditions are met, such as if the transaction is not genuine or if the transfer is made along with the control and management of the underlying business.

In the case of Foreign Portfolio Investors (FPIs), the tax laws stipulate that all securities held by FPIs are treated as capital assets. As a result, any gain or loss arising from the transfer of these securities is classified as capital gains or losses for tax purposes. This means that regardless of the intent or strategy behind the investment, gains or losses from the sale of securities by FPIs will be treated as capital gains or losses.

Income arising from Capital Gains

- Capital gains in India are computed using the First-In-First-Out method and categorized as either long-term or short-term based on type of security and holding period. The following table outlines the holding period for the classification of gains as short-term or long-term:

Type of instrument	Holding period in months	Characterization
Listed securities (other than a unit, market linked debentures and units of specified mutual funds), unit of equity-oriented mutual fund, the Unit Trust of India, and Zero-Coupon Bonds.	More than 12	Long-term
	12 or less	Short-term
Unlisted shares of a company (other than shares listed on a recognized stock exchange in India)	More than 24	Long-term
	24 or less	Short-term
Market Linked Debentures (MLD) and units of specified mutual funds*	–	Short-term
Other securities not covered above	More than 36	Long-term
	36 or less	Short-term

* Specified Mutual Fund is defined as a mutual fund wherein < 35% of total proceeds are invested in the equity shares of domestic companies. The equity shareholding of the Mutual Fund is to be computed using the annual average of the daily closing figures.

- The tax rates applicable to capital gains from the transfer of Indian securities vary based on the classification of the asset as mentioned above. Long-term gains (LTCG) are subject to a tax rate of either 10%* (for non-residents as well as residents) or 20%* (primarily for residents), depending on nature of security and the availability of a cost step-up benefit in certain cases. Conversely, short-term capital gains (STCG) arising from on-market transfers of the listed shares, units of equity oriented mutual funds and units of business trust (REIT/InvIT) are taxed at 15%*, while any other STCG is taxed at 30%* for non-corporates or 40%* for corporates.

- The Indian tax law provides for computation of capital gains by reducing cost of acquisition from full value of consideration received on transfer of securities. Expenses related to purchasing securities can be added to the cost, while expenses in connection with transfer, such as brokerage, custody fees, bank charges and other transaction charges are deductible when computing capital gains. However, Securities Transaction Tax (STT) paid during the purchase or sale of securities is not considered part of the purchase cost, nor is it deductible when calculating capital gains.

- Further, foreign investors may also invest in American Depository Receipts or Global Depository Receipts with an Indian security as underlying. Transfer of depository receipts is not taxable in India. However, where these depository receipts are converted into the underlying Indian securities, any subsequent sale of the underlying Indian security is taxable in India.

- In managing capital gains and losses, investors have the flexibility to offset Short-term Capital Losses (STCL) against STCG, as well as LTCGs. However, long-term Capital Losses (LTCL) can only be offset against LTCG. Additionally, losses incurred from one type of security can be set off against gains from another type of security as long as they share the same classification as capital assets. For example, losses from short-term equity (taxable at 15%) can be offset against gains from short-term derivatives (taxable at 30%). Furthermore, any unused STCL and LTCL losses can be carried forward for up to eight years. However, for corporate taxpayers, gains can only be set off against losses from a prior year if at least 51% of the investors (by voting power) remain unchanged.

- In addition to the above, foreign investors may also be subject to indirect share transfer provisions under certain circumstances. These provisions aim to tax gains derived from the transfer of shares or interest in a foreign entity that derives its value substantially (>50%) from assets located in India. Exemption is provided to non-residents holding less than 5% share/interest in the foreign entity. Further, investors in a Category I FPIs are specifically exempted from the applicability of indirect transfer provisions. Moreover, if non-resident investors hold interests indirectly (through an entity outside India) in a Category I or Category II Alternative Investment Fund (AIF), and the redemption of such interests occurs due to the transfer of shares or securities held in India by such AIF, resulting in taxable income in India, the non-resident investor is exempt from the indirect transfer provisions.

- The Indian tax laws include provisions regarding "bonus stripping," where any short-term capital loss incurred by a taxpayer through purchase or sale transactions of a security close to the record date of a bonus issue is disallowed. Instead, this loss is added to the cost of the bonus shares or units received. Additionally, the laws encompass deemed income provisions if investors acquire securities without consideration or at a value lower than the fair market value (FMV) of such securities.

Other incomes

- Income from securities, including dividends and interest, held by foreign investors is typically subject to tax at a rate of 20%*. However, resident Indian entities and individuals are taxed on such income at their applicable rates. For individuals and non-corporates, this rate is usually 30%*. For corporates, the tax rate varies depending on the regime opted by such entities, ranging from 22%* to 30%*.

- Business income and any other income, including interest received on income tax refunds, earned by both residents and non-residents are taxable as regular income at the maximum applicable rate, determined by the investor's category.

Taxability on investment in Alternative Investment Funds (AIFs)

AIFs are categorized into three groups: Category I, Category II, and Category III. Category I and Category II AIFs benefit from a special tax regime, wherein they are granted pass-through status. This means that any income, excluding business income, earned by these AIFs is directly taxable in the hands of the investors at the applicable rates (as mentioned above).

Conversely, Category III AIFs established in India are not covered by any special tax regime and are subject to complex trust taxation provisions. Typically, Category III AIFs are taxed at the trust level, and the income distributed by these AIFs to their investors is exempt from tax in the hands of the investors.

Category III AIFs operating in the International Financial Services Centre (IFSC) enjoy certain tax exemptions and lower tax rates. These exemptions include exemption from capital gains on securities other than shares of Indian companies and a reduced tax rate of 10%* on dividend and interest income, among others.

Moreover, the Fund Management Entity (FME) of such AIFs in IFSC also enjoy a 10-year tax holiday. Additionally, such entities are also not liable to the Goods and Services Tax (GST) on their income.

Withholding tax

Indian entities are required to withhold taxes at applicable rates (as mentioned above, subject to lower rates available under the tax treaties) while making payment to non-residents. However, no taxes are required to be withheld on capital gains earned by FPIs.

Tax payments and annual income tax return

Indian advance tax obligations mandate timely tax payments in four installments during each financial year as follows as per prescribed due dates, failing which a minimal penal interest of 1% per month is levied. Any taxes not paid by the end of the financial year can be paid subsequently, along with applicable interest. Also, Indian tax return filing deadlines applicable to foreign non-corporate and corporate investors is July 31 and October 31 of the relevant assessment year respectively, considering the investor is not subject to transfer pricing provisions.

Benefits under a tax treaty

In case an investor belongs to a jurisdiction wherein a tax treaty has been signed by India, the Indian tax law allows such taxpayers to avail beneficial provisions/

TO THE POINT

- This article focuses on the taxation of gains from the transfer of Indian securities and its implications for foreign investors. India has a dual taxation regime, with residents taxed on global income and non-residents taxed on income sourced from India.
- Taxability of securities gains in India depends on factors like investment nature, security type, holding period, and investment route. Gains from security transfers can be categorized as "capital gains" or "business income" based on these factors as well as on the intent of investment.
- India offers promising investment opportunities for foreign investors, but a comprehensive understanding of the tax landscape is crucial. It emphasizes the importance of adhering to regulations, effectively managing capital gains and losses, and leveraging exemptions to optimize investment strategies.

rate as prescribed in the tax treaty, provided the investor fulfils the criteria's mentioned therein and is eligible to claim treaty benefits. However, it is pertinent to note that tax benefits available in the tax treaty can be denied by Indian tax authorities if provisions of the General Anti-Avoidance Rule (GAAR) or Multilateral Instrument (MLI) are attracted. Investors from jurisdictions such as Mauritius, Singapore, France, Netherlands, Ireland, Denmark, and few other EU countries enjoy capital gains exemption on transfer of all securities other than equity shares, while residents of certain countries, such as France, Netherlands, Denmark, among others, enjoy complete capital gains exemption, even on sale of equity shares subject to conditions. Investors from Mauritius and Singapore enjoy tax exemption on sale of equity shares only with respect to shares purchased before 1 April 2017.

CONCLUSION

In conclusion, India offers promising investment opportunities for foreign investors, but success hinges on a comprehensive understanding of the tax landscape. The Government has tried to provide a light touch tax and regulatory environment for offshore funds investing in India without a local presence. The Government has also taken several steps to make the GIFT City a hub not just for financial markets but also for banks, insurance, leasing and support services companies. Tax environment is also sought to be modernized by several steps to digitize tax compliance and administration.

By adhering to the regulations, strategically managing capital gains and losses, and leveraging exemptions where applicable, foreign investors can optimize their investment strategies. Effective tax planning and compliance are essential for unlocking the full potential of investments in the dynamic Indian market.

* plus applicable surcharge and cess

Foreign investing in India: trends, opportunities and forecasts

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INTRODUCTION

India's economic landscape shines brightly, showcasing resilience and potential bolstered by robust foreign investments and a burgeoning competitive edge. The steady influx of Foreign Portfolio Investment (FPI) and Foreign Direct Investment (FDI) into key sectors underscores global confidence in India's trajectory, with a projected growth rate of 6.6%. India is on the course of becoming the 4th largest economy in the near future in terms of nominal Gross Domestic Product (GDP), surpassing Japan. Additionally, efforts to improve the ease of doing business and implementing structural reforms further attract international investors.

In tandem with India's economic ascent, the asset management industry has also experienced a surge in growth, mirroring the nation's upward trajectory. As investors flock to capitalize on India's promising prospects, asset management firms play a pivotal role in channeling investments effectively, driving wealth creation and fostering sustainable economic development. This symbiotic relationship between India's economic expansion and the growth of the asset management industry underscores a dynamic era of prosperity and opportunity on the horizon.

Mr. Shiv Sehgal, President & Head of Nuvama Capital Markets and **Mr. Ankit Jain**, Senior Fund Manager of Mirae Asset Investment Managers India Private Limited, discuss current trends in investments in India and expected transformations in the investment landscape over the coming years.

1. How do you assess India's economy, considering GDP growth, inflation, employment, and fiscal policy? How will these factors shape India's economic future?

Mr. Shiv Sehgal, President & Head of Nuvama Capital Markets: India today is in a sweet spot when seen from both growth as well as macro-economic stability. First, with regards to growth, what catches headlines is the real GDP growth – which is certainly one of the highest in the world. However, what is underappreciated is the quality of the same. It is driven by government-led infrastructure investment and real estate development, which have high growth multipliers compared to the consumption-led growth seen in 2000s.

It is because of these factors that despite buoyant growth there is low inflation as its productivity led. Such a combination is likely to continue for many years as India has just started on the investment front, balance sheets are strong and there is focus on productivity by both the government and the private sector.

Mr. Ankit Jain, Senior Fund Manager of Mirae Asset Investment Managers India Private Limited: India's GDP growth has been projected to grow at 6.6% in FY26 by the World Bank, which makes it the fastest-growing major economy in the world. The inflation has been kept under control thanks to the coordinated focus of the monetary and fiscal policy in the last 7-8 years. The fiscal deficit has been budgeted to narrow to 4.5% of GDP by FY26, down from 5.8% in FY24. With a GDP of $3.7 trillion, India currently ranks as the 5th largest economy in the world and it is expected to be the 3rd largest economy by 2028 as per the International Monetary Fund (IMF) estimate. With an expected growth rate of 6-7%, India is estimated to lead the global growth in the next 5-10 years.

(see Figure 1)

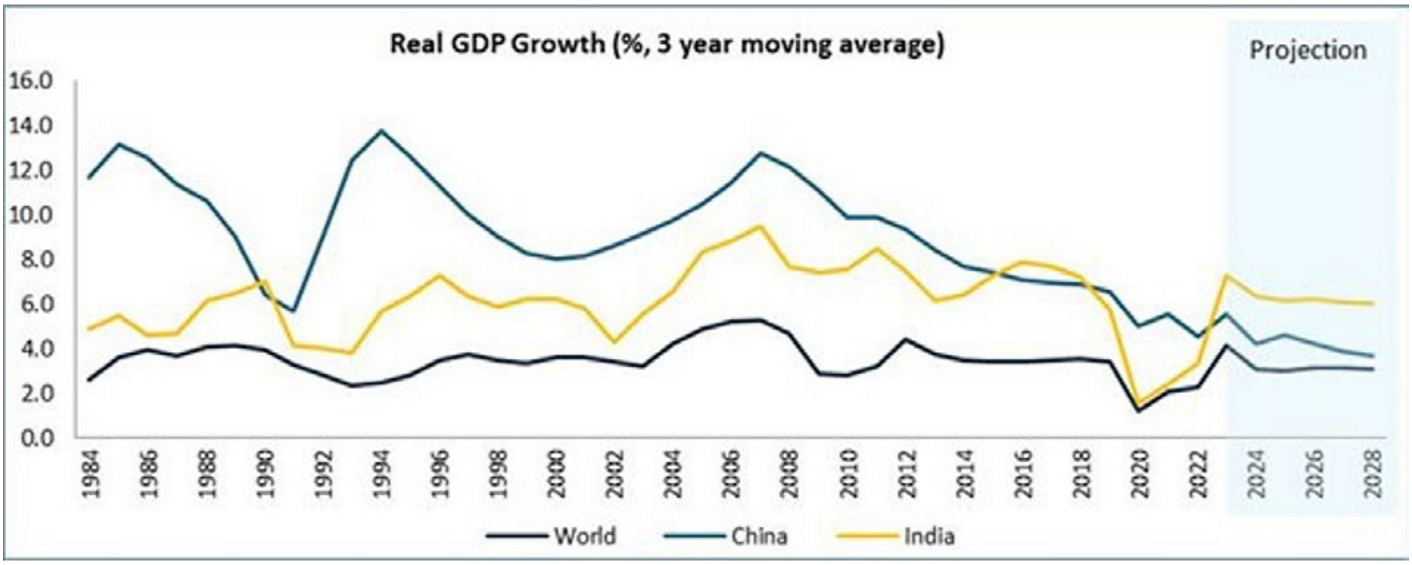
2. How do you perceive India's competitiveness as an investment hub compared to other key Asian and developing markets?

Shiv Sehgal: It's fascinating how things have changed in last decade. India was famously part of the "fragile five," a decade ago. Today, it's an investor darling and one of the few beacons of growth. Similarly, with regards to markets India used to be clubbed along with (Ems) today people perceive it quite differently.

India is balancing capacity building and inclusive development. Economic reforms ranging from Goods and Services Tax (GST), bankruptcy code, ease of doing business combined with sustained push toward capex through Production Linked Incentive (PLI) schemes, are working to expand India's potential growth rate. At the same time, a social revolution of sorts is unfolding at the ground level with expanding reach of electricity and cooking gas, free food, direct benefit transfers, affordable housing and many more all of which add up to a social safety net for the lower income brackets.

Such a comprehensive development has not been seen before. India is still in the lower part of the S-curve, with a long journey still ahead. Today, the world is going

Figure 1: **India to lead global growth in the next five to 10 years** - Source IMF



through what many experts' terms as "Polycrisis" – as there are geopolitical tensions, high debt, weakening US hegemony, ageing population, and policy uncertainty. In such an environment India stands out. With its young population, low debt, and (one of the few countries to have de-levered over last decade), clear policy direction, it's becoming a popular destination compared to both EM as well as other developing markets.

Ankit Jain: India's competitive position as an investment hub has improved massively due to its faster growth compared to other developing economies in Asia. India's position as an investment hub is promising. It's large domestic consumption market, economic growth potential, and government reforms are significant advantages. The country's rankings on various competitiveness indexes, are improving (e.g. World Bank Logistics Performance Index, Global Innovation Index).

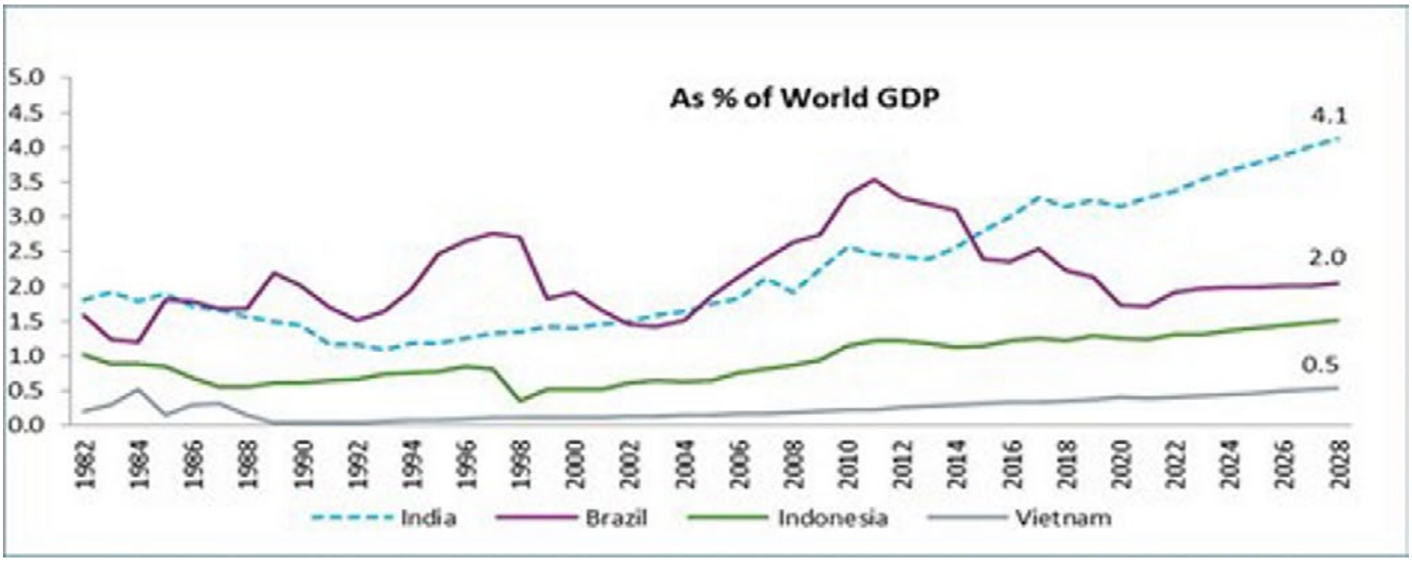
(see Figure 2)

3. What market shifts are driving more funds into Indian markets ,and what is the primary catalyst for these changes?

Shiv Sehgal: Well, most investors are familiar with the long-term rationale for investing in Indian equity markets (Ems) — demographics, a growing middle class, and digitalization. While these are certainly valid points, there are other compelling reasons to consider a distinct investment into Indian markets.

India is one of few emerging markets (Ems) where equity investors get rewarded for underlying economic growth. In other words, company earnings, (and thus the index) tend to grow in line with GDP. This sounds logical and somewhat basic, but most investors would be surprised to learn that this is not the case for a large swath of emerging markets, where earnings have not grown in line with underlying GDP. There are several potential reasons why this could be the case, including weak corporate

Figure 2: **India's share in world GDP is on the rise** - Source IMF



governance, share dilution, index composition, or simply an overstatement of actual GDP growth.

What this means is that investors in emerging markets – many of whom invest for the high growth prospects – are not being rewarded for that growth. The benefits of economic growth, even if being felt by companies through higher revenues, are not accruing to shareholders.

India's EM, represented by Morgan Stanley Capital International (MSCI) India, stands out as an interesting example within EM. Corporate earnings at the index level have closely tracked India's nominal GDP growth over the last 20 years. Over most relevant investment time frames, the Indian equity market (MSCI India) is amongst the most consistent and best performing global indices. An equally surprising factor to most investors is that these impressive equity returns have largely been driven by a long track record of relatively consistent compounded earnings. In fact, the 20-year compounded average growth rate (CAGR) for MSCI India earnings is 10.9%, which matches the 20-year annualized equity return of 14.9% (in local currency) for the equity market.

Ankit Jain: India has political stability as the current regime completes 10 years in office. Political stability is expected to continue beyond 2024 as Prime Minister Narendra Modi's approval rating remains high. The government has focused on building infrastructure in the last 9 years. Government capex jumped from $40 billion in FY20 to $130 billion in FY25. National Highway network has improved from 91,000 km in 2014 to 147,000 km. The focus is to remove the infrastructure bottlenecks to pave the path for faster growth. The other reason for foreign flows is the healthy domestic flows into EMs. FPIs come to invest in a country where domestic flows are strong. Domestic mutual fund (MF) industry Assets Under Management (AUM) grew by about 4 times in the past 7 years. These are the main reasons why FPIs are positive on Indian economy.

4. Which sectors do you expect to thrive over the next decade, and why?

Shiv Sehgal: I think the investment opportunities in India, for the long term, are big. India is one of the markets where, during sell-offs, you can keep buying and gradually build your investments over time. In the US, just 16% of personal financial assets are in cash or savings accounts, while Indians still hold more than 60% of their wealth in the form of cash or savings account. This is our opportunity to drive savings into capital markets. There seems to be a domestic equity cult developing, with domestic MF growing 10 times more in the last 10 years. This is similar to the post-1980s US, where combination of demography and deregulation spurred strong retail investor interest. The trend that started in 2016 is not an anomaly but a structural change and we need to give it the importance it deserves.

Sectorally, during phases of upswing, cyclical sectors tend to see both earnings, as well as valuation tailwinds. Given that we are at the early stages of the cycle, one should have a bias toward domestic cyclicals, such as banks, industrials, real estate, and cars.

Ankit Jain: We see good investment opportunities across three key areas:

- Domestic growth potential: India currently boasts the fastest-growing economy globally, with a GDP of $3.5 trillion and projections to become the fifth-largest economy soon. Real GDP is anticipated to grow at 7%, with nominal GDP growth at 11%, indicating a potential doubling of the economy within 6.5-7 years. With all four balance sheets — banking, housing, government, and corporate — in good shape, the growing economy presents numerous opportunities in mid-cap companies. The government's targets to increase income levels, combined with favorable demographics for a long time (median age of 28 years) and policies aimed at boosting the workforce, contribute to long-term growth prospects.

- Given these factors, we perceive significant opportunities in the consumer and financial services sectors.

- Manufacturing potential: The manufacturing sector currently constituting 14% of GDP and India's share of exports is low. Initiatives like "China+1" and localization efforts are expected to drive manufacturing growth. Investments in logistics to reduce costs — coupled with government measures to lower interest rates — aim to enhance the competitiveness of the manufacturing sector. India is poised to offer a competitive advantage in manufacturing for the next two decades, with incentives provided to both domestic and foreign companies.

- Economy formalization: Reforms aimed at formalizing the economy have been instrumental in benefiting mid-cap and smaller companies. These reforms have created a conducive environment for businesses, leading to increased opportunities and growth potential within the mid-cap segment. We are positive about the building material, logistics, and real estate sectors to benefit from this trend.

5. Which recent trends have led to the growth of the asset management industry in India?

Shiv Sehgal: If one has to look at India's financial evolution, post-1980s US offers the best template. In the US, the combination of financial de-regulation, young population, and improved macro-stability (after stagflation of 1970s) spurred a big rise in equity cult. The US equity MF AUM rose 100 times in 20 years, and equity MF AUM as a percentage of bank deposits rose from 3% to 60% between 1980 to 2000. India today is at a similar cusp, with equity cult just started. While equity MF AUMs have risen by 10 times over the last decade, there is still a long way to go. Even after such a stupendous rise, its share of bank deposits is just 15%. Thus, progress is likely to continue as incomes and aspirations of India's incomes rise.

Ankit Jain:

- Increase in the contribution of Systematic Investment Plan (SIP) has made asset management company (AMC) business relatively sticky (SIP AUM as a percentage of equity AUM has gone up from 25.7% in March 2019 to 46.6% in March 2024);
- High net-worth individuals (HNI) contribution is leading to strong growth in AMC especially equity AUM; and,
- With increase in the popularity of direct (gone up from 16.2% in FY19 to 25.8% in FY24) and its cost effectiveness also contributed to growth.

6. What key factors guide your investment decisions in the Indian market? Can you elaborate on your investment thesis and rationale?

Shiv Sehgal: While investing in India, it's important to have a couple of things in mind. One must focus on not just getting macro themes like capex or consumption, but also micro themes within it right. Second, in lot of industries earnings prospects are being shaped by competitive intensity rather than just demand dynamics, which is a –key variable that needs to be kept in mind. Typically, I like to buy into growth stories rather than focusing on value. In India, growth gets a hefty premium, so even if you buy something expensive but fast-growing, you are likely to generate good returns.

Ankit Jain: We prioritize maintaining a well-diversified portfolio and consciously avoid heavy sector allocations. Our portfolio takes reference from the mid-cap 100 index as a benchmark, aligning its sector allocation while emphasizing active stock weights. This approach highlights our dedication to stock selection, which is underscored by our confidence in our stock-picking abilities. Our stock selection process follows a growth at a Reasonable Price (GARP) philosophy, considering:

- Business selection: We seek companies that have demonstrated double-digit growth over a reasonable period.
- RoCE: Our preference is for companies with a pre-tax Return on Capital Employed (RoCE) exceeding 15%.
- Management: Strong management with thought leadership is a crucial factor in our decision-making.

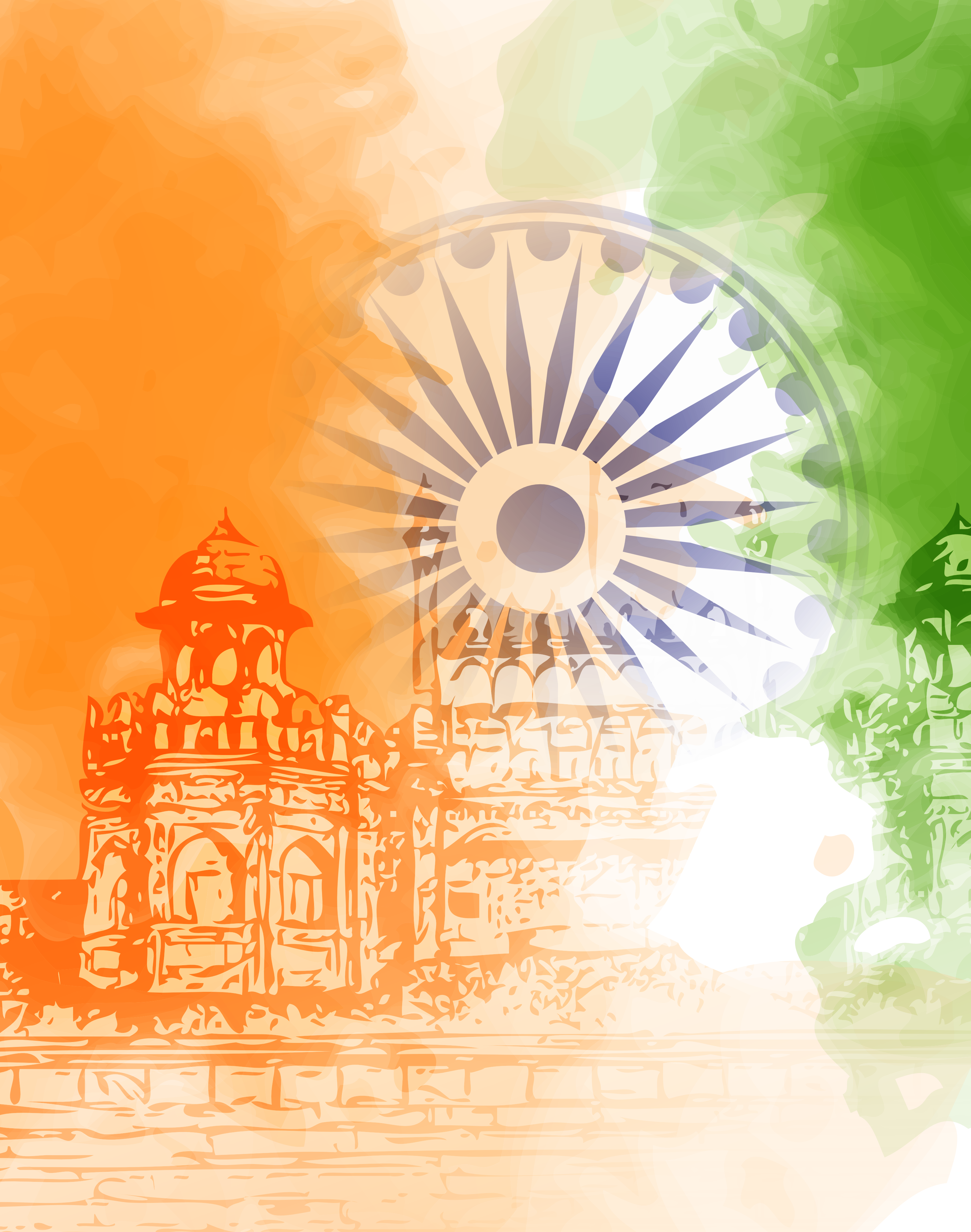
Our stock selection decisions reflect our value assessment, underpinned by rigorous primary research, especially within the mid-cap and small-cap segments.

Given India's status as a growth market, our portfolio leans significantly toward growth businesses, accounting for approximately about 70%-75% of our investments, while the remaining is allocated to value businesses. This strategic diversification approach aims to deliver risk-adjusted returns to our investors.

Our is a 15-member team comprises sector specialists who contribute to generating investment ideas. We place substantial emphasis on in-house ideation. Further, our analysis places significant weight on the Discounted Cash Flow (DCF) methodology.

7. As an asset manager in India, what transformations do you anticipate in the investment landscape ahead?

Shiv Sehgal: As markets evolve, many transformations are likely to occur. As we go ahead, I think the role of technology in asset markets will rise, as will the scope for financial innovation.



Today in India, despite the boom in asset management over last decade, most financial products are either linked to equity or debt. There has been rise in structured products, but it's nowhere close to that seen in western world. This is one space where things could evolve going ahead.

Ankit Jain:
- Financialization of household savings;
- Increase in direct participation in EM either Cash Market or derivatives; and,
- Strong growth in dematerialized (demat) account opening (151 million in FY24 Vs 36 million in 2019) suggest sustained participation of retail players in the market.

8. How do you foresee the growth of foreign investments in India through alternate spaces? (Alternative investment funds (AIFs), real estate investment trust (REITs), Infrastructure Investment Trust (InVITs))

Shiv Sehgal: You know, when it comes to foreign investments in India, things have really evolved. Recent regulatory changes have opened exciting opportunities for foreign investors. We're talking about AIFs, REITs, and InvITs. These aren't your typical stocks and bonds; they offer exposure to different kinds of assets. AIFs are privately pooled funds that invest in infrastructure, hedge funds, private equity, and venture capital.

AIFs in India have come of age and experienced an annual growth rate of 30% in FY23. According to recent trends, AIFs are getting a lot of attention. By the end of March 2023, AIFs had committed a total of approximately US$100 billion, had a corpus of around US$44 billion, and had invested a total of about US$40 billion, according to cumulative data compiled by the market regulator Securities and Exchange Board of India (SEBI). Corresponding to annual growth rates of 30%, 16.49%, and 19% respectively. According to the Indian Association of Alternative Investment Funds (IAAIF), the AIF industry managed assets worth a total of approximately US$84.3 billion.

Now, here's the interesting part: REITs and InvITs collectively raised ₹11,474 crore in 2023. That's a clear sign of investor confidence. And why are these investment vehicles so appealing? Well, it's all about transparency, favorable tax structures, and ongoing reforms.

AIFs have gained prominence, especially when it comes to attracting foreign capital. Regulated by SEBI, AIFs offer exposure to assets beyond the conventional stock and bond markets. Their strategic significance lies in fostering economic development by supporting sectors like startups, real estate, and distressed assets. Thus, for foreign investors seeking growth avenues, AIFs are increasingly compelling choices.

Therefore, if you're a foreign investor looking for growth avenues, keep an eye on AIFs, REITs, and InvITs. They're shaping India's investment landscape in exciting ways.

9. Given the surge in investment activity, particularly in the Alternate Investment sector, SEBI has been closely monitored Indian managers. Do foreign investors encounter significant challenges in India?

Shiv Sehgal: Undoubtedly, navigating the Indian investment landscape, particularly in the alternative investment sector, presents its fair share of challenges for foreign investors. Firstly, regulatory compliance can be complex and time-consuming, as SEBI imposes stringent regulations, however this is primarily to safeguard investor interests. Furthermore, market volatility and geopolitical uncertainties require a keen understanding and proactive risk management approach.

Despite these challenges, the potential for high returns and diversification benefits makes India an attractive investment destination worth exploring. Indeed, India's vibrant market offers substantial growth opportunities, with the alternative investment sector witnessing a remarkable surge in recent years.

10. Do you anticipate a rising prevalence of passive fund management in India, or do you expect greater demand for active management of funds?

Shiv Sehgal: The eternal tug-of-war between active and passive fund management. Let's break it down. Globally, passive funds have been on the rise. They've snagged around 31% of mutual fund assets worldwide, and in the US, they're at a whopping 40%. India's no exception — our passive funds have surged nearly fivefold in the last five years, thanks to institutional players like provident fund trusts.

But here's the twist: actively managed funds have been under the microscope lately. Many haven't quite outpaced the market benchmarks. Now, will this recent underperformance push folks toward passive funds? Well, that's the million-dollar question. And spare a thought for our distributor community — they're already grappling with declining expense ratios.

In a nutshell, it's a fascinating run. Active or passive, the answer lies in the stars — or maybe just in the next market cycle.

Ankit Jain: Large of exchange-traded fund (ETF) AUM growth ins driven by Employees Provident Fund Organization (EPFO) participation of EM. However, retail and HNI investors who drive equity AUM for MFs still participate in active equity. Yet, new MFs, such as Zerodha, Angel etc. want to create products around to ETF to grow their MF stories. Given the reach of these brokers, we expect small-ticket investments to pick up.

11. How do you envision sustainability influencing the asset management environment when making investments in India?

Shiv Sehgal: Sustainability is rapidly becoming a focal point in the asset management landscape, particularly in India. Consider this: ESG (Environmental, Social, and Governance) investing has seen a surge of over 34% globally, totaling $35.3 trillion in assets. In India alone, sustainable assets have more than doubled in the last three years, reaching $1.7 trillion.

Now, with the Indian government pushing ambitious sustainability agendas and investors increasingly prioritizing responsible investing, sustainability considerations are permeating investment decisions. From renewable energy projects to green bonds and socially responsible initiatives, sustainable investments are not just a trend, but a crucial aspect of long-term wealth creation and societal impact.

12. How will artificial intelligence (AI) shape asset management's future, and which strategies or technologies do you believe will drive innovation and efficiency in the industry?

Shiv Sehgal: AI is poised to revolutionize asset management, offering unparalleled opportunities for innovation and efficiency. Globally, AI adoption in financial services is projected to grow by 23.9% annually, reaching $37 billion by 2027. In India, AI-driven fintech investments have surged to $2 billion, with a staggering 33% year-on-year growth rate.

Looking ahead, AI-powered algorithms for predictive analytics, machine learning-driven portfolio optimization, and natural language processing for sentiment analysis are expected to be game-changers. These technologies not only enhance decision-making processes but also enable real-time risk assessment and personalized investment strategies, ultimately driving superior returns and client satisfaction.

13. Do you see growing interest amongst Indian investors to invest in overseas market, whether directly or through the GIFT city?

Shiv Sehgal: Absolutely, there's a noticeable uptick in interest among Indian investors to tap into overseas markets, both directly and through platforms like the Gujarat International Finance Tec (GIFT) City. Recent data indicates a substantial increase in outward remittances from India, with the Reserve Bank of India (RBI) reporting a notable increase in individuals' overseas investments, reflecting a growing appetite for international exposure. Factors, such as portfolio diversification, access to global opportunities, and risk mitigation strategies drive this trend. Additionally, initiatives like GIFT City offer streamlined avenues for international investing, further catalyzing investor interest in exploring offshore markets.

Ankit Jain: We see a good interest from Indian investors to invest in overseas market both directly and via through the Gift City. They would like to diversify their investments across asset classes, and many global markets, especially US Tech, provide good return potential. Additionally, there are many themes and sectors present in global markets, such as AI, EV, Genomics, Semi-Conductors, Block Chain, ED Tech, Cloud Computing, that are not present in India, and the investors can gain exposure to those themes. The dampeners to global investing are taxation, investment limits (especially in Mutual Funds wherein further exposure is not possible for overseas securities), and LRS limits (for the Gift product).

CONCLUSION

India's exponential growth in GDP, bolstered by low inflation, government reforms and macroeconomic stability, is attracting a significant influx of foreign investment that is set to continue.

TO THE POINT

- India's buoyant GDP growth, low inflation, structural reform and ease of doing business have transformed its foreign investment landscape and catalyzed its asset management industry.
- Currently ranked the world's fifth-largest economy, the IMF estimates India will become the third-largest by 2028.
- India's burgeoning domestic equity cult is similar to the post-1980s US economy.
- Recent regulatory changes have created enticing routes for foreign investment, including AIFs, REITs, and InvITs.
- Sustainability and emerging technologies are poised to reshape the Indian asset management industry.

GenAI: Revolutionizing digital transformation for fund services



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INTRODUCTION

Compared to other types of artificial intelligence (AI), Generative Artificial Intelligence (GenAI) models stand out due to their wide-ranging capabilities and flexibility.

GenAI encompasses various AI models capable of creating original content, including but not limited to text, images, music, video, or code. In contrast, large language models (LLMs) are a specific application of Generative AI, focusing on generating and understanding human language through extensive text data, and excelling in tasks like text generation and comprehension.

These models can be particularly enhanced with two cutting-edge techniques: retrieval augmented generation (RAG) and fine-tuning. RAG combines generative capabilities with an ability to search for and incorporate relevant information from your knowledge base. Fine tuning is another technique that gives additional information to the LLM and retrains it on a specific task or dataset.

Nonetheless, to unlock GenAI's full value, organizations must reimagine traditional processes by building upon digital, data, and cloud technology advancements and putting human adoption at the center of their transformation.

This article delves into the critical pain points observed in the market, such as regulatory compliance, fee pressure or sophisticated client demand, and showcases examples of how Generative AI can help tackle these challenges while mitigating its risks.

Data & digitalization

By leveraging sentiment analysis, synthetic data generation, and automation capabilities of both machine learning (ML) and GenAI, organizations stand to transform their processes significantly.

- **Enterprise-wide data search and access:** Many organizations have data stored in multiple locations, either on premise or utilizing a cloud environment. GenAI can serve as the interface between search layers and data storage, returning synthetic data that retain the properties of the original datasets. Synthetic data has several uses, most of them related to testing, system refinement and training.
- **Portfolio management:** GenAI can process and synthesize real-time and historical market data, news articles, and financial data and then communicate about it in natural language; this would help portfolio managers identify trends, mitigate risk, and enrich investment strategies with informed recommendations.

Innovation

GenAI is the game changer in meeting increased client expectations and cost pressures. Specifically, it addresses these challenges through a variety of innovative approaches, including:

- **Customer onboarding and management:** GenAI can guide customers through onboarding steps, provide instantaneous responses to queries via LLMs, ensure necessary data is gathered seamlessly, and draft reports for new and existing clients.
- **Hyper-personalized sales and marketing assistant:** GenAI can rapidly generate customized marketing materials that not only ensure compliance with regulations, but match the messaging, tone, language, and cultural references of the target audience.

Operations

Machine learning is reshaping operations by making tasks more efficient and insightful; GenAI further enhances this by automating repetitive and time-consuming tasks, freeing up resources for strategic activities. These functionalities have led to its increased relevance in several investor services, including:

- **Chatbots and virtual assistants:** These tools can provide instant responses to customer queries. Generative AI can extend the capabilities of existing rules-based chatbots by providing natural language responses to queries that are beyond pre-programmed conversational pathways.

- **AML and KYC:** GenAI could take machine learning one step further by learning from typical, innate patterns of fraudulent behavior to generate synthetic training data. This data could then be used to improve the accuracy of fraud detection and even create new fraud signals not yet known by the organization.

- **Enhanced due diligence:** GenAI can assist in due diligence by generating detailed risk profiles for individual clients or transactions. This enables asset servicers to tailor their activities according to the risk level.

- **Exception handling:** Operations personnel can use a simple language-based chat interface to navigate a complex database, helping identify reasons behind discrepancies or delays and suggests remediation strategies.

- **Regulatory compliance:** GenAI can automatically generate compliant, up-to-date documentation by learning from the latest information on regulatory changes. Consequently, organizations can adapt to regulatory changes more efficiently and effectively, thereby reducing the risk of error and non-compliance.

- **Client reporting:** Firms can produce insightful reports that are tailored to clients' individual needs and preferences for improved understanding and a more efficient communication process.

As employees familiarize themselves with prompt writing, they will be able to refine the model's output to increase the accuracy of answers and train the system to handle a wider set of scenarios.

Product development

GenAI can assist front-office and distribution teams on multiple levels, such as:

- **Deal sourcing:** GenAI can summarize market data, news, and other sources into customized reports to help portfolio managers identify potential investment opportunities.

- **Client profiling:** The combined use of machine learning and Generative AI can help distribution teams provide better investment advice and attract more investors to the alternative asset classes.

- **Client query assistance:** Clients are confronted with several challenges when working toward compliance. GenAI can search through long, complex policies and regulations and provide users with natural language responses that are easier to understand.

How to mitigate certain limitations

- **Hallucinations:** Because GenAI searches through a broad spectrum of information that includes policies, regulations, and papers, there is a potential risk that it returns inaccurate or non-existent information. This phenomenon descends from the transformer architecture on which large language models (LLMs) are currently built. A way to mitigate or limit this risk would be to use the best LLM models available in the market (e.g., GPT4), design and track key performance indicators (KPIs) related to output quality, and have the output reviewed by a human.

- **Limited creativity:** Users must be aware of initial AI's limited capabilities. Since it is strictly confined to its training data, it is unable to generate content beyond its training scope. To overcome this obstacle, organizations should seek to create collaborative environments where human expertise complements AI; people will be critical to feeding AI models with industry-specific information, enabling them to provide increasingly refined and relevant outputs, which should then also be reviewed by humans.

- **Privacy:** When dealing with client information, privacy is key. Therefore, organizations should use secure, encrypted channels for transmitting data between AI systems. They should also consider in-house AI processing for particularly sensitive data. Finally, educating users on how to safely engage with LLMs will be essential for mitigating data confidentiality risks.

- **Data ownership:** In addition to the privacy concerns, data ownership also demands significant attention: Who is the data owner, and who has the right to use the data? These potential issues can be mitigated by ensuring contracts and agreements clearly define the ownership of AI-generated content and data; implementing a second LLM to manage and track data usage rights and generated content; and assessing copyright infringements.

- **Output reliability:** Furthermore, relying on GenAI to ensure compliance and provide accurate information through automated outputs might produce random, or less reliable, responses. To tackle this challenge, a LLM providing response ratings could be developed to evaluate the relevance and accuracy of AI outputs, with feedback loops for continuous improvement. Additional layers of AI that specialize in contextual analysis could also be implemented to filter out irrelevant responses.

- **Biased data:** Finally, existing bias in AI models (for example, AI trained on biased data) can lead to unbalanced or non-sensical outputs in both client query assistance and reporting process automation. This risk could be mitigated by: 1) deploying bias detection tools and methodologies to detect and correct output biases; and 2) curating the training data set along with providing ample amounts of data.

CONCLUSION

Generative Artificial Intelligence stands as a powerful innovation to entrenched challenges within the funds industry, paving the way for growth and innovation. Recognizing it not merely as a trend, but as a significant structural technology, positions organizations to thrive in an era where adaptive technologies drive industry transformation. Financial institutions, especially asset servicers, cannot afford to ignore GenAI: Its adoption will be key to staying competitive, fostering innovation, and unlocking new avenues for growth in the years to come.

TO THE POINT

- Generative AI (GenAI), alone or paired with machine learning, can majorly transform the fund servicing industry. Existing examples across the value chain showcase its transformative impact, from operating model to process optimization.
- Adopting GenAI requires strategic decision-making. Developing in-house capability provides control but demands significant resources. Acquiring third-party technology offers immediate expertise but introduces integration challenges. Using off-the-shelf products is efficient but might limit potential customization.
- The complexities and associated risks of GenAI demand a comprehensive assessment. Organizations must address data biases, ethical concerns, misuse risks, accuracy challenges, and the evolving nature of GenAI's user experience. It's important to assess measures like implementing a trustworthy GenAI framework and appropriate safeguards.
- GenAI adoption also poses regulatory challenges. Financial firms must navigate evolving regulations like the EU AI Act, GDPR, and the AI Bill of Rights. These frameworks impose stringent requirements for AI usage, emphasizing data privacy and ethical standards. Careful attention is imperative to avoid legal complications and maintain regulatory compliance.

Digitalization of financial assets is underway, and it will be revolutionary

PASCAL KOENIG
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INTRODUCTION

On 1 May 2024, Securitize, a key player in the digitalization of financial assets, announced it had secured a staggering US$47 million in funding in collaboration with BlackRock, solidifying the latter's commitment to digitizing traditional financial assets.

This move effectively bridges the gap between conventional investments like bonds and stocks and their digital counterparts through tokenization. It echoes similar strides made by industry giants like JPMorgan, Goldman Sachs, Citi, and UBS, signaling a collective leap toward embracing the future of finance.

1. Insight AM is a consulting firm specializing in thematic analysis and positioning based on quantitative and qualitative surveys for financial actors.
2. Patrimeta is the very first virtual and permanent showroom of savings solutions for wealth management advisors.

A true "storming of the Bastille" for the fund management industry

The beginning of the decade saw the emergence of financial actors performing exploratory work and isolated experiments around tokenization. They envisioned a fundamental disruption in infrastructure and financial assets, without truly kicking off the Darwinian process.

Among the most significant reports on the subject, The Investment Association's *Investing for the future: Three potential paths for a tech-powered UK fund industry* presents a coherent scenario for the future of financial management.[4] It discusses the massification of investment in a context of operational efficiency, improved transparency, reliance on advice, broadening the base of accessible assets, and the dissemination of financial knowledge. This is to mitigate the devastating effects of the Retail Distribution Review (RDR) on advised savings.

Another piece of evidence to consider is the joint BCG and ADDX report *Relevance of on-chain asset tokenization in 'crypto winter'*, which aims to demonstrate the proven advantage of using decentralized finance (DeFi) for illiquid assets.[5] It estimates that by 2030, the value of already tokenized assets could increase fiftyfold and represent up to 10% of global GDP.

If the BlackRock-Securitize collaboration confirms asset tokenization's shift from experiment to industrialization, this initiative is far from isolated. In recent weeks, several significant projects have emerged, including those from:

- "Pure players" like Tokeny, a Luxembourg-based tokenization pioneer, collaborating with Kakao, the Korean IT giant with a compatible public blockchain platform.
- Cryptocurrency players, such as Coinbase's Diamant project.
- Traditional institutions like HSBC partnering with Metaco, a Swiss specialist in cryptocurrency custody, to launch a digital securities custody business.
- Issuers like Société Générale (via Forge, the institution's crypto branch) completing the first tokenized green bond issuance of EUR10 million.[6]

Securitize: a key player in the digitalization of financial assets
Securitize positions itself as the global leader in real-world asset tokenization, with over US$600 million invested through the chain. The platform provides access to private debts, venture capital, and even US treasury bonds in the form of funds promoted by management companies such as KKR, ARCA, or Hamilton Lane. Securitize has established a presence in Spain in partnership with the Spanish real estate investment fund Mancipi Partners. This initiative is part of the EU's new pilot regime for distributed ledger

Digital assets offer unique advantages to portfolio managers and investors

Tokenization involves converting the ownership of an asset, such as artwork, a commodity, company stocks, or debt securities, into a digital token stored on the blockchain. The token represents the asset and is used to track and transfer ownership of that asset (Figure 1). Tokens can be issued alongside traditional shares in funds, with the only difference for the investor being the potential cost savings of the on-chain model.

The primary benefits of this model for illiquid assets include:

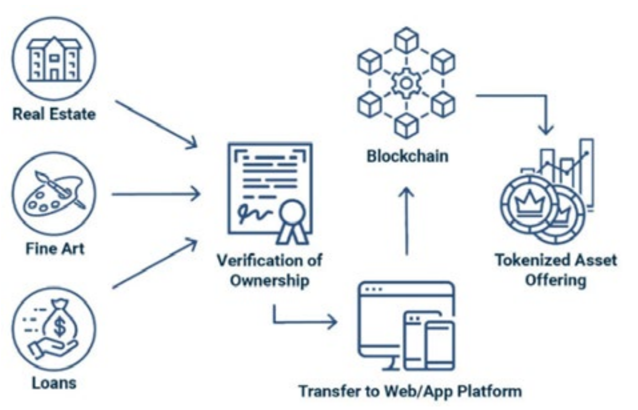
- Compliance with the issuance of securities and throughout their lifecycle, such as universal application of know your customer (KYC) and anti-money laundering rules;
- Control of liabilities by the issuer at measured costs;
- Access for the same issuer to an amplified primary market of distributors and investors; and
- The establishment of a secondary market capable of addressing liquidity issues.

Tokenization significantly boosts operational efficiency, particularly for wealth advisors and private bankers, who are increasingly tasked with managing a growing proportion of their clients' portfolio allocations.

Digitalization generates unprecedented horizons for innovative distribution methods

The range of possibilities offered by fractionalization allows more savers to access cutting-edge, ultra-tailored strategies through replicable model portfolios, which are based on a range of factors like horizons, risk levels, and opinion communities.
For example, investors' ideal portfolios (in the form of non-fungible tokens) could be created through mini-basket stocks grouped by investors or their advisors. Advisors (or their

Figure 1: Principles of tokenization (source: Securitize)



4. The Investment Association, Investing for the future: Three potential paths for a tech-powered UK fund industry, July 2022.
5. Sumit Kumar, Rajaram Suresh, Darius Liu, Bernhard Kronfellner and Aaditya Kaul, Relevance of on-chain asset tokenization in 'crypto winter', BCG and ADDX, September 2022.
6. Reuters, "SocGen issues 10-mln-euro digital green bond on a public blockchain," 4 December 2023.

platforms) could also assume an "influencer" role for less affluent savers at controlled costs.

While many obstacles exist, a substantial market is ready to respond to the new investment forms of the post-COVID generations of savers. This will help open access to managed advice for many European savers—nearly 40% of French savers rely solely on themselves to manage their wealth and prepare for retirement.

It will also be a breath of fresh air for emerging savings solution providers, who are seeing distribution barriers topple.

A facilitating or constraining regulatory environment?

France's Pacte Law established a framework for digital asset service providers in 2019. This legislation, focusing on infrastructure, heavily influenced the EU's Markets in Crypto Assets (MiCA) Regulation. Coming into force at the end of 2024, MiCA introduces two new categories of crypto-assets:

01. Electronic money tokens, such as stablecoins, which refer to one asset or currency; and

02. Asset-referenced tokens (ART), which refer to multiple assets or currencies.

The EU also initiated a distributed ledger technology (DLT) pilot regime in 2023, aiming to encourage the digitization of financial securities and allow the listing, trading, and settlement of digitized financial instruments, known as security tokens.

However, while European regulation has tackled infrastructure and issuers, it has yet to fully consider the impacts of tokenization on investor protection. The EU continues to debate distribution and price control business models rather than breaking the isolation of savers orphaned of advice.

The EU must fully embrace emerging technologies, providing savers with the necessary tools for better understanding, informed comparison, efficient management, and the dissemination of advice suited to the new generation of retail investors.

CONCLUSION

BlackRock's significant investment is the latest sign that the fund industry is on the cusp of an asset digitalization revolution. Alongside increasing operational efficiencies, tokenization and fractionalization enable greater customization and widen market access to a larger range of savers and investors. However, the EU's regulatory framework must do more to support the opening up of the European fund market.

TO THE POINT

- BlackRock, by announcing a major investment in the tokenization of real-world assets within the Securitize group, is engaging the fund industry in a new evolution of massification and customization.
- Besides its operational efficiency advantages, tokenization expands the spectrum of liquid and illiquid assets accessible to a significant number of savers.
- It also allows for greater personalization through fractionalization and provides easier access to advised management for everyone.
- The ongoing debate on investor protection regulation has failed to grasp this technology's full potential in opening up the European fund market and unlocking advised savings.

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