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India's First International financial Service Centre in GIFT City: A New Chapter in the Indian Financial Sector

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International Financial Service Centre

International Financial Service Centre: A New Chapter in the Indian Financial Sector

International Financial Service Centre (IFSC) is a hub of financial services within a country, which has laws and regulations different from the laws and regulations in the rest of the country. Usually these centres have low tax rates and flexible regulations for securities and currency trading, banking and insurance, which makes them attractive for foreign investment.

Back in 2008 one such centre was envisaged in Mumbai; however the initiative was abandoned due to the global financial crisis in 2008. Recently in budget 2015, finance minister Arun Jaitley had announced that first IFSC centre in India shall be set up in Gujarat International Finance Tec-City (GIFT), near Ahmedabad. Finally, on Friday, April 10, 2015 GIFT was officially launched by the finance minister and a booklet containing all the rules and guidelines issued by the various regulators with regard to the governing of these IFSC centre was also released. This is indeed a new chapter in the India financial service sector

Global Presence of IFSC

Globally, the concept of IFSC is not a new concept. International financial services are being provided by various International Financial Centres (IFC) worldwide, amongst which centres located in London, New York, Singapore and Dubai are the prominent ones. London has been a significant IFC for over three centuries now, whereas New York rose to eminence with the growing importance of the US economy between late 19th century and early 20th century and also due to the persistent American innovation in the field of finance. IFCs in Dubai and Singapore are relatively recent.

Indian Scenario

In 2007 Percy Mistry Committee Report¹ had explored the idea of setting up an IFSC in India and had suggested the setting up of International Financial Centre in Mumbai. The report recommended for the reform of the Indian financial system and suggested that India had the potential of competing with the likes of London, and New York. However, the plan was subsequently abandoned due to the 2008 global financial crisis.

Further, a concept paper² on the establishment of finance SEZs, submitted by the National Institute of Public Finance and Policy to the Ministry of Finance, also recognized that the existing financial and taxation regimes are the main reasons which have caused the global business to shift from India to countries like Singapore and Dubai, which provides a beneficial business environment. In order to combat this, it advocated on the establishment of a new

¹ <http://finmin.nic.in/mifc/mifcreport.pdf>

² http://finmin.nic.in/suggestion_comments/Policy%20framework%20for%20Finance%20SEZs.pdf



International Financial Service Centre

financial regulatory framework either through enacting and enforcing a 'Finance SEZ Act', or an IFSC. Further the Ministry of Finance is working on the policy framework for Finance SEZ which will have features such as capital account convertibility, modern regulatory framework and resident based taxation and seeks public comments on the concept paper, which was made available to the public on February 27, 2015.

Further, recently, in budget 2015, it was announced that first IFSC centre in India shall be set up in Gujarat International Finance Tec-City (GIFT City), near Ahmedabad. The Minister of Finance in his budget speech stated that,

“While India produces some of the finest financial minds, including in international finance, they have few avenues in India to fully exhibit and exploit their strength to the country’s advantage. GIFT in Gujarat was envisaged as International Finance Centre that would actually become as good an International Finance Centre as Singapore or Dubai, which, incidentally, are largely manned by Indians. The proposal has languished for years. I am glad to announce that the first phase of GIFT will soon become a reality.”

GIFT is a globally-benchmarked international financial centre that will target 8-10 percent of financial services on 84 million sq ft of space and create one million employment opportunities. Its core operations will include offshore banking; insurance, assurance and reinsurance; regional financial exchanges and back offices³.

Expected impact of setting up an IFSC

Establishment of an IFSC in India is necessary for the growth of the Indian financial sector. The impact of this establishment is expected to be far reaching. The move is expected to increase the revenue of the country by capturing approximately Rs.1,334 crore per day or Rs.2 lakh crore per year worth of trading in rupee derivatives that presently goes to places outside India.⁴ Further, it will help the country to attract global financial service business which is otherwise lost to other countries due to the absence of an IFSC.

The existing regulatory structure and tax regime in the country do not create a conducive environment for foreign investment and have thus caused a huge amount of trading in rupee and Nifty to go out of the country. Presently, global trading in Indian rupee and Nifty takes place in Singapore and Dubai because they provide a sound regulatory framework with regard to financial regulations and taxation. This has an adverse effect on the Indian economy as it causes

³ <http://giftgujarat.in/documents/Brief-on-GIFT-Project-Feb-2013.pdf>

⁴ <http://profit.ndtv.com/news/market/article-sebi-board-nod-for-international-financial-services-centre-guidelines-748680>



International Financial Service Centre

a drain on the revenue of the country. Establishing IFSC with sound regulatory framework would aid in bringing back the revenue stream to the country.

Further, only large Indian companies having international presence are able to attract global fund managers to invest in them and are able to go to London or New York to raise money. Various other Indian companies fail to get noticed. Now, given the current scenario, when an IFSC will be set up in India, foreign entities working in it, will have access to many more Indian companies and will also get engaged in the Indian economy in a better way. Further, these entities will be able to invest in the equity and debt of a large number of Indian companies.

Moreover, when Indian companies raise equity and debt capital outside India, revenues pertaining to the financial services performed for these activities accrue in places where such capital was raised. Salary and tax with respect to the same are paid outside India. Therefore if entities set up in an IFSC, globally compete to provide these services, we would be able to prevent the above mentioned payments from going out of India.

The most important impact of setting up an IFSC is that it will be able to generate employment opportunities in the country. Branches or subsidiaries of stock exchanges, banks, clearing corporations and depositories set up in an IFSC would definitely require a work force to manage their operations, this in turn would create employment opportunities within the country.

IFSC will be set up under the Special Economic Zone (SEZ) Act of 2005

An International Financial Services Centre (IFSC) will be set up under Section 18(1) of Special Economic Zones Act, 2005. Section 18(1) says that

18(1) The Central Government may approve the setting up of Setting up of an International Financial Services Centre in a Special Economic Zone and may prescribe the requirements for setting up and operation of such Center:

Provided that the Central Government shall approve only one International Financial Services Centre in a Special Economic Zone.

Establishment of an IFSC in SEZ means that separate regulations shall be formed for an IFSC which shall be different from the rest of India. Section 49 SEZ Act states:

49. (1) The Central Government may, by notification, direct that any of the provisions of this Act (other than sections 54 and 56) or any other Central Act or any rules or regulations made thereunder or any notification or order issued or direction given thereunder (other than the provisions relating to making of the rules or regulations) specified in the notification



International Financial Service Centre

- (a) shall not apply to a Special Economic Zone or a class of Special Economic Zones or all Special Economic Zones; or
- (b) shall apply to a Special Economic Zone or a class of Special Economic Zones or all Special Economic Zones only with such exceptions, modifications and adaptation, as may be specified in the notification.

Furthermore, India has several constraints in the financial sector, such as partial capital account convertibility and foreign investment restrictions. Establishment of an IFSC in an SEZ can serve as an experimental ground for financial sector reforms before they are made applicable to the entire nation.

As far as the tax implications are concerned, it shall be on the lines of the tax regime applicable to an SEZ. S Thakur, Chairman of the Policy Making Committee of International Financial Centre in an interview with CNBC-TV18 said, “The tax also we are recommending that whatever the tax implication available for the special economic zone (SEZ) sectors, the same will be applicable in this international financial centre also.”⁵

Slew of Regulations

1. Foreign Exchange Management (International Financial Service Centre) Regulations, 2015⁶:

To operationalise the IFSC, a notification under the Foreign Exchange Management Act, 1999 (FEMA) was issued by Reserve Bank of India (RBI) on March 23, 2015, namely the Foreign Exchange Management (International Financial Service Centre) Regulations, 2015, making regulations relating to financial institutions set up in the IFSC. The key features of the regulations are that any financial institution (or its branch) set up in the IFSC:

- a. shall be treated as a nonresident Indian located outside India,
- b. shall conduct business in such foreign currency and with such entities, whether resident or nonresident, as the Regulatory Authority may determine, and
- c. subject to section 1(3) of FEMA, nothing contained in any other regulations shall apply to a unit located in IFSC.

For this purpose a financial institution has been defined in sub-section b of section 2 of the said regulations. It states that:-

- 2 (b) ‘Financial Institution’ shall include
- i. a company, or

⁵ http://www.moneycontrol.com/news/economy/what-it-takes-to-create-indias-first-intl-finance-centre_1335960.html

⁶ <http://rbi.org.in/scripts/NotificationUser.aspx?Id=9619&Mode=0>



International Financial Service Centre

- ii. *a firm, or*
- iii. *an association of persons or a body of individuals, whether incorporated or not, or*
- iv. *any artificial juridical person, not falling within any of the preceding categories engaged in rendering financial services or carrying out financial transactions.*

Explanation: For the purpose of this sub-regulation, and without any loss of generality of the above, the expression 'financial institution' shall include banks, non-banking financial companies, insurance companies, brokerage firms, merchant banks, investment banks, pension funds, mutual funds, trusts, exchanges, clearing houses, and any other entity that may be specified by the Government of India or a Financial Regulatory Authority.

Given the above pretext, a financial institution set up in the IFSC shall be treated as a foreign entity and investment made by it into India shall tantamount to foreign direct Investment unless the same is amended. Further loans extended by it to Indian entities will be covered under the guidelines for External Commercial Borrowings, unless the same is amended. Furthermore, for an India entity, including NBFCs and banks, making investment in an IFSC financial institution, the rules of Overseas Direct Investment will be applicable, unless amended to allow infusion of capital without restrictions or conditions.

IFSC Banking Units

Pursuant to the above regulations RBI has formulated a scheme for the setting up of IFSC Banking Units (IBUs) by banks in IFSCs vide notification no. DBR.IBD.BC.14570/23.13.004/2014-15 dated April 1, 2015⁷. Indian banks allowed to deal in foreign exchange and foreign banks already having presence in India are allowed to set up IBUs in IFSC. Following are the main highlights of the scheme:

- Each eligible bank will be able to set up only one IBU in each IFSC.
- IBUs of Indian banks shall be treated at par with their foreign branches and norms as applicable to foreign branches shall be applicable to these IBUs.
- Banks intending to set up an IBU would require a prior license from RBI before opening such IBU.
- Respective parent bank will have to contribute a minimum capital of \$20 million.
- IBUs have been exempted from reserve and priority sector lending requirements.
- They have been allowed to raise funds only from person resident outside India, however they can utilize funds with both person resident outside India and in India.

⁷ <http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=9636&Mode=0>



International Financial Service Centre

- They have been permitted to deal in all types of derivative and structured products with prior approval of their board of directors. Further, they can deal with wholly owned subsidiaries or joint ventures of Indian companies registered abroad and can undertake transactions in currency other than Indian rupee.
- They are not permitted to open any current or savings accounts and are not empowered to issue bearer instruments or cheques. All payment transactions must be undertaken through bank transfers.
- Deposits of IBUs shall not be covered by deposit insurance and they are allowed to have liabilities, including borrowed funds in foreign currency, which have original maturity of more than one year.
- All transactions of IBUs shall be in currency other than Indian Rupee and IBUs will be required to maintain separate nostro accounts with correspondent banks which would be distinct from nostro accounts maintained by other branches of the same bank.
- No support shall be provided to IBUs by RBI in times of crisis, more specifically RBI shall not be the 'lender of the last resort for IBUs'. Any kind of financial crunch will have to be supported by the parent Bank.

Given the above pretext, it is highly likely that banks would be more than willing to set up IBUs in IFSC as the capital requirement is not much and there is an exemption from the reserves and priority sector lending requirements. Moreover as the branches of the domestic banks in IFSC will be treated as foreign branches, this would increase their access to international banking. However, absence of current and savings account facilities and any kind of support from RBI may cause reluctance amongst banks to set up such units in IFSC.

2. **SEBI (International Financial Services Centres (IFSC)) Guidelines, 2015⁸ :**

On March 22, 2015, the Securities and Exchange Board of India (SEBI) approved SEBI (International Financial Services Centres (IFSC)) Guidelines, 2015 with an aim to facilitate a conducive environment for setting up of capital market infrastructure like stock exchanges, clearing houses, depository services in such centres. The guidelines permit foreign entities to raise capital within the centres through issue of depository receipts and other securities and entail stock exchanges to do business with a comparatively low level of capital. Following are the main highlights of the guidelines:

i. Entities permitted to operate in an IFSC

Stock exchanges, Clearing Corporations, Depositories, Intermediaries including stock brokers, merchant bankers, an underwriter, a portfolio manager, a foreign portfolio manager, an investment adviser and persons associated with the securities market, and

⁸ http://www.sebi.gov.in/cms/sebi_data/attachdocs/1427450911533.pdf



International Financial Service Centre

Funds comprising of Alternative Investment Funds and Mutual Funds have been permitted to operate in an IFSC.

ii. **Criteria for setting up Stock Exchanges, Clearing Corporations And Depositories**

Indian recognised stock exchanges, depositories and clearing corporation as well as foreign stock exchanges, depositories and clearing corporation recognised by its country's regulator, can set up subsidiaries in an IFSC where at least 51% of the paid up equity share capital needs to be held by those seeking to form a stock exchange or a clearing corporation or a depository. They can undertake the same business subject to relaxed norms.

- A stock exchange, local or foreign, can be set up with a net worth of rupees 25 crores as against the normal requirement of rupees 100 crore rupees, however, they would have to raise their net worth to 100 crores within a span of three years and they would also be given a time span of three years within which they would have to complete de-mutualisation
- A Clearing Corporation can be set up with a net worth of rupees 50 crore rupees as against the normal requirement of rupees 300 crore, however, they would also have to raise their net worth to 300 crores within a span of three years.
- A depository, local or foreign, can be set up with a net worth of rupees 25 crores as against the normal requirement of rupees 100 crore rupees, however, they would have to raise their net worth to 100 crores within a span of three years.

Further these guidelines have provided exemptions to stock exchanges, clearing corporations and depositories, to be set up in an IFSC, from certain provisions of Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 and SEBI (Depositories and Participants) Regulations, 1996 which requires them to transfer every year a certain percentage of profits of these entities to the relevant "fund" prescribed under the applicable regulations. However, these entities in IFSC will have to comply with the IOSCO principles and Principles for Financial Market Infrastructures (FMIs) and such other governance norms specified by SEBI.

Furthermore these guidelines also provide for trading in securities and products in such securities in any currency other than Indian rupee such as equity shares issued by companies incorporated outside India, depository receipts, debt securities, currency and interest rate derivatives, index based derivatives and such other securities as may be specified by SEBI from time to time

iii. **Operations of Intermediaries in an IFSC**

A recognized intermediary or any foreign intermediary recognized by its country's market regulator will be allowed to operate as securities market intermediaries in IFSC



International Financial Service Centre

only in the form of a company. Further they shall extend their services to prescribed category of clients which will include person resident outside India, a non-resident Indian, institutional investors, and resident Indians eligible under the FEMA. Furthermore investment advisory or portfolio management services shall also be provided to the above named clients only. Permitted intermediaries in an IFSC are also required to appoint a senior management person as a 'Designated Officer' to ensure compliance with all the regulatory requirements.

iv. **Issue of Capital**

Domestic companies intending to raise capital in an IFSC, in a currency other than Indian Rupee, shall comply with the norms Foreign Currency Depository Receipts Scheme, 2014 and Companies of foreign jurisdiction, intending to raise capital, in a currency other than Indian Rupee, in an IFSC shall comply with the provisions of the Companies Act, 2013 and relevant provisions of Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009. Further these companies have an option of listing their securities on on stock exchanges set up in an IFSC.

v. **Issue of Debt Securities**

Issue of debt securities shall be permitted only to those issuers who are eligible to issue debt securities as per its constitution. Further these securities are required to be mandatorily listed on stock exchanges set up in an IFSC. The requirements pertaining to credit rating, appointment of trustees, creation of debenture redemption reserve, agreement with a depository/custodian, reporting of financial statements shall have to be complied with. The debt securities shall be traded on the platform of securities exchange and shall be cleared and settled through clearing corporations set up in an IFSC.

vi. **Funds in an IFSC**

Investment in Mutual Funds(MF) and Alternative Investment Funds (AIF) set up in IFSC can be made only by person resident outside India, a non-resident Indian, institutional investors, and resident Indians eligible under the FEMA and these investments can be made in foreign currency. Further these guidelines require that an Asset Management Company (AMC) of a MF operating in IFSC is required to have a minimum net worth of USD 2 million, which should be increased within three years of commencement of business to USD 10 million.

3. IRDAI (International Financial Services Centres (IFSC)) Guidelines, 2015⁹

⁹ https://www.irda.gov.in/ADMINCMS/cms/whatsNew_Layout.aspx?page=PageNo2465&flag=1



International Financial Service Centre

On April 7, 2015 Insurance Regulatory Development Authority of India issued guidelines with regard to regulate the insurance offices set up in the IFSC. According to these guidelines domestic insurance companies have been permitted to set up IFSC Insurance Office (IIO) in SEZs to carry on Reinsurance business and foreign insurance companies can do the same if they meet the following conditions and obtain prior approval of IRDA:

- i. It is registered or licensed for doing Insurance or Reinsurance business in the country of incorporation;
- ii. If they have been duly authorized by the Regulatory or Supervisory Authority of that country to set up such office;
- iii. the proposed firms must be in continuous operation for at least five years, and
- iv. must have a satisfactory track record in respect of regulatory or supervisory compliance
- v. If they have net owned funds as specified in the Insurance Act, 1938.

For reinsurance business, section 10 of the regulations state that the companies should

“demonstrate an assigned capital of Rs 10 crore which may be held in the form of Government Securities issued by the Government of India or held as deposits with scheduled banks in India and shall be maintained at all times during the subsistence and validity of its registration under these guidelines”

Further in case of direct insurance, the Indian insurers (except a statutory body) may also establish an IIO to transact a specified direct insurance business within the SEZ.

Conclusion

Establishment of an IFSC will aim to get back some of the financial businesses that has drifted to Dubai and Singapore due to the absence of any IFC in India and will also provide a level playing field to domestic entities to be competitive globally. To ensure the smooth functioning of the IFSC it is important that all regulators involved in the functioning of an IFSC, develop, monitor and review the regulatory framework on a regular basis.

Also see our other related write-ups: <http://www.india-financing.com/sebi.html>