MAKING INDIA A HUB OF INTERNATIONAL FINANCIAL SERVICES

So close, yet so far

The dynamic nature of business in IFSCs necessitates a high degree of inter-regulatory coordination, say experts

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SUDIPTO DEY

The recent appointment of former Corporate Affairs Secretary Injeti Srinivas as the first chairman of the newly established regulator, International Financial Services Centres Authority, and the political slugfest in Hong Kong — an established financial centre in Asia — have put the spotlight on India's aspirations to be a hub of international financial services (IFS).

The regulatory landscape to govern such financial centres, however, is still in the making, and the efforts, so far, have generated mixed results, say experts. The International Financial Services Centres Authority (IFSCA) will have to do most of the heavy lifting, along with other sectoral regulators, to put in place a conducive regulatory framework for India to become an attractive destination for such services.

The need for setting up International Financial Services Centres in India was felt in the mid-2000s. The idea was to make the country a key producer and exporter of IFS. This would also help the country capture an increasing share of the growing global IFS market. The objective was to create IFSCs like Singapore, Dubai, and HongKong.

Way back in 2007, a high-powered expert committee headed by Percy Mistry estimated that IFS purchases by Indian households and firms are likely to grow from $13 billion in 2005 to $120 billion by 2025 in nominal terms.

The committee also mooted a roadmap and the need for an omnibus legislative framework to govern all aspects of financial services, along with a unified regulator, in designated IFSCs. However, it took another 13 years — and the tenure of four central finance ministers — for the International Financial Services Centre Authority (IFSCA) to finally take shape. The newly established Authority will regulate IFSC-designated financial products, financial services, and financial institutions, duly approved by appropriate regulators.

Experts point out the dynamic nature of business in the IFSCs necessitates a high degree of inter-regulatory coordination. This may require frequent clarifications and amendments to the existing regulations governing financial activities at the IFSCs. That is a space not many Indian regulators are familiar with, working mostly in silos. The IFSCA, in its own ways, is in uncharted waters.

"We are entering the game a little late, so we need to run faster and better," says Nishith Desai, managing partner, Nishith Desai Associates.

Experts say the priority for the unified regulator should be to create an environment conducive to business through rational, harmonious and predictable laws and regulation, competitive tax rates, quality infrastructure and the ability to attract the best talent. But it is easier said than done, given the myriad of regulations governing financial services.

Tax-related issues remain the top concern among potential investors in international financial centres. The tax department remains outside the ambit of the unified regulator, experts point out. The ambiguous or subjective provisions in tax laws and discretionary powers given to officials do not exude confidence among investors, they add.

A way forward, feels Desai, may be to have a separate IFSC-related Income Tax Act or Code. "Emulating laws from well-regulated jurisdictions like Delaware (the US), the UK and Hong Kong, provide us with a wealth of judicial wisdom in the form of judicial cases," he says. Especially in the early years, the tax department should stay a bit liberal and avoid "nit-picking", he adds.

Over the years, the government has provided various fiscal benefits to businesses that set up operations at the IFSCs. This includes a 10-year income tax holiday benefit, exempting non-residents from tax in India on the interest that they earn from a unit in an IFSC, and capital gains exemptions to non-residents who trade Indian securities in the IFSCs.

Russell Gaitonde, partner, Deloitte India, says the government may have to take a long-term view on matters relating to the longevity of income-tax holiday. Some global offshore centres have already taken a call not to levy income tax on units that operate there for 40-50 years, he adds.

The templates from international financial centres across the world demonstrate that the speed and consistency of dispute resolution form a critical factor for their success. Most international financial centres are popular international arbitration centres as well, points out Cyril Shroff, Managing Partner, Cyril Amarchand Mangaldas. "IFSCs must also have specialised courts and tribunals for the adjudication of disputes."

The Percy Mistry committee, too, had noted that significant improvements were needed in the Indian legal system for resolving disputes, adjudicating settlements, and enforcing financial contracts in real-time. "If that does not happen, the prospects for Mumbai emerging as IFC, or aspiring to become a GFC, will be irreparably damaged," the committee had noted in its report. The brief before the committee was to look at making Mumbai an international financial centre.

As for making the most of the opportunity provided by the political disturbance in Hong Kong, Jyoti Prakash Gadia, managing director, Resurgent India, gives a simple advice: "Continue with the economic, judicial and financial reforms."

REGULATING IFSCs

DECEMBER 2019: Parliament clears the International Financial Services Centres Authority Bill, 2019

APRIL 2020: The government notifies the establishment of the IFSCA. The unified authority would regulate all financial services carried out in IFSCs, established under the Special Economic Zone Act, 2005. The Gujarat International Finance Tech-City (GIFT City) SEZ in Gandhinagar is India's first IFSC

JULY 2020: Injeti Srinivas appointed the IFSCA's first chairman. The nine-member authority would include representatives from various regulators, including Sebi, the RBI, Irdai, and the PFRDA, besides from officials of the ministry of finance

- The government is yet to notify all the provisions of the International Financial Services Centres Authority Act that relate to rule-making powers concerning certain financial products and services