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KEY DETERMINANTS BEHIND AN INTERNATIONAL FINANCIAL SERVICES CENTRE: AN EXPLORATORY STUDY OF INDIA'S MAIDEN IFSC AT GANDHINAGAR, GUJARAT

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ABSTRACT: Several countries in Asia and Middle East established new age International Financial Centres e.g. Singapore, Dubai, Abu Dhabi, Qatar to name a few. India, which is one of the largest and fastest growing major economies in the world, established its maiden International Financial Services Centre (IFSC) at GIFT City, Gandhinagar in State of Gujarat, India. This research paper focuses on the journey of operationalizing India's maiden IFSC in GIFT City. It highlights some of the compelling factorings behind the setting up of an IFSC in India and provides insights into the key determinants for its development.

KEYWORDS

IFSC, GIFT IFSC, Global Financial Centres, Offshore Financial Centres (OFCs), India International Bullion Exchange (IIBX).

1. Introduction

International Financial Centres (IFCs) have assumed prominence in the global financial system primarily because of two reasons, one, they have contributed enormously to the growth in the volumes of international financial transactions and two, these centres have played a pivotal role in accelerating the pace of financial globalization. Broadly speaking, an IFC is a jurisdiction with a heavy concentration of a variety of financial institutions, that offer specialized financial services and products to non-residents as well as residents, in an environment that facilitates the development of financial markets.

Typically, scholars distinguish and divide the IFCs into two broad categories (IMF 1987): Traditional IFCs are the ones that have evolved during the 19th and 20th Century in the cities of Europe and the United States of America and the Offshore Financial Centres (OFCs), which are relatively of recent origin and have come up in developing countries as a carve-out jurisdiction. While the traditional centres evolved as a result of growth in international trade and commerce, the new age OFCs have been developed by countries through a more calibrated approach with a view to onshore international financial services business and acquire global expertise in niche and emerging financial services activities.

The advent of OFCs can be categorized as an inflection point for the global financial system as it paved the way for onshoring of highly specialized and niche international financial services business into Asia and the Middle East. In the early 1980's China took the lead by developing Hong Kong as a leading offshore financial centre, which would later emerge as a second engine of growth for the country, subsequently, several other countries established OFCs including Malaysia, which established the Labuan International Business and Financial Centre (IBFC) in 1990, UAE established the Dubai International Financial Services Centre (DIFC) in

2000 and Abu Dhabi Global Markets (ADGM) in 2015 and Qatar established the Qatar Financial Centre (QFC) in Doha in 2005.

India, on the other hand, was a rather late entrant in establishing an international financial centre, however, several compelling arguments can be put forth for the relative delay, which inter alia, are as follows: one, the liberalization of the Indian economy began only after the 1991 LPG reforms (Prasad, 2021), which paved the way for gradual and calibrated integration of Indian economy into the global financial system. Second, the Indian financial markets were at an evolutionary stage and not mature enough to deal with the vagaries associated with international financial transactions and most importantly, the 2008 Global Financial Crisis was a big setback for the entire developing world.

However, the inflection point came about in 2015 when Government of India implemented a major financial sector reform by operationalizing India's maiden International Financial Services Centre (IFSC) in GIFT City located at Gandhinagar, State of Gujarat, India.

It was only in 2015, that India's tryst with operationalizing the maiden International Financial Services Centre (IFSC) in GIFT City became a reality. A spin-off advantage of being a late entrant in the global IFC ecosystem, was that India could evaluate, assess and learn from the development models adopted by other offshore financial centres in their respective jurisdictions.

On the policy front, three-four compelling factors can be attributed to India's setting up of its maiden IFSC. First, as one of the largest and fastest growing major economies in the world, India could not afford to play a passive role in International Financial Services business, by merely being a consumer of International Financial Services. Therefore, GIFT IFSC was operationalized to transform India from being an importer of International Financial Services to become self-sufficient as well as an exporter of International Financial Services. Moreover, it was estimated that even under conservative assumptions, purchases by Indian households and firms of IFS will be nearly $50 billion by 2015 and could exceed $120 billion by 2025 (DEA, 2016).

Secondly, a vibrant IFSC has the potential to act as a catalyst for growth of domestic India economy. Banking services, asset management, stock market and intermediary services provided in an IFSC attracts huge amounts of global capital inflows (Mangaldas, 2021), which can then be channelized into domestic Indian economy for development purpose.

Thirdly, India has the inherent advantage of having vast young talent pool, in the field of finance as well as Informational Technology. Therefore, operationalization of IFSC in India would give huge employment opportunities to talented young professionals in financial segments such as Banking, Fund Management, FinTech, Insurance, etc.

GIFT-IFSC: Journey

Recognizing the substantial contribution which can be made by an OFC to the socio-economic growth and development of a country, Indian policy makers legally incorporated the concept of an International Financial Service Centre (IFSC) in the Special Economic Zones Act 2005 (SEZ India). Section 18 of the act provides that Central Government may approve the setting up of an IFSC in a Special Economic Zone and may prescribe the requirements for setting up and operation of such centre.

On the policy front, another major development occurred in the year 2007, when the High-Power Expert Committee Constituted by Finance Ministry to examine the feasibility of setting up an IFC in India, submitted its report to the Government. The committee made a range of recommendations which, inter alia, included regulatory and policy reforms that would be required if India were to develop an IFC. However, with the onset of 2008 Global Financial Crisis, the proposal was put on backburner.

The committee in its report observed that the rapid growth of Indian economy had created substantial local demand for International Financial Services and a failure to respond to on the supply side would result in purchase of such international financial services from overseas financial centres (DEA, 2016).

Later, it was only after the Indian economy started showing signs of economic recovery, in the aftermath of 2008 financial crisis, that the breakthrough moment finally arrived. Government of India in the Union Budget 2015-16 made the following announcement:

"87. 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. Appropriate regulations will be issued in March (Union Budget, 2016)".

The Union Budget announcement paved the way for operationalizing the maiden IFSC in GIFT City Multi-Service SEZ, Gujarat. To set the ball rolling, the domestic financial regulators namely RBI, SEBI and IRDAI notified the initial set off regulations to allow for financial institutions to commence operations in IFSC. Most importantly, in 2015 RBI's foreign exchange rules under the FEMA, inter alia, provided that financial institution set up in IFSC would be treated as Person Resident Outside India under Foreign Exchange Management Act 1999, thereby removing capital control restrictions on the flow of foreign capital into and out of IFSC. This in effect made the maiden IFSC in GIFT City a separate international financial jurisdiction.

Despite the regulatory enablers provided by the Government of India, the IFSC did not achieve desired results because the growth and development of an IFSC is a rather complex and evolving concept, which is contingent on a host of other determinants, which is discussed in the following paras.

Key Determinants for Setting up an International Financial Services Centre (IFCS) in India:

The Global Financial Centres Index (GFCI) Report is a leading international report published by China Development Institute (CDI) in Shenzhen and Z/Yen Partners in London, which evaluates and assesses more than 100 financial centers on predetermined competitiveness factors. The instrumental factors used in the GFCI model are grouped into five broad areas of competitiveness: **Business Environment, Human Capital, Infrastructure, Financial Sector Development, and Reputation (GFCI 2020)**.

This research paper attempts to discuss and evaluate the current position of GIFT IFSC across the 4 broad determinants highlighted in GFCI report.

The institutional and regulatory environment is an essential component of Business environment. To provide for dedicated institutional & regulatory intervention at the maiden IFSC in India, the policymakers evaluated the regulatory architecture prevailing in several international financial centres such as Hong Kong, Singapore, Dubai & Qatar and acknowledged the prevalence of a unified financial regulatory body in some form or the other, in all the aforesaid financial centres. Therefore, to promote ease of doing business, the Union Parliament passed the International Financial Services Centres Authority Act 2019 and established the International Financial Services Centres Authority (IFSCA), as a unified financial regulator for development and regulation of financial institutions, financial products, and financial services.

The IFSCA, which assumed regulatory powers with effect from 1st Oct 2020, worked primarily on three fronts: **one**, to bring internationally aligned regulatory regime across various verticals including Banking, Capital Markets, Fund Management, Insurance, etc. thereby moving away from India centric regulatory regime, **second**, to onshore new financial services and products which were previously being purchased from offshore jurisdictions, including services such as Aircraft Leasing and Finance, International Bullion Exchange, FinTech, etc. and **third**, proactively working towards facilitating ease of doing business for the financial services industry (Shah and Chugan, 2015).

Another key component of the Business Environment is Tax competitiveness. Towards this end, the Government of India provided a special tax incentive in the form of Section 80 LA of Income Tax Act 1961 which exempted firms in IFSC to pay tax on business profits for a 10 year bracket out of first 15 years (Income tax India, 2019). Additionally, various other tax concessions were extended in IFSC so as to position GIFT IFSC at a par with overseas financial centres.

Availability of **Human Capital** is the next key determinant of success as per GFCI Report. In this regard, India has an inherent and natural advantage on account of favorable demographic dividend. The country produces some of the brightest minds in Finance and IT sector. In addition to this, GIFT City is strategically located between Ahmedabad and Gandhinagar, both of which are established education hubs with IIM's, IITs, National Law Schools all established in close vicinity. Moreover, GIFT IFSC is also accelerating inter-city migration with professionals moving from Mumbai, Delhi, Bangalore to GIFT IFSC on account of new and favorable job opportunities.

For any International Financial Centre to thrive, it is crucial that **physical and social infrastructure** is world class. On this particular determinant, GIFT City truly stands out as it is India's first fully operational greenfield Smart City. The city is planned on 886 acres of land with 62 Mn. sq. ft. of Built Up Area which includes Office spaces, Residential apartments, Schools, Hospitals, Hotels, Clubs, Retail and various Recreational facilities (GIFT City, India 2022 c).

The Civic infrastructure of the city includes:

a) Automated Waste Collection System (AWS) through chute system provides end to end automated waste management services without any human intervention

b) District cooling system is an Energy Efficient and Sustainable air conditioning system which conserves up to 30% energy as compared to traditional air conditioning systems (GIFT City, India 2022 a).

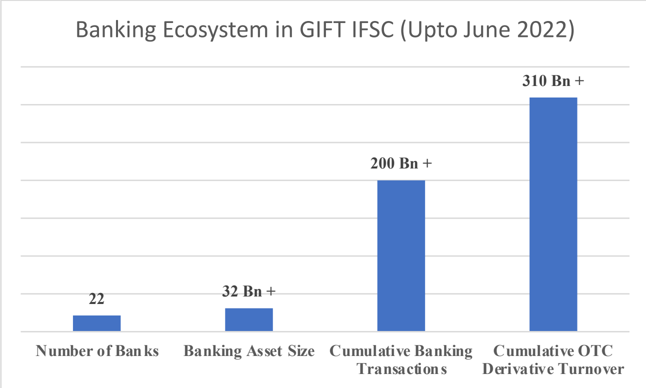
c) To achieve the vision of "Digging Free City", a Utility Tunnel has been dug across the city so that there is no need to excavate the roads in future for repair/ maintenance /renovation/up gradation of any utility. The provisions are made in the tunnel for smooth access, separation of utilities, proper drainage, lighting, and other long-term concerns, such as maintenance and security (GIFT City, India 2022 b).

The next important determinant in the GFCI Report is "Financial Sector Development", which inter alia, evaluates the depth and breadth of the financial sector in any financial jurisdiction. GIFT IFSC in its short journey has been able to provide an attractive and competitive platform to avail full spectrum of International financial services. This can be attributed to the internationally aligned regulatory ecosystem that has been created by IFSCA since 2019. Some of the key financial services being offered in GIFT IFSC are:

I. International Banking: Banking sector is the most important pillar of an international financial centre both as a financial intermediary and provider of other services. In general, international banking activities may include foreign trade financing, foreign exchange trading, transfer of fund across national boundaries (foreign currency deposits), foreign borrowing and lending and foreign investment. Further, the banking system maintains a coordination among all the units like mutual funds, AIF, stock exchanges thus helping in effectiveness in their functioning.

To develop a vibrant banking ecosystem, Banking Regulations 2020 (IFSCA Banking Regulations 2020) were notified by the IFSCA, which are essentially principle-based regulations and lays down the regulatory framework for setting up International Banking Units (IBU) in IFSC. The IBUs are permitted to offer a range of financial services including but not limited to Wholesale Banking, Retail Banking, Treasury Management, Merchant Banking, etc.

The key highlights of the Banking ecosystem in IFSC are provided below:



II. Capital Markets: Well-functioning and innovative capital markets is essential for enabling firms, households and governments to access stable funding and saving opportunities that are vital for consumption, investment and, ultimately, economic growth and employment (ECB Europa 2020). The unique position of IFSC enables it to become a preferred jurisdiction for Indian firms, IFSC firms as well as foreign firms to raise global capital at competitive cost through various debt and equity instruments.

The capital market regulatory ecosystem comprises of the Market Infrastructure Institutions Regulations, 2021, Issuance and Listing of Securities Regulations, 2021 and Capital Market Intermediaries Regulations, 2021. In terms of market infrastructure institutions, IFSC has the two international stock exchanges namely, India INX and NSE-IFSC which are operational for more than 20 + hours daily and offer various products including Index Derivates, Commodity Derivatives and Currency derivatives. The highlights of the capital marker ecosystem are as under:

III. Insurance & Reinsurance: GIFT-IFSC has the potential to become a hub for Reinsurance and retail insurance, particularly for Indian diaspora living abroad. To facilitate the development of this business segment, IFSCA notified (Registration of Insurance Business) Regulations, 2021 as well as (Insurance Intermediary) Regulations, 2021. The Insurance business landscape is rapidly evolving with GIFT IFSC emerging as a Reinsurance and retail insurance hub.

IV. International Bullion Exchange: India is the second largest consumer of Gold in the world (next only to China) and is the largest importer of Silver. Also, the country is presumed to possess close to 25,000 tonnes of gold as above the ground/ household stocks. Despite its position as a principal consumer in the precious metals market, India continues to be a price-taker and not in setting the price for gold in global markets. On the other hand, the existing dominant centers of bullion trade which are neither producing or consuming countries, play a major role in influencing the prices of the bullion. Further, Options Derivatives in commodities appeared in 1990´s and became popular tool of hedging and risk management (Kaur and Rattol 2016).

In the Union Budget 2020, Hon'ble Finance Minister announced the setting up of an International Bullion Exchange at the International Financial Services Centre in GIFT City (E-Parliament 2020). To implement this key budget announcement, the bullion spot delivery contract and bullion depository receipt (with bullion as underlying) were notified as Financial Products and related services as Financial Services and IFSCA was entrusted with the responsibility of operationalization of this Exchange.

The setting up of India International Bullion Exchange (IIBX), thus comes at a most opportune time which got inaugurated on 29th July 2022 by the Hon'ble Prime Minister of India which will serve as a watershed in the growth story of India's financial markets. With the Market Infrastructure Institutions already in place, the Bullion Exchange is expected to go live shortly and is envisaged to reform the gold ecosystem in India by virtue of the following:

i. **Price Discovery:** It shall harness all the synergies available locally, bring all the market participants at a common transparent platform of bullion trading and provide an efficient price discovery by channelling demand-supply information into a central mechanism. Increase in use of gold bars and gold-backed financial products replacing the demand for jewelry specially for investment which may be effortlessly liquidated. The channelization of demand-supply information into a central mechanism shall enhance the discovery of price at the International Bullion Exchange.

ii. **Price Influencer:** IBE shall enable the country to become a dominant trading hub for bullion with transparency, speed and efficiency which is unparalleled and enable India to be a major player and price setter in the global bullion ecosystem.

iii. **Supply chain integrity:** Sourcing integrity and quality of bullion can be easily established in a system-based tracking module, brought in as a consequence of the International Bullion Exchange shall enable enforcement agencies to curb malpractices.

iv. **Financialization of Gold:** Greater integration with other segments of financial markets and routing retail investment into gold by increase in use of gold bars and gold-backed financial products replacing the demand for jewellery specially for investment. Also, India has an opportunity to ensure that gold being designated as a Financial Product as 'Bullion Depository Receipts' will play a major role in the financialization of bullion holdings. There is a possibility of mainstreaming a portion of household holdings of 25000 tonnes approx. which is currently estimated to be lying unused and locked.
(IFSCA 2022).

V. Aircraft Leasing and Financing:

The size of the global aircraft leasing industry was estimated to be USD 290.07 billion in 2019. From owning just 25% of the total commercial fleet in 2000, aircraft lessors have grown to owning about 48.9% of the total fleet in 2020. The leasing model is even more popular in India with close to 80% of the total commercial fleet operating under lease compared with the global average of 53% (PWC 2021).

Despite the fact that aircraft leasing and financing is one of the most profitable business segments in the entire aviation value chain, this crucial business segment was entirely absent in India was being purchased by commercial airlines from offshore jurisdictions like Ireland, Singapore, etc. To onshore this crucial business activity in GIFT-IFSC, IFSCA with support of Ministry of Civil Aviation developed and implemented a comprehensive strategy and within a short span of 1 year, a globally competitive regulatory and tax architecture was put in place.

This business is expected to gain significant traction as India is already the 3rd largest domestic aviation market in the world and is expected to have a fleet strength of 5000 strong aircrafts by 2050 (Shah and Chugan, 2019).

Challenges in the development of GIFT-IFSC

Globally, when we look at the evolution of new-age offshore financial centres, we find that the federal governments have adopted a targeted and focused development strategy to bring in place an internationally aligned regulatory regime, beneficial tax structures and robust legal and dispute redressal system. In addition to the above, countries have also worked on creating world class social and physical infrastructure with a view to attract best in class financial talent from across the globe. In the case of GIFT IFSC, the Government in consultation with relevant stakeholders has worked on all the major determinants to ensure the centre emerges as a globally recognized international financial centre with trusted business regulations and ease of doing business.

The availability of robust, cost effective and time bound dispute settlement system is one of the prerequisites of a successful financial centre. According to the current legal process in IFSC, there is no uniform and streamlined dispute resolution mechanism, which can cater to the needs and demands of the offshore business and foreign players, who may be looking out to set up their businesses in IFSCs. This problem is further amplified by the fact that there exist multiple laws which are applicable in IFSCs, accompanied by multiple judicial mechanisms.

Further, the state of dispute resolution which is available presently for the entities established in IFSCs is complicated, due to various reasons including

i. Absence of Alternative Dispute Resolution system.
ii. Absence of any Special Court designated under Section 23 of the SEZ Act, 2000.
iii. Local courts at Gandhinagar having jurisdiction to try all civil/commercial/criminal disputes which may arise in the SEZ.

On the other hand, if we study leading global financial centres such as Dubai International Financial Centre (DIFC), its parent statute itself establishes DIFC Judicial Authority (DJA) for the effective resolution of legal disputes based on Common Law principles.

Further, the Law establishing the Judicial Authority at the DIFC establishes the DIFC Courts of First Instance and Appeal and prescribes the jurisdiction of the DIFC Courts. The Dubai Law provides for the appointment of the DIFC Courts Justice, including the Chief Justice of the DIFC Courts.

The Law allows the courts to deal exclusively with all claims and disputes arising from or within the DIFC. The Law also provides for the enforcement of judgments, orders and awards made by the DIFC Courts. The Law gives the Chief Justice the responsibility for administering the courts and any other circuits or divisions that are established.

To facilitate ease of doing business and provide for a robust dispute settlement mechanism in GIFT IFSC comparable with global standards, Hon’ble Finance Minister in Union Budget 2022-23 announced that an International Arbitration Centre would be set up in the GIFT City for timely settlement of disputes under international jurisprudence. The fast -track implementation of this key budget announcement would give further confidence to global financial industry to do business with GIFT-IFSC.

Conclusion

Considering the fact that India’s maiden IFSC has come of age and has firmly taken roots in the mindshare of the global as well as Indian financial services industry, it is now an opportune time to utilize this special carve-out jurisdiction to onshore International Financial Services business generated from India and make India truly “Atma Nirbhar” (Self-reliant) in the field of International Financial Services.

It would be critical to see how the key determinants namely Business friendly Regulations, Competitive tax regime, Alternate Dispute Resolution Mechanism, Corporate Law for ease of doing business, Skill Manpower and High-Quality Infrastructure & Quality of Life play an important role in the success of the IFSC in India.

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