Role of IFSC in India's globalization

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1. Good Morning to everyone who is present at this virtual lecture session. Friends, I am deeply honored to deliver the 38th Sir Purshotamdas Thakurdas Memorial Lecture and I want to thank the organisers for giving me this opportunity.

2. Today, I will speak about one of the deepest financial sector reforms carried out by the Government of India, which is aimed at enabling India, which has become the 5th largest economy in the world with a GDP of USD 3.5 trillion (and also the fastest-growing large economy in the world) to plug-in into the global financial system in order to be able to realize its full economic potential. As a country with strong macroeconomic fundamentals, a huge demographic dividend, the third largest startup ecosystem in the world, strong democratic credentials, rule of law, a large domestic market, abundance of skilled manpower, a well-developed and sophisticated financial market, and unlimited investment opportunities, India requires huge flows of foreign capital to bridge the gap in the availability of domestic capital to meet its investment needs. According to a joint white paper issued by GE-EY, India will require over USD 10 trillion to meet its net-zero emission commitment by 2070. This means India has to treble or may be quadruple its foreign capital inflows to be able to reach its full economic potential, which would be possible only if we are able to plug-in into the global financial system.

3. This topic of discussion assumes additional significance, as this lecture series is dedicated to the fond memory of a man who was a great visionary and someone who deeply influenced the banking and finance space in the country during the 1930s and 1940s. Sir P. T. as he was fondly referred to, was one of the prominent architects of the famous Bombay Plan, which was the economic plan proposed for India by a group of industrialists and technocrats in January 1944. He was a luminary and a thought leader, who played a key role in determining the regulatory and governance architecture of our financial sector. I, therefore, have no doubt in my mind that, had he been here today, he would have been the first one to have championed the cause of financial globalization of India.

4. When we look back at India's economic liberalization during the early nineties, soon after the economic crisis caused by, amongst others, a severe balance of payments crisis, the dominant narrative underlying the entire reform process undertaken during those days was about opening up the Indian economy to the outside world and dismantling of controls within the country by abolishing industrial licensing (barring a few sensitive sectors), removing permit-raj, doing away with administrative pricing, easing restrictions on foreign technology, foreign capital inflows, etc. However, one major control which was still not given up was the foreign exchange control. The economy was still not ready to expose itself to the vagaries of global financial system.

5. However, even during the early period of India's economic liberalization the question of whether the rupee should be made fully convertible on capital account was hotly debated. In 1997, RBI had constituted a Committee on Capital

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Account Convertibility, popularly referred to as Tarapore Committee, for suggesting a roadmap on full-convertibility of the rupee on capital account. The Committee submitted its report in May 1997 wherein it defined full capital account convertibility as the freedom to convert local financial assets into foreign financial assets and vice versa at market determined rates. The Committee recommended a phased approach for capital account convertibility over a three-year period, 1997-1998 to 1999-2000, subject to satisfaction of some pre-conditions such as fiscal deficit and inflation staying within the targeted limits and reduction of banking Non-Performing Assets (NPAs). Although the report never got implemented because it coincided with the East Asian financial crisis which demonstrated the risks arising out of unbridled foreign capital flows, certain measures were taken towards partial capital account convertibility such as relaxation in External Commercial Borrowing (ECB) guidelines, Liberalized Remittance Scheme (LRS), etc.

6. A decade later, RBI appointed the second Tarapore Committee to revisit the same subject. The Committee submitted its report in September 2006. It reiterated what the earlier committee had recommended in terms of phased implementation of capital account convertibility. It suggested that the full-convertibility plan may be implemented in three phases, first in 2006-'07; second in 2007-'08; and third by 2011. It also recommended further liberalization in ECB guidelines, permitting NRIs to invest in Indian capital market, tax benefits on NRI deposits, liberalization of banking regulations, and discouraging participatory notes route for Foreign Institutional Investors (FIIs). Like its predecessor the second Tarapore Committee report also was not implemented, as it was soon followed by the global financial crises of 2008.

7. In the year 2007, the Government of India constituted an expert committee on the subject of setting up of an International Financial Centre (IFC) in India. The Committee observed in its report that the global international financial services market in the 21st century is one in which competition is driven by rapid innovation in financial products, services, instruments, structures, and arrangements to accommodate and manage myriad requirements, risks, and a ceaseless quest for cost reduction. The Committee identified the necessary pre-requisites for a competitive International Financial Services Centre (IFSC) as extensive network of corporate and government client connections possessed by financial institutions participating in an IFSC; high-end human resources, including ancillary services support; world-class connectivity; Information Technology support; a well-developed, sophisticated, open financial system with diversified sources and uses of capital; best-in-class regulations; and hinterland advantage. The Committee recommended that India should become a large producer of International Financial Services (IFS) and capture an increasing share in the global IFS market. The Committee estimated that the size of IFS procured by Indian households and firms stood at USD 13 billion in 2005 (IFS revenue is estimated at 2% of the total India-related cross-border flows). It is estimated that this figure could cross USD 120 billion in nominal terms by 2025. The Committee was of the view that India should not only be in a position to cater to its own requirement of IFS, but also emerge as a net exporter of IFS in the long-term. The main recommendations of the Committee were full capital account convertibility, establishment of a unified regulator and large-scale financial sector reforms.

8. As per the International Monetary Fund (IMF), classes of major financial centres are International Financial Centres such as New York City and London; Regional Financial Centres (RFCs) such as Singapore, Shanghai and Hong Kong; and Offshore Financial Centres (OFCs) such as Dubai, Abu Dhabi and Cayman Island. Whereas IFCs and RFCs are full-service financial centres with direct access to large capital pools from banks, insurance companies, investment funds and capital markets, OFCs are essentially tax havens. According to IMF, an

IFC is characterized by advanced payment and settlement systems, supporting large domestic economy, deep market liquidity with diverse sources and uses of funds and robust legal and regulatory systems. RFCs in contrast have smaller domestic economies. OFCs offer more specialist services and are entirely tax efficiency-driven. Of course, these are not water-tight compartments and one often finds some overlap between RFC and OFC such as Dubai may fall under both the classifications.

9. When we talk about Gujarat International Finance Tech-City (GIFT) IFSC, we have to root it in the above context to understand as well as appreciate its genesis. According to the Economic Survey 2022-'23, GIFT IFSC has been a path-breaking financial reform underpinning India's increasingly liberal outlook towards capital account convertibility. Given the necessity to connect with the global financial system and the impracticality of adopting full capital account convertibility at one go, the Government of India took a conscious decision to adopt an "enclave approach" to implement full-capital account convertibility. This led to the setting up of India's first IFSC at the GIFT City SEZ in 2015. Initially, for a few years, the domestic regulators were assigned with the responsibility of managing their respective functions in the newly created financial zone. Subsequently, in December 2019, the International Financial Services Centres Authority (IFSCA) Act was passed. IFSCA was established in April 2020 and the powers of the four domestic regulators (RBI, SEBI, IRDAI and PFRDA) exercised under 16 Central Acts (including RBI Act, FEMA, SEBI Act, SCRA Act, IRDAI Act, Insurance Act and PFRDA Act) were conferred upon the IFSCA with respect to development and regulation of financial services, financial products and financial institutions in IFSCs established in India. In other words, IFSCA became a unified financial regulator for IFSCs set up in India. IFSCA has been given the twin mandate of development and regulation. As a modern regulator, IFSCA acts as an enabler and catalyst and encourages innovation. It is also responsible to protect the interests of investors and depositors, ensure orderly conduct of market, ensure financial stability, prevent money laundering and financing of terrorist activities. Apart from development of the financial sector, IFSCA has also developed a suitable framework for development of ancillary support services such audit and accounting services, legal advisory services, custodial services, back office services to financial institutions, asset administration, etc.

10. In the words of Prime Minister, Narendra Modi, who conceptualized the whole concept of GIFT City way back in 2004 when he was the Chief Minister of Gujarat state, the GIFT IFSC connects India with global opportunities and global investors with India's opportunities. GIFT IFSC's primary role, at least in the initial 5 to10 years is to act as a gateway for global capital flows into and out of the country. In the second phase, after gathering enough critical mass, it would be able to compete with the leading IFCs for a greater share in the global market for IFS.

11. The next question is about the positioning of GIFT IFSC. If we have to compare GIFT IFSC with another financial centre, the most appropriate comparison would be with Hong Kong. Hong Kong channelizes global capital flows into mainland China, which otherwise has fairly stringent exchange controls in place. It is estimated that 60% of FDI flowing into mainland China comes through Hong Kong. Chinese companies raise huge amounts of foreign capital by listing their securities in Hong Kong. Hong Kong also plays an important role in the internationalization of Renminbi. In the same way, GIFT IFSC can do for India what Hong Kong IFC is doing for China.

12. The unique features of GIFT IFSC include the existence of a unified financial regulator in the form of IFSCA, best-in-class regulations, treatment of GIFT IFSC as a separate international financial jurisdiction under Foreign Exchange Management Act (FEMA), 1999, a competitive tax regime, full capital account convertibility,

concentration of financial institutions across banking, insurance, capital market, funds etc. including the supporting ecosystem, and above all the full support of the Government of India. As per the Statement of Objects and Reasons of the IFSCA Act, 2019, the primary purpose of the IFSC is to bring back financial transactions and financial services carried out in foreign financial centres by Indian entities (or the subsidiaries of Indian entities) to India by offering world-class business and regulatory environment.

13. The next question that arises is that, in what ways GIFT IFSC can accelerate financial globalization of India? The most important service it can render is raising of foreign capital in terms of debt and equity and their variants, including risk management appendices attached to primary fund-raising transactions to ensure risk exposure of the primary borrower or fund-raising entity (to currency, interest rate, market, operational and political risk) does not exceed tolerable limits. Today, Indian firms instead of going to Singapore or London are now able to raise foreign capital at GIFT IFSC at competitive rates. This has become possible because of the concentration of financial institutions, including global players such as HSBC, J. P. Morgan Chase, Barclays, Citibank, MUFG, Deutsche Bank, Standard Chartered, BNP Paribas, etc. For example, in banking sector there are already 23 banks, including several foreign banks, apart from the representative office of New Development Bank. The combined balance sheet size of GIFT IFSC based banks today is about USD 38 billion. Trade financing and derivative transactions are also picking up rapidly. The total banking transactions since October 2020 has been of the order of USD 354 billion and that of derivatives, around USD 470 billion. New products like credit enhancement, total revenue swaps, acquisition financing, etc. have also started. IFSCA has also enabled the creation of a market place for factoring and forfaiting. 4 entities have been given approval to set up international trade servicing platforms for trade financing. This will enable MSME to access trade financing in international currencies at competitive rates.

14. Similarly, on the funds side there are more than 50 funds domiciled in GIFT IFSC today with a commitment size of approximately USD 15 billion. The IFSCA Fund Management regulations adopt a holistic approach and regulate the Fund Management Entity (FME), which in turn can operate all types of funds such as angel funds, venture capital funds, private equity funds, hedge funds, exchange traded fund, ESG funds, sovereign funds, etc. It also provides for portfolio management services, investment advisory services, family offices, investment trusts and trusteeship services. Many important domestic fund managers who were hitherto pooling funds offshore in foreign jurisdictions such as Dubai or Mauritius or Luxembourg, have now set up their pooling structures in GIFT IFSC. Some of the big domestic players in the funds business include SBI Funds, Kotak, Birla Sun Life, Kedaara, Avendus, Multiples, True North, Philip Capital, etc. Now some big foreign fund managers have also shown interest in having their commercial presence in GIFT IFSC. Many large foreign funds are already participating as investors in funds set up in GIFT IFSC.

15. Insurance and reinsurance services is another priority area. Today, in India a lot of reinsurance business is captured by cross-border insurance companies with no commercial presence in India. The annual outflow of reinsurance premium is estimated to be around USD 3 billion. IFSCA has brought out best-in-class regulations to attract foreign and Indian insurance and reinsurance companies to set up branches in GIFT IFSC and do reinsurance business from GIFT IFSC. At present, there are 4 reinsurers and 19 intermediaries, but it is expected that in the coming 6 months or so many global players may set up operations in GIFT IFSC. Currently, the cumulative premium booked by the reinsurers and intermediaries is about a billion dollars.

16. GIFT IFSC has established the complete capital market ecosystem with 2 international exchanges, 1 international bullion exchange, 2 international clearing corporations, 1 international depository, and a large number of

brokers, clearing members, trading members, etc. The securities issued from GIFT IFSC have a separate ISIN, which is different from the domestic ISIN. Some of the highlights of the capital market in GIFT IFSC include global access provided by India INX to over 130 jurisdictions through international brokers, introduction of fractionalized unsponsored depository receipts of popular American stock, the SGX connect (which will bring back the entire NIFTY FIFTY trading on SGX with an overnight open interest of USD 12 billion to NSE IFSC exchange in GIFT IFSC), an International Sustainability Platform, etc. The monthly average trading on the GIFT IFSC exchanges is around USD 30 billion. So far, over USD 50 billion debt has been raised, including USD 9 billion ESG debt.

17. The International Bullion Exchange is another major initiative taken in GIFT IFSC, which is expected to be a gamechanger in bringing about financialization of gold in India. India is the second largest consumer of gold in the world with an average annual import of 1,000 tons, which accounts for 25% of global production. Besides, India has above ground gold stock estimated at over 25,000 tons, which is mostly lying as an unproductive asset with households and institutions. The bullion exchange enables India jewelers to import directly through the exchange without having to go through intermediaries. This will ensure transparent price discovery, quality assurance and standardization apart from sourcing integrity. The other activities in the pipeline include operationalization of gold metal loan, introduction of gold ETFs, gold accumulation savings account, hedging, etc. While, as of now, the operations have just started and less than half a ton of gold has been imported through the exchange, this is expected to grow exponentially in the coming months. A connect with the domestic bullion exchange is also envisaged in due course.

18. Global in-house centres is another thrust area for providing back office support to financial institutions. These are in the nature of business process outsourcing/knowledge processing centres, which aid and assist financial institutions in producing and providing financial products and financial services. Today, more than 3,500 jobs have got created in this area. It is expected that this figure will cross 20,000 in the next 2 years. The idea is to promote GIFT IFSC as the Finance and Accounting hub of the world in the long-run.

19. IFSCA is supporting the development of a few niche business areas in GIFT IFSC. Aircraft leasing is one such area. India has the third largest domestic aviation market and is amongst the fastest growing aviation markets in the world. About 80% of the total fleet of around 700 aircrafts are on operational lease, and bulk of them are being leased from Ireland (Dublin). Today, we have one of the largest order books and in next 3 years out fleet size is expected to grow to 1,200, and to 5,000 by 2047. The outflow of lease rentals is around USD 5 billion per annum. The necessary tax and regulatory regime have been put in place in GIFT IFSC and 19 lessors have got themselves registered. In the last 1 year, 29 aircrafts have been leased out from GIFT IFSC (including some engines and ground equipment). However, as of now, there is no large lessor in GIFT IFSC, and in our belief in the initial stage the Indian capital has to take the lead to create the multiplier effect. On similar lines, ship leasing is also being promoted.

20. The next high priority area is FinTech. GIFT IFSC is being positioned as a global FinTech hub. IFSCA has notified a Fintech Entity framework and introduced a FinTech incentive scheme. It is the only Indian financial regulator to introduce an incentive scheme which provides for financial grant up to Rs. 75 lakh. The grants are available for startup, proof of concept, sandbox, accelerator, green finance and listing. IFSCA has also entered into an Inter Operable Regulatory Sandbox with the 4 domestic financial regulators wherein for cross-border FinTechs, IFSCA will act as the principal regulator. Similarly, IFSCA is developing connects with domestic and foreign FinTech associations as well as FinTech bridges with counterpart regulators in important financial jurisdictions. Recently, IFSCA has entered into an agreement with Monetary Authority of Singapore

for setting up a joint regulatory sandbox. So far, 64 applications have been received, including from 12 foreign jurisdictions, for sandbox/full authorization and 31 have been approved. The FinTech development will promote innovation in a big way. IFSCA has already conducted several I-sprints (accelerator programmes) in different areas such as KYC, green finance, cyber security, etc. Another area of concern is to prevent reverse flipping by Indian startups. Majority of Indian Unicorns are headquartered in the US or Singapore even though majority of management is Indian, majority of business is in India, and majority of employees are in India. The main reasons are the pressure exercised by the foreign funders, easier procedure for merger & acquisition and a more favourable tax regime. IFSCA has constituted a committee to study this and make recommendations on how to redomicile such Indian startups to GIFT IFSC.

21. With a view to develop the extended ecosystem, the Government of India has notified foreign universities providing courses in Finance and STEM (Science, Technology, Engineering, and Maths) disciplines as a financial service. IFSCA has notified the regulations for enabling foreign universities/other foreign educational institutions to set up their branch campuses/overseas educational centres in GIFT IFSC. This will be a game-changer, as it will make available high-end human capital for the financial and ancillary institutions set up in GIFT IFSC. It will also provide opportunities of collaboration between industry and academia. There has been a very enthusiastic response and one foreign university has already been granted approval, and many more are at an advanced stage of applying. Going by the response, the GIFT City authorities are planning to develop an education hub over an area of 250 acres within GIFT IFSC.

22. Sustainable Finance is the most important emerging area, which is poised to completely re-align the financial regulatory architecture for global capital flows by aligning it with climate change and Sustainable Development Goals concerns. IFSCA has laid down the basic regulatory principles for banking, funds and the exchanges. Further, IFSCA is focused on capacity building in this area and hopes to assume thought leadership role for South Asia. There is a need to recognize that the challenges faced by developing countries and those by developed countries are not the same. The developing countries have a long way to go to achieve SDGs, whereas, the developed world does not face that challenge. So, unlike the developed world, the developing world have to balance growth and sustainability concerns in a manner that the transition towards sustainability is not disruptive. This requires a lot of engagement with all stakeholders on recognizing the different transition pathways and how to promote all three, growth, green and sustainability in a smooth manner.

23. Finally, for any financial centre to thrive, a robust alternative dispute resolution and litigation mechanism is essential. As directed by the government, IFSCA is in the process of developing an International Commercial Arbitration Centre at GIFT IFSC. There is a proposal to enable this by amending the IFSCA Act, 2019 by providing for a special regime for international commercial arbitration in GIFT IFSC, which is comparable with other jurisdictions such as London, Singapore and Hong Kong.

24. Friends, in conclusion, I can say without any hesitation that GIFT IFSC, which is the India's maiden IFSC, will play an important role in India's growth story by channelizing global capital flows into the country to bridge the investment gap, and make India a major exporter of international financial services in times to come. In short, it will supplement the domestic financial sector and emerge as the second engine of growth to take the India story forward with global participation.

Thank you for listening to me patiently.