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# The Evolution of International Financial Services Centers in India: The Role of IFSCA

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## ABSTRACT

*The Government of India has established the International Financial Services Centre (IFSC) initiative through Special Economic Zones (SEZs) to facilitate India's growth in international financial services. The IFSC at GIFT City in Gujarat, operational since 2015, reached a major milestone with the establishment of the International Financial Services Centres Authority (IFSCA) in 2019 through an Act of Parliament. The IFSCA has emerged as a unified regulator overseeing the development and regulation of banking, capital markets, insurance and other financial sectors in IFSCs. This paper examines the rationale for setting up IFSCs globally and in India, analyzing it from the perspectives of host jurisdictions, businesses operating in the IFSCs, and customers utilizing their services. It delves into the legislative framework instituted by the IFSCA Act 2019 which has strengthened the regulatory landscape, catalyzed the establishment of financial institutions, and spurred innovation within IFSCs. While acknowledging IFSCA's accomplishments in regulatory oversight, enforcement, and global coordination, the paper highlights key challenges that need to be addressed through infrastructural upgrades, talent development, and cross-border regulatory harmonization. Recommendations are provided for enhancing operational efficiencies, legal/compliance frameworks, and international regulatory coordination to fully unlock the potential of Indian IFSCs as leading global financial hubs.*

**Keywords:** IFSC, Gift City, Evolution, Recommendations.

## I. INTRODUCTION

The Government of India (GoI) has undertaken the initiative to establish the International Finance Services Centre (IFSC) in India through the Special Economic Zone (SEZ) method, with the aim of facilitating India's attainment of its potential in the realm of international financial services.

In the budget speech (Union Budget 2016) in February 2015, the Hon'ble Finance Minister made a statement regarding the IFSC. He stated that although India produces highly skilled

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financial experts, including those in international finance, there are limited chances for them to effectively showcase and employ their abilities for the betterment of the nation within India.

The purpose of Gujarat's GIFT is to establish itself as a global financial centre that can compete with Singapore or Dubai in terms of excellence. It is worth noting that the majority of its staff members are Indian. The proposal has remained inactive for some years. I am pleased to announce that the initial phase of GIFT will imminently materialise as a result of the implementation of suitable regulatory measures in March 2015.

After the budget was released, the regulators, namely the Securities Exchange Board of India (SEBI), Reserve Bank of India (RBI), and Insurance Regulatory and Development Authority of India (IRDA), individually issued regulations to implement the provisions of the Special Economic Zone Act for the International Financial Services Centre in India. In April 2015, India made a little advancement in the realm of financial centres by introducing the operational rules for the International Financial Services Centre (IFSC). This development occurred despite the fact that the approval for the building of the IFSC in GIFT City, Gujarat, was obtained in 2011. The Indian government has granted authorization for the establishment of India's inaugural International Financial Services Centre (IFSC) at GIFT City in Gandhinagar . The inaugural IFSC banking unit in the country commenced operations in October 2015. The establishment of the International Financial Services Centres Authority (IFSCA) by the Government of India in 2019, through the enactment of the International Financial Services Centres Authority Act 2019 (referred to as the Act) by Union Parliament, represented a notable milestone in the IFSC's process of evolving into a comprehensive international financial hub that can effectively compete with other foreign financial centres.

The IFSCA has been granted legal jurisdiction to enhance and regulate the financial markets in India's International Financial Services Centres (IFSCs). In order to develop and regulate financial products, financial institutions, and financial services that fall under the purview of IFSCs, the Act grants the IFSCA the authority powers of four domestic regulators: the Reserve Bank of India (RBI), Securities & Exchange Board of India (SEBI), Insurance & Regulatory Development Authority of India (IRDAI), and Pension Fund Regulatory & Development Authority (PFRDA).

On October 1st, 2020, the IFSCA assumed control of the four local regulators and has since been spearheading the establishment of India's inaugural International Financial Services Centre at GIFT City. The governing body has implemented a comprehensive and well planned approach to the establishment of the inaugural International Financial Services Centre (IFSC).

This approach encompasses various aspects, including the creation of a global regulatory structure that encompasses diverse industrial sectors, such as banking, capital markets, fund management, insurance, and others. The governing body is also endeavouring to introduce novel and specialised global financial services that were previously only accessible from foreign financial jurisdictions domestically.

Specialty financial services encompass several sectors such as International Bullion Exchange, aeroplane leasing and finance, ship leasing and financing, and fintech-related services.

Additionally, the International Financial Services Centres Authority (IFSC) has demonstrated a proactive approach in engaging with diverse stakeholders to facilitate the operations of both domestic and international financial services sectors (GIFT IFSC) (International Financial Services Centres Authority, 2020).

During the foundation stone ceremony for the IFSCA Headquarters Building on 29 July 2022, the Prime Minister of India made a declaration stating that the IFSCA would serve as both an enabler and a catalyst for growth prospects, while also fostering innovation (PIB Delhi 2022). GIFT City's IFSC was placed #1 among 15 global financial centres in the Global Financial Centres Index Report (GFCI, 2022). This ranking acknowledges the increasing significance of GIFT City's IFSC in the financial services sector and its projected growth in importance over the next two to three years.

The IFSCA is an exceptional regulatory body that has been granted the responsibility of both developing and overseeing the International Financial Services Centres (IFSCs) in India. According to Section 12 of the Act, the IFSC Authority is responsible for developing financial institutions, financial services, and financial products within the IFSCs, in addition to the regulatory functions of IFSCA (International Financial Services Centres Authority 2020).

## **II. WHY IFSCA NEEDED?**

In its research, Corporate Law Group (CLG 2009) outlines a number of significant reasons for the construction and rapid growth of International Financial Services Centres in a variety of jurisdictions. These reasons can be regarded from the following points of view:

- From the point of view of the jurisdictions that are hosting the International Financial Service Centre.
- From the point of view of the units that make up the International Financial Service Centre.

- From the point of view of the people who get services from the International Financial Service Centre (also known as consumers).

1. From the point of view of the jurisdictions that are hosting the International Financial Service Centre.

Numerous countries all over the world have established International Financial Service Centres as a result of the characteristics and magnitude of their own economies. It is primarily the business of borrowing short-term funds from non-residents and lending them to non-residents in developed economies because these economies have advanced settlement and payment systems, large domestic economies, deep and liquid markets, and diverse sources and uses of funds. Examples of such economies include the United Kingdom and the United States. Developed economies consider such centres as an effective means of preserving and extending the quantity of their international business. This is due to the sheer enormity of their economies and the economies of scale that emerge from the business that is performed from those economies.

For regional jurisdictions such as Singapore and Hong Kong, which have a well-established financial market and an efficient financial infrastructure, such centres are essentially considered to be effective tools for guaranteeing that foreign trade and commerce are carried out in a straightforward and extensive manner.

The development of the International Financial Service Centres was done with the intention of drawing as much foreign currency as possible for minor centres and many small jurisdictions in the Caribbean, such as the Bahamas, Aruba, Barbados, and other similar places. With the intention of achieving this goal, numerous fiscal concessions and exemptions have been implemented. These include tax rates that are either completely or nearly completely nonexistent, regulatory processes that are liberal, assurances of strong confidentiality, low operational constraints, and so on. Their primary objective was to enable the largest inflow of foreign cash as well as international trade and business by ensuring many fiscal and non-fiscal privileges for the units that were based in such jurisdictions. This was done because such small International Financial Service Centres have small economies. These kinds of facilities are and have been a source of significant worry for international organisations such as the International Monetary Fund, the Organisation for Economic Cooperation and Development, and others. Many of these smaller jurisdictions have been placed on a blacklist and ordered to take remedial actions and measures in order to conform to international standards. This is because of the widespread participation in activities that involve the laundering of money.

In a nutshell, despite the fact that the precise objective of the multitude of International Financial Services Centres in the world tends to "vary from one jurisdiction to another jurisdiction, depending on the geographical location and developmental requirements of the said jurisdictions," the fundamental fundamental of all of the International Financial Service Centres in the world continues to be the same: to attract as much offshore financial business as possible to the respective jurisdictions.

**2. From the point of view of the units that make up the International Financial Service Centre**

The banking and non-banking financial institutions that are typically located in the International Financial Service Centres have their own reasons for locating themselves in such centres. However, different activities and corporate entities that are operating or intending to operate in the concerned International Financial Service Centres may have different reasons for locating themselves in such centres. According to Cassis (2010) and Corporate Law Group (2009), the following primary reasons can be identified as the primary reasons for various corporate units to operate in such International Financial Service Centres:

- Low or nonexistent tax rates.
- A high profit margin as a result of an absence of taxes or a low tax rate.
- There is a mechanism for liberal regulatory oversight.
- These International Financial Service Centres guarantee the confidentiality or secrecy of any information they receive.
- It is possible for certain centres to allow the use of "Shell Units."
- There is a prevalence of money laundering activities in certain centres, and these activities are permitted.
- The ease with which procedures for incorporation can be completed, as well as the allowability of branch offices or subsidiaries within International Financial Service Centres.
- The high volume of financial transactions that can be conducted within such centres.
- The internationalisation of their activities inside such financial centres;
- The centralization of their activities in accordance with the location of the financial centres.

**3. From the point of view of the users of the International Financial Service Centre**

Since the offshore Banking and Non-Banking Financial units are essentially authorised to deal

with non-residents exclusively and in foreign currencies only, the customers of the services of such offshore organisations come with diverse aims, some of which are stated below:

- Keeping assets in jurisdictions with low or no taxation allows one to avoid paying larger taxes than they would otherwise.
- able to take advantage of a flexible regulatory system that would otherwise be unavailable in the domestic market.
- Protecting assets from any potential legal conflicts that may arise in the jurisdictions in which they are located.
- The utilisation of low tax rates and high returns within the jurisdiction of the International Financial Service Centre in order to guarantee the highest possible returns and profits.
- Take use of the confidentiality provisions that are typically guaranteed at the International Financial Service Centre in order to make an effort to legalise black money.
- Access to a wide international market with diverse financial goods.
- The business risk of one jurisdiction should be weighed against the risk of the other jurisdiction.

### **III. LEGISLATIVE FRAMEWORK IN INDIA**

It is safe to say that the IFSCA Act 2019 has made a substantial contribution to the establishment and functioning of IFSCs in India. By building a strong regulatory framework that was suited to the specific requirements of IFSCs, this objective was successfully attained. This framework provides an overview of the regulatory principles that govern licencing, monitoring, compliance, and enforcement. The integrity, stability, and competitiveness of IFSCs are all things that these laws intend to protect and ensure IFSCs maintain. The foundation of the IFSCA as a unified regulatory authority with complete powers as a result of the Act has resulted in the simplification of the regulatory landscape, the reduction of regulatory arbitrage, and the improvement of regulatory supervisory consistency.

Additionally, the provisions of the Act that reduce regulatory standards, expedite registration procedures, and provide tax advantages have provided financial institutions with an incentive to establish a presence in information and financial services centres (IFSCs). Because of the entry of institutions, a vibrant ecosystem consisting of banks, insurance companies, asset managers, fintech enterprises, and other financial intermediaries has arisen. This has accelerated

the development of internal financial service companies (IFSC), which are organisations that provide financial services to the government. Not only has the presence of a diverse range of financial institutions within IFSCs increased the depth and breadth of these organisations, but it has also made it easier to collaborate and synergize across industries, which has resulted in the stimulation of innovation and the creation of an environment that is conducive to the development of innovative financial products.

IFSCA has been instrumental in fostering innovation, technological advancement, and worldwide competition among integrated financial services companies (IFSCs) ever since it was established. By fostering the development of cutting-edge financial goods and services through the adoption of a robust regulatory framework that strikes a balance between stability and innovation, the International Financial Services and Capital Markets Authority (IFSCA) has established international financial service centres (IFSCs) as leading locations for international financial activity.

In addition, the International Financial Services and Capital Markets Authority (IFSCA) has consistently proved its dedication to enhancing compliance and enforcement measures, thereby enhancing market integrity and boosting investor confidence. The International Financial Stability Council (IFSC) has successfully minimised systemic risks and maintained the reputation of Investment Funds and Securities Commissions (IFSCs), thereby making a beneficial contribution to the stability of the global financial system.

In addition, it is laudable that the International Financial Services Consumer Agency (IFSCA) has taken actions to improve regulatory coordination and harmonisation on a global basis. To expedite international financial transactions and establish regulatory standards that are uniform across borders, the International Financial Services and Compliance Authority (IFSCA) has been working to encourage collaboration among industry actors, governments, and international regulatory organisations. Because of this, investors from all over the world are more interested in investing in IFSCs.

It is necessary to continue making efforts to strengthen the regulatory system and handle new risks in spite of these accomplishments because there are still a number of difficulties and concerns that need to be addressed. In spite of this, the efficient operation of IFSCs is complicated by ongoing conflicts regarding the legislative framework, substantial operational complexity, and concerns pertaining to legal compliance and compliance with regulations. Regulators, legislators, and industry stakeholders need to work together in order to overcome the challenges that continue to exist, which include the harmonisation of regulations, the

development of infrastructure, and the procurement of talent. In order to fully exploit the potential of international financial service centres (IFSCs) as internationally competitive financial centres, it is necessary to achieve regulatory convergence across countries, make upgrades to both physical and digital infrastructure, and cultivate a staff that is adequately trained.

#### **IV. CONCLUSION**

In the year 2020, the International Financial Services Centres Authority (IFSCA) was established, which resulted in considerable enhancements to the regulatory framework of India's financial sector. In addition to demonstrating the Indian government's dedication to fostering an environment that is conducive to international financial transactions, the establishment of this specialised regulatory entity was intended to address the specific requirements and complexities that are associated with International Financial Services Centres (IFSCs).

In the future, the IFSCA needs to confront issues while also building on its existing strengths. It is possible for IFSCA to increase the resiliency, efficiency, and competitiveness of the IFSC all while assuring their continued expansion in the future. This may be accomplished by putting into action a comprehensive set of proposals and encouraging continuous improvement.

##### **(A) Recommendations**

- **Enhance Operational Efficiency:** The International Financial Services Supervisory Council (IFSC) should collaborate with key stakeholders in order to eliminate operational bottlenecks and improve the efficiency of IFSC operations. This will allow the IFSC to achieve its goals. It is necessary to make investments in the development of infrastructure, the acquisition of talent, and actions to upgrade skills in order to facilitate the growth of IFSCs. This is done with the intention of fostering the expansion of IFSCs.
- **Enhance Legal and Compliance Frameworks:** In order to accommodate new threats and challenges, the International Food Safety and Food Control Authority (IFSCA) should regularly examine and update its legal and compliance frameworks. This will allow the IFSCA to better manage new risks and challenges. The promotion of adherence to international best practices, the tightening of data privacy and cybersecurity regulations, and the enhancement of anti-money laundering (AML) and counter-terrorism financing (CTF) initiatives are some of the activities that fall under this category.

- Regulatory Coordination: The International Financial Services and Coordination Authority (IFSCA) ought to increase the amount of effort it puts out in order to improve regulatory coordination and alignment on a global scale. covered in this are the enhancement of communication channels with foreign regulatory authorities, participation in regulatory debates and conferences, and the promotion of collaboration on themes relevant to cross-border regulation.

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