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FINANCIAL HUB, A WORK IN PROGRESS

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Capital Market & SEBI

A subsidiary of the National Stock Exchange on Thursday introduced a facility by which Indian retail investors can directly trade in stocks that are listed on the U.S. stock exchanges. The NSE arm would invest the funds in those specific stocks against which investors would receive depository receipts in lieu of actual shares.

The subsidiary – NSE IFSC – is registered at the International Financial Services Centre (IFSC) at the Gujarat International Finance Tec-City (GIFT), a financial district located between Ahmedabad and Gandhinagar in Gujarat.

Global ambitions

The City was conceptualised as an alternative to global financial hubs such as Hong Kong, Singapore or London. Though the idea was mooted in 2007, work on the physical infrastructure started in 2012. It was only in 2015 that business regulations were introduced; 2017 saw the setting up of an international exchange.

The GIFT City SEZ — with demarcations for domestic and export-oriented units — is the only place in India to be designated as an IFSC.

“A jurisdiction that provides financial services to non-residents and residents, to the extent permissible under the current regulations, in any currency except Indian Rupee,” is how GIFT City defines the IFSC.

Doing business inside the IFSC comes with the benefit of a relaxed tax regime — a 10-year tax holiday with no securities transaction tax, commodities transaction tax, or tax on long-term capital gains.

The Global Financial Centers Index report, London, had in March 2021 placed the IFSC in GIFT City at the top among 15 centres globally, which are likely to become more significant over the subsequent two to three years.

A step at a time

In recent years, the IFSC has seen a trickle of regulations or developments. For instance, February 2021 saw regulations for registration of aircraft leasing firms inside the IFSC in place; in a year from then, 13 companies had registered under this umbrella. In May 2021, a gazette notification clarified that foreign investors in a certain category of alternative investment funds would not need a PAN number to bring their funds into the financial jurisdiction.

The announcement of the IFSC Authority (IFSCA) in late 2020 under the chairmanship of former Insolvency Law Committee chair Injeti Srinivas infused welcome energy to the project. The IFSCA assumes responsibility as a unified regulator — across realms overseen by the RBI, SEBI, IRDAI and the PFRDA. The nature of business in IFSCs requires a high degree of inter-regulatory coordination within the financial sector. Businesses had likely found it slow-going when it came to approvals from each of these regulators.

The IFSCA recently urged the RBI to include aircraft leasing as a financial service, so that banks can become eligible to fund such leasing.

In October 2021, the NSE agreed to establish a data connection with SGX via the IFSC, allowing SGX investors access to real-time data. After close to two decades of partnership, the NSE had blocked SGX's access to real-time data in 2018. The pipeline is seen as the first step towards migrating Nifty futures trades that were taking place on the SGX, to the NSE IFSC. In 2021, the SGX witnessed trades, on average, that numbered twice the volume of Nifty futures traded on the NSE. Open interest, or unsettled derivatives contracts, were also higher, at 3.38 times. Starting this April, trading of Nifty Future to the IFSC will begin in a phased manner.

Currently, more than 200 entities have taken up office space in the City, where 12,000 people work. Both the BSE and the NSE have set up their international stock exchanges inside the IFSC; 17 banks, of which five are international banks, have been issued licences to operate, more than 100 units offer broking services, depository, and clearing operations, and 19 companies have begun operations for non-life reinsurance.

Investor concerns

Despite these incremental steps, investors have been slow to take up offers. Most new trading jurisdictions tend to allow benefits to financial trading firms for early participation or to encourage liquidity of stock, but the aim is to eventually spur genuine participation from retail investors.

Media reports have indicated that even as late as in February 2021 much of the trade on stock exchanges inside the IFSC were proprietary — that is, trading done by companies for their own profit, rather than using funds of investors to generate profit for participants.

Predominant among concerns for institutional investors have been that the Indian currency has not become fully convertible, that the country has not been visibly consistent in its tax laws and their interpretation, and that the speed of dispute resolution has been less than satisfactory.

India's rupee is currently partially convertible, meaning that there is freedom to exchange currencies at market rates but when larger amounts are involved, approvals are necessary. A fully convertible currency would also not have authorities intervening in markets to stem volatility or bring the rate to a certain level. A case in point is the RBI which enters the market to prop up the currency should global events or oil prices drive extreme weakness in the rupee, as was the case on Friday, when the rupee dropped below the 76-to-a-dollar level.

India's move to nix the retrospective tax laws to bring to closure cases against the likes of Cairn Energy and Vodafone were likely viewed favourably.

On dispute resolution, Budget 2022 had proposed the setting up of an International Arbitration Centre; this aims to offer offshore investors in the IFSC an assurance on intent, given the uncertainty that comes with corporate litigation in India.

Cross-border insolvency

Insolvency norms in the country did get a leg up with the introduction of the Insolvency and Bankruptcy Code; but under this umbrella too, the time taken for lenders to retrieve funds due to them – even allowing for significant haircuts – is keeping investors wary of venturing in with gusto.

Legal experts have pitched for cross-border insolvency norms that meet the IFSC's requirements as a way to initiate broader insolvency reforms in the country. While there are some provisions on this count in the IBC, a stronger framework is seen needed to assure investors of intent. In 2018, the Insolvency Law Committee had submitted to the government its recommendations for the adoption of the ‘UNCITRAL Model Law on Cross Border Insolvency’. The United Nations Commission On International Trade Law (UNCITRAL) says the law is ‘designed to assist States in developing a modern, harmonised and fair insolvency framework to more effectively address instances of cross-border proceedings concerning debtors experiencing severe financial distress or insolvency’.

Significantly, India can take some learnings from the Dubai International Financial Centre and the Abu Dhabi Global Market, which have adopted the UNCITRAL law even though the United Arab Emirates as a nation does not have a law yet to address cross-border insolvency. These are cited as examples for the IFSC to set the pace independently.

In focus

The NSE IFSC has introduced a facility by which Indian retail investors can buy and sell stocks that are listed on the stock exchanges in the United States

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