OPPORTUNITIES FOR FOREIGN BANKS IN GIFT CITY

1. INTRODUCTION

The Gujarat International Finance Tec-City ("**GIFT City**") is rapidly emerging as a pivotal hub for global finance, attracting foreign banks eager to establish a foothold in India. The International Financial Services Centre at GIFT City ("**IFSC**") offers a unique blend of regulatory advantages, tax incentives, and state-of-the-art infrastructure designed to facilitate international banking operations.

Launched in 2008 and operational since 2015, GIFT City represents a significant step towards establishing a global financial hub within the country. Being India's first operational greenfield smart city and IFSC, GIFT City is designed to provide world-class infrastructure, and a business-friendly environment tailored for financial and technology firms. With its strategic location, integrated development, and business-friendly environment, GIFT City has been attracting global attention and investment, positioning itself as a key player in the international financial landscape.

In recent years, the influx of foreign banks into GIFT City has been significant, driven by the desire to tap into India's burgeoning economy. The establishment of banking units allows these banks to conduct a range of financial activities, from trade finance to capital market transactions, all within a regulatory framework that promotes ease of doing business. Institutions such as Standard Chartered Bank, Hongkong & Shanghai Bank Corporation Ltd., Citibank NA, Barclays Bank, Deutsche Bank, JP Morgan Chase Bank National Association and MUFG Bank of Japan have set up their banking units in GIFT City. As per recent data, cumulative banking transactions in GIFT City during Q1 of 2024 reached almost USD 90 billion (Ninety), with total banking asset size crossing USD 62 billion (Sixty-Two).[1]

This article will explore the factors motivating foreign banks to set up offices in GIFT City and the regulatory landscape that supports their operations. As GIFT City continues to evolve, it represents not just an opportunity for foreign banks but also a transformative shift in India's financial services sector.

2. KEY ADVANTAGES FOR FOREIGN BANKS AT GIFT CITY

Establishing an office in GIFT City offers numerous benefits for foreign banks. Here are the key advantages along with recent initiatives aimed at enhancing this appeal:

2.1. GIFT City's incentives

GIFT City offers a variety of incentives to all businesses in its jurisdiction, irrespective of its sector. These incentives can broadly be categorised as infrastructural, financial, and regulatory incentives.

2.1.1. Infrastructural incentives

GIFT City features modern infrastructure including fully automated district cooling system, automated waste collection system and underground utility tunnels. The urban centre is complemented by contemporary social amenities, such as an international school, healthcare

[1] https://ifsca.gov.in/Viewer?Path=Document%2FReportandPublication%2Fifsca-bulletin-apr-jun-202416082024052409.pdf

facilities, a five-star hotel, an international exhibition complex, GIFT City business club with sports facilities, diverse dining options, and well-planned residential projects. It is well connected to the financial capital, Ahmedabad, and the political capital of the state, Gandhinagar, through metro and road, and is placed close to an international airport.

2.1.2. Financial / tax incentives

Several lucrative tax incentives are offered by GIFT City that are competitive with other financial services centres around the globe. These may be broadly divided under direct tax, indirect tax and client-centric heads. Some of these key incentives are discussed below:

a. *Direct tax benefits available to businesses operating in GIFT City*:

(i) Tax holiday: A 100% (One Hundred percent) tax exemption is provided for 10 (Ten) consecutive years (at the option of the taxpayer) within the first 15 (Fifteen) years of operations in GIFT City.[2]

(ii) Minimum alternate tax: A low minimum alternate tax ("**MAT**") of 9% (Nine percent) on book profits to companies and other entities established as units within the IFSC.[3] MAT does not apply to companies in the IFSC that choose to adopt the new tax regime.[4]

(iii) Dividend distribution: Profits distributed from a branch to its head office are not subject to taxation, effectively treating this income as self-generated.[5]

b. *Indirect tax benefits available to businesses operating in GIFT City*:

There is no Goods and Services Tax ("**GST**") on services: (i) received by units within the IFSC from Indian or non-resident individuals; and (ii) provided to other IFSC units and offshore clients.[6] However, GST applies to services rendered to the domestic tariff area.

c. *Client-centric tax benefits available to businesses operating in GIFT City:*

Clients of banks established in GIFT City also benefit from tax exemptions, such as in terms of interest earned on deposits with a banking unit[7] and interest received on funds borrowed by an IFSC unit is tax-exempt.[8] By creating a holistic tax incentive framework, operational costs of businesses are significantly lower at GIFT City, making it an attractive location for foreign banks.

2.1.3. Regulatory incentives

Contrary to the domestic territory of India, businesses in IFSC are governed by one unified regulator which has been empowered to exercise the powers of all existing regulators, called the International Financial Services Centres Authority ("**IFSCA**"). Having a single regulator allows

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[2] Section 80-LA of the Income Tax Act, 1961 ("**IT Act**").
[3] Section 115-JC(4)(i) read with Section 115-JD and Section 115-JF of the IT Act.
[4] Section 115BAA(4) of the IT Act.
[5] Section 115O of the IT Act.
[6] Section 16(b) of the Integrated Goods and Services Act, 2017.
[7] Section 10(15)(viii) of the IT Act.
[8] Section 10(15)(ix) of the IT Act.

for flexibility in operations and easier cross-linkages across financial regulations, with a dedicated aim of building business. Further, as the Indian Rupee is not the main currency for operations in IFSC, systemic risks on the economy are reduced, allowing for a light-touch regulatory framework.

Alongside the single regulator system, the IFSC area is treated as offshore territory within India for trade purposes (i.e., a special economic zone) and foreign exchange purposes. Hence, any financial institution or branch of a financial institution set up in the IFSC is treated as a person resident outside India.[9] The entities setup in IFSC can transact in, retain, repatriate the foreign currencies without limitations which are otherwise applicable to the entities established in Indian domestic territory.

The IFSCA also offers various sandbox options (regulatory sandbox, innovation sandbox, inter-operable regulatory sandbox and the overseas regulatory referral mechanism)[10] to encourage financial institutions, including foreign banks, to experiment with new technologies and business models in a live setting while being exempt from some regulatory requirements. This initiative is designed to foster innovation and enhance the competitiveness of the financial sector.

2.2. Banking sector incentives in GIFT City

Apart from incentives available to all businesses in GIFT City, banks at GIFT City are specifically permitted to undertake activities otherwise unavailable in domestic Indian territory. Some of these key measures are discussed below:

2.2.1. Synthetic securitisation

Recently, the IFSCA has permitted IFSC Banking Units ("**IBUs**") to participate in their parent banks' synthetic securitisation programs.[11] Synthetic securitisation allows IBUs to transfer credit risk associated with a portfolio of assets while retaining the assets on their balance sheets. This enables banks to manage their capital more effectively, improving their risk profiles and allowing them to allocate capital to other areas of their operations.

By participating in synthetic securitisation, IBUs can achieve capital relief, which is essential for maintaining regulatory capital ratios. This can enhance the IBU's ability to lend and invest in new opportunities, thereby increasing their competitiveness in the Indian market.

2.2.2. Wider range of options in dealing in foreign currencies

Recently, the IFSCA has amended the International Financial Services Centres Authority (Banking) Regulations, 2020 ("**Banking Regulations**") and added 4 more foreign currencies — Swedish Krona (SEK), Norwegian Krone (NOK), New Zealand Dollar (NZD), and Danish Krone (DKK) — to the list of specified foreign currencies.[12] These currencies are designated for foreign currency transactions within IFSC. This allows foreign banks to conduct a wider range of

[9] Regulation 3 of Foreign Exchange Management (International Financial Services Centre) Regulations, 2015.

[10] 'Framework for FinTech Entity in the International Financial Services Centres (IFSCs)', Circular no. F.No. 521/IFSCA/FinTech/FE Framework/2022-23 issued by the IFSCA on April 27, 2022.

[11] 'Permission to participate in the synthetic securitisation program of Parent bank', Circular no. IFSCA-FMPP0BR/1/2021-Banking-Part (1)/1 issued by the IFSCA on July 11, 2024.

[12] International Financial Services Centres Authority (Banking) (Amendment) Regulations, 2024.

financial transactions in these currencies, thereby enhancing the attractiveness of IFSC. Foreign banks can now more easily facilitate cross-border transactions denominated in these additional currencies, which is crucial for their international operations. This flexibility reduces the need for currency conversions and simplifies transaction processes.

2.2.3. Real-time dollar settlement

Plans for real-time dollar settlement by the year 2025 are also in place.[13] This will further enhance the efficiency of transactions conducted by foreign banks in GIFT City. This capability will streamline cross-border transactions and improve overall market efficiency. Currently, international transactions often face delays due to differences in time zones and banking systems. The introduction of real-time dollar settlements aligns with global trends towards faster payments, which could attract more foreign banks looking for efficient transaction mechanisms.

2.2.4. Diverse service offerings

Foreign banks can provide a wide range of services from GIFT City, including commercial banking, trade finance, capital market activities, and investment advisory services.[14] This diversity allows them to cater to various client needs and expand their operational scope.

2.2.5. Increased investment flexibility

By way of a recent notification, the Ministry of Finance, Government of India, exempted certain provisions of the Banking Regulation Act, 1949 to IBUs of foreign banks in IFSC. The prescribed limits on holding shares in any company will not apply to an IBU of a foreign bank for a transaction entered in the ordinary course of business or if the shareholding or interest acquired or held in the course of satisfaction of debts due to it, is disposed of within 5 (Five) years.[15] The ability to hold shares as part of normal business operations enables banks to manage their portfolios more effectively, facilitating smoother transactions and enhancing their service offerings.

2.2.6. Relaxation in maintaining prudential norms

The Banking Regulations provide significant regulatory flexibility for IBUs by allowing essential prudential ratios—such as minimum capital, liquidity coverage ratio, and net stable funding ratio—to be maintained solely at the parent bank level.[16] This approach simplifies compliance for IBUs, enabling them to focus on their operational activities without the burden of maintaining these ratios at the unit level.

3. REGULATORY OVERVIEW

Under the Banking Regulations, a banking unit may be established in GIFT City in the form of either a branch (known as IBUs) or a subsidiary (known as IFSC Banking Company ("**IFSC BC**"). Foreign banks

[13] https://www.ccilindia.com/documents/43866/65664203/RFP+to+act+as+Settlement+Bank+for+Proposed+FCSS.pdf/ddfc43d5-59d6-c1e3-7cc9-acf270eed534?t=1722262311856
[14] Regulation 13 of the Banking Regulations read with Section 3(1)(e) International Financial Services Centres Authority Act, 2019 read with Section 6 of the Banking Regulation Act, 1949.
[15] Section 19(2A) of the Banking Regulation Act, 1949.
[16] Chapter III of the Banking Regulations.

can establish a banking unit in the IFSC without the prerequisite of having a domestic branch or presence in India[17]. Presently, almost all foreign banks present in GIFT City have set up banking units in the form of branches.

3.1. Branches - IFSC Banking Units (IBU)

At GIFT City, both Indian and foreign banks (whether having a presence in India or not) are permitted to establish IBUs. An IBU can be set up only if the parent bank is duly regulated by its home regulator.[18] Under the Banking Regulations, foreign banks must obtain a license from IFSCA to set up an IBU.[19] To secure this license, applicants must meet the following criteria:

(i) Minimum capital requirement: The parent bank is required to provide a minimum capital of USD 20 million (Twenty) to its IBU, for the purposes of starting operations and for maintenance throughout the operation of the IBU.[20]

(ii) No-objection letter ("**NOC**"): An NOC from the parent bank's home regulator is necessary to establish an IBU in GIFT City.[21]

(iii) Undertaking: The parent bank must provide an undertaking to the IFSCA regarding the following:[22]

  (a) it shall provide liquidity to the IBU whenever needed;
  (b) it complies and shall continue to comply with its home regulator's prudential requirements;
  (c) it will share with the IFSCA reports pertaining to capital adequacy, liquidity risk and leverage ratio that it submits to its home regulator, within such time as may be specified by the IFSCA; and
  (d) in case of any anticipated or actual breach of any prudential requirements set by its home regulator, it shall notify the IFSCA forthwith.

Foreign banks can apply for the aforesaid license by filling an application form along with the requisite documents and fees with the IFSCA.[23] In considering the application of the parent bank, the IFSCA shall take into account various financial and non-financial parameters such as past business record, feasibility of business, etc. After considering the submissions made, the IFSCA may accept, reject or grant the opportunity to make further written submissions to the applicant. Apart from the aforesaid license, the parent bank is also required to obtain approval from the Special Economic Zone Authority.[24]

3.1.1. Permissible activities

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[17] FAQ no. 1 of FAQs for IFSC Banking business accessible at https://giftsez.com/documents/FAQs-GIFT%20City_IFSC_Banking_Unit(IBU).pdf
[18] Clause 5(iv) of 'Interpretation' chapter of the of the IFSCA Banking Handbook: General Directions – version 5.0 ("**IFSCA General Directions**").
[19] Regulation 3(1) of the Banking Regulations.
[20] Clause 3(i)(a) of Module 1 of the IFSCA General Directions.
[21] Regulation 3(3)(b) of the Banking Regulations.
[22] Clause 3(i)(b) of Module 1 of the IFSCA General Directions.
[23] A copy of the said form and the list of documents required is provided at Annexure I of Module 1 of the IFSCA General Directions and may be accessed at https://ifsca.gov.in/Viewer?Path=Document%2FLegal%2Fthe-ifsca-banking-handbook-gen-directions-v5-005042024051405.pdf
[24] Rule 17 of Special Economic Zones Rules, 2006.

IBUs in IFSC are authorized to engage in a diverse range of activities that enhance their operational capabilities and facilitate international banking services. These units amongst other activities can provide loans to individuals and corporates, engage in factoring and forfaiting services, undertake over-the-counter derivative contracts, operate as a foreign portfolio investor or as an eligible foreign investor, accept deposits, engage in equipment leasing and hire purchase, provide portfolio management services, investment advisory services, participate in authorised payment system, become a trading and clearing member in any derivatives segment of IFSCA recognised stock exchanges, become a bullion trading and clearing member in the IFSC, act as a custodian of assets or securities, undertake remittances, invest in securities issued outside IFSC, operate as an investment banker, engage in corporate and retail lending, participate in authorised payment system and offer payment services etc.[25] However, IBUs are specifically prohibited from effecting contracts of insurance.[26] An IBU shall conduct business in specified foreign currencies,[27] however, administrative expenses may be defrayed in Indian Rupees.[28]

3.1.2. Compliance requirements

The parent bank shall, prior to the commencement of the IBU's operations at IFSC, appoint a governing body of the IBU with at least 3 (Three) members and inform the IFSCA about the same in writing.[29] Apart from the governing body, there shall be a compliance officer who shall be an employee working out of IFSC and a senior officer designated by the parent bank who is engaged in compliance function at the head office of the parent bank as the 'HO Compliance contact' of its IBU.[30] An IBU should have a minimum of 5% (Five percent) of gross loans and advances directed toward green, social, sustainable or sustainability-linked sectors or facilities. The 5% (Five percent) target must be computed on incremental loans and advances in a financial year.[31] Further, while carrying out their activities, IBUs have to strictly adhere to the International Financial Services Centres Authority (Anti Money Laundering, Counter-Terrorist Financing and Know Your Customer) Guidelines, 2022[32] ("**IFSCA AML Guidelines**").

3.2. <u>Subsidiaries - IFSC Banking Company (IFSC BC)</u>

To set up an IFSC BC, the parent bank will have to satisfy the following requirements for grant of licence:

1. <u>Minimum capital requirements</u>: The parent bank shall provide necessary capital for the IFSC BC, subject to a minimum of USD 50 million (Fifty).[33]

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[25] Regulation 13 of the Banking Regulations read with Section 3 of the International Financial Services Centres Authority Act, 2019, Section 6 of the Banking Regulation Act, 1949 and Clause 4 of Module 1 of the IFSCA Banking Handbook on Conduct of Business Directions – version 6.0 ("**IFSCA Business Directions**").
[26] Clause 5 of Module 1 of the IFSCA Business Directions.
[27] US Dollar (USD), Euro (EUR), Japanese Yen (JPY), UK Pound Sterling (GBP), Canadian Dollar (CAD), Australian Dollar (AUD), Swiss Franc (CHF), Hong Kong Dollar (HKD), Singapore Dollar (SGD), UAE Dirham (AED), Russian Rouble (RUB), Swedish Krone (SEK), Norwegian Krone (NOK), New Zealand Dollar (NZD) and Danish Krone (DKK).
[28] Regulation 17 of the Banking Regulations.
[29] Clause 3 of Module 2 of the IFSCA General Directions.
[30] Clause 9(iii) and 9(v) of Module 2 of the IFSCA General Directions.
[31] 'Guidance framework on Sustainable and Sustainability linked lending by financial institutions', Circular no. F. No 584/ IFSCA/Sustainable Finance- LF/2022-23/001 issued by IFSCA on April 26, 2022.
[32] Clause 6 of Module 1 of the IFSCA Business Directions.
[33] Regulation 3(3A)(a) of the Banking Regulations.

2. NOC: The parent bank shall obtain an NOC from its home regulator regarding setting up of the banking unit in the IFSC as a subsidiary company of the parent bank.[34]

   Further, a parent bank which has already set up an IBU in an IFSC, may be permitted to convert the same to an IFSC BC, with the prior approval of the IFSCA.

3.2.1. Permitted activities

As per the Banking Regulations, the kind of activities that a parent bank is permitted to undertake through an IFSC BC are similar to those permissible through an IBU.

3.2.2. Compliance requirements

An IFSC BC is required to maintain liquidity coverage ratio net stable funding ratio and comply with other prudential norms as may be specified by the IFSCA.[35] Further, the following compliance requirements of an IFSC BC are similar to those of an IBU: (a) ensuring compliance with the IFSCA AML Guidelines; and (b) conducting business in specified foreign currencies.

Though IFSC BCs are governed under the overall framework set by the Banking Regulations, the IFSCA has not yet issued any operational guidelines for an IFSC BC. As a result, additional regulations and guidelines for IFSC BCs are awaited to ensure clarity in its operational framework and compliance requirements.

3.3. Representative Office and Global Administrative Office

Apart from the aforesaid banking units, the parent bank may also establish a Representative Office ("**RO**") or a Global Administrative Office ("**GAO**") in IFSC.[36] Both entities serve distinct functions within the framework of IFSC:

1. RO: An RO of a parent bank can undertake 'marketing activities' pertaining to financial services or financial products offered in a jurisdiction outside the IFSC by a 'related party',[37] such as providing information and conducting promotional events about financial services or products offered by its head office or a group member outside IFSC. The RO may also: (a) be the point of contact and source of information about its head office; and (b) report to the head office on matters such as business trends, business opportunities and developments. If the applicant parent bank is duly regulated in its home jurisdiction, complies with anti-money laundering guidelines in its home jurisdiction and has obtained an NOC from its home regulator[38] then it may file an application with the IFSCA for opening an RO. Currently, only the New Development Bank has established an RO at GIFT City.

2. GAO: A GAO of a parent bank can perform the following functions: (a) managing, administering, or coordinating the operations of the parent bank or any of the group entities either in IFSC or outside IFSC; (b) providing support services to parent bank or any of the group entities. The application process for opening a GAO in IFSC is similar to the application process of an RO.

[34] Regulation 3(3A)(b) of the Banking Regulations.
[35] Regulation 5 of the Banking Regulations.
[36] Clause 3(9) of the Banking Regulations.
[37] The term "related party" under Clause 6 of Module 12 of the IFSCA Business Directions means "*the head office, another branch of the head office or a group member of the parent bank*."
[38] Clause 3 of Module 12 of the IFSCA Business Directions.

4. CONCLUSION

In conclusion, GIFT City presents a compelling opportunity for foreign banks seeking to establish or expand their presence in India's rapidly evolving financial landscape. Foreign banks can benefit from a range of advantages highlighted above, including state-of-the-art infrastructure, substantial tax incentives that enhance profitability, introduction of synthetic securitization measures and plans for time dollar settlement further diversify the options available for dealing in foreign currencies, while the deemed foreign jurisdiction status offers a favourable regulatory environment. The regulatory framework governing IBUs, IFSC BCs, ROs, and GAOs ensures that foreign banks can operate efficiently while adhering to international standards. This supportive environment fosters growth and innovation, making GIFT City a strategic choice for foreign banks.

As GIFT City continues to develop and attract global financial institutions, it stands poised to become a key player in the international banking arena. The vibrant financial ecosystem positions GIFT City as a prime destination for foreign banks aiming to capitalize on the vast opportunities presented by India's dynamic market.

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