Executive summary

The International Financial Services Centres Authority (IFSCA)\textsuperscript{1} has issued the International Financial Services Centres Authority (Banking) Regulations, 2020 (Regulations)\textsuperscript{2} dated 18 November 2020 to provide a framework for banking and investment activities in an International Financial Services Centre (IFSC) in India.

The Regulations have come into force from 18 November 2020.

This alert summarizes key aspects of the Regulations.

\textsuperscript{1} IFSCA is a regulatory authority established under the International Financial Services Centres Authority Act, 2019 for regulating financial institutions, financial services and financial products in an IFSC in India.

\textsuperscript{2} IFSCA/2020-21/GN/REG004
Background

- The Reserve Bank of India (RBI) had issued the Foreign Exchange Management (International Financial Services Centre) Regulations, 2015 vide Notification \(^3\) dated 2 March 2015 prescribing regulations relating to financial institutions set-up in an International Financial Services Centre (IFSC). Subsequently, the RBI prescribed a Scheme \(^4\) on 1 April 2015 (Scheme) outlining the regulatory and supervisory framework for setting-up of IFSC Banking Units (IBU) by Indian Banks and Foreign Banks already having presence in India in an IFSC.

- The IFSCA \(^5\) has now vide Notification \(^2\) dated 18 November 2020 issued the International Financial Services Centres Authority (Banking) Regulations, 2020 (Regulations) to provide a framework for banking and investment activities in the IFSC. The Regulations have come into force from 18 November 2020.

- This alert summarizes the key Regulations and highlights key points of distinction between the Regulations and the Scheme.

**Requirement of licence to set-up a Banking Unit (BU)**

- Indian Banks \(^6\) and Foreign Banks \(^7\) (collectively referred to as Parent Bank) can obtain licence from the IFSCA to set-up a BU in an IFSC.

Unlike under the Scheme, even Foreign Banks not having existing presence in India have been permitted to set-up a BU in the IFSC. The Regulations mentions additional conditions to apply to such Foreign Banks which shall be specified.

- The Application for approval of the IFSCA to set up a banking unit in the IFSC shall be made by the Parent Bank in the form and manner (yet to be) prescribed by the IFSCA.

- An Applicant shall satisfy the following requirements:
  - The Parent Bank shall provide a minimum capital of USD 20 Mn (or equivalent in any foreign currency) or such amount specified by the IFSCA, to its BU, for the purpose of starting operations, that shall be maintained on an unimpaired basis, at all times;
  - The Parent Bank shall obtain a No Objection Letter from its home regulator regarding setting-up of the BU in the IFSC;
  - The Parent Bank shall submit an undertaking that it shall provide liquidity to its BU whenever needed for the operations of the BU.

Under the Scheme, the minimum prescribed regulatory capital, including for the exposures of the BU, was required to be maintained on an on-going basis at the parent level. This requirement is not presently prescribed under the Regulations, though one expects that this will be appropriately dealt with, shortly.

- As an alternative to a branch presence, Representative Offices shall be allowed to be set-up in the IFSC, subject to conditions as may be prescribed by the IFSCA.

The Scheme did not provide for setting-up a Representative Office in the IFSC. This alternative form of presence has been allowed under the Regulations.

**Prudential Regulatory requirements**

**General prudential requirements**

- A BU shall adhere to the norms/ guidelines prescribed by the IFSCA from time-to-time.

- The IBU shall also comply with the directions and instructions issued by the RBI as applicable for RBI approved IBUs, unless otherwise specified by the IFSCA.

**Liquidity ratios**

- A BU shall maintain the Liquidity Coverage Ratio (LCR). However, LCR may be maintained by the Parent Bank with approval from the IFSCA.

(amongst other prescribed regulators) relating to regulating financial products, financial services and financial institutions in an IFSC are subsumed with the IFSCA.

Indian Bank means any bank incorporated or established under any Act and includes a wholly owned subsidiary of a foreign bank incorporated in India but does not include a co-operative bank.

Foreign Bank means a banking company incorporated or established outside India.

---

\(^3\) Notification No. FEMA.339/2015-RB dated 2 March 2015


\(^5\) IFSCA is a unified regulator appointed by the Government to develop and regulate financial products, financial services and financial institutions in an IFSC. Effective from 1 October 2020, powers of the RBI, the Securities and Exchange Board of India and the Insurance Regulatory and Development Authority of India relating to regulating financial products, financial services and financial institutions in an IFSC are subsumed with the IFSCA.

\(^6\) Indian Bank means any bank incorporated or established under any Act and includes a wholly owned subsidiary of a foreign bank incorporated in India but does not include a co-operative bank.

\(^7\) Foreign Bank means a banking company incorporated or established outside India.
Under the Scheme, LCR was required to be maintained by the IBU on a stand-alone basis. The Regulations grant relaxation as the LCR requirements may be maintained at the Parent Bank level.

Net Stable Funding Ratio (NSFR) shall be applicable and maintained by the BU as and when determined by the IFSCA. However, NSFR may be maintained by the Parent Bank with an approval from the IFSCA.

Unlike the Scheme, the Regulations grant relaxation that the NSFR requirements may be maintained at the Parent Bank level.

Leverage Ratio

A BU shall adhere to the norms/ guidelines relating to leverage ratio as may be specified by the IFSCA.

Under the Scheme, no specific guidance was provided on maintenance of leverage ratio.

Exposure Ceiling

A BU shall be subject to an exposure ceiling of 5% of the Parent Bank’s Tier 1 capital in case of a single borrower and 10% percent of Parent Bank’s Tier 1 capital in the case of a borrower group.

Reserve requirements

The liabilities of a BU, other than the deposits raised from Qualified Individuals and Qualified Resident Individuals, shall be exempt from Cash Reserve Ratio (CRR) or other such requirements.

Deposits raised from Qualified Individuals and Qualified Resident Individuals shall be subject to such reserve ratios as specified by the IFSCA.

Under the Scheme, liabilities of the BUs were exempt from CRR and Statutory Liquidity Ratio requirements of the RBI. This is because the Scheme did not contemplate a BU doing retail business. Though retail business is presently also, not permitted, we understand that allowing a BU to also do limited retail business is being actively considered.

Permissible activities

Currency

A BU shall conduct business in freely convertible foreign currencies and with such persons, resident or otherwise, as may be specified by the IFSCA.

A BU may be permitted to conduct business in Indian Rupee (INR) with such persons, resident or otherwise, as may be specified by the IFSCA, subject to settlement of the financial transaction in relation to such business in freely convertible foreign currency.

Foreign currency accounts

The following persons are permitted to open, hold and maintain foreign currency accounts with a BU:

- Qualified Individuals.
- Persons resident outside/ in India being corporate or institutional entities, in the manner as may be specified by the IFSCA.
- Qualified Resident Individuals are permitted to open, hold and maintain accounts in a freely convertible foreign currency, with a BU, for undertaking any permissible current or capital account transaction or a combination of both as specified in the Liberalised Remittance Scheme of the RBI.

Transactions through foreign currency accounts

Cash transactions in foreign currency accounts shall not be permitted.

An account in a freely convertible foreign currency may be opened, held and maintained with a BU, subject to conditions as may be specified by the IFSCA:

- Individual account holder - in the form of current/ savings/ term deposit
- Other cases - in the form of current or term deposit.

Lender of Last Resort

Lender of Last Resort support shall not be available to a BU.

---

8 Qualified Individual means an individual who is a person resident outside India having a minimum net worth of USD 1 Mn/ equivalent in the preceding financial year, determined in a manner as specified by the IFSCA.

9 Qualified Resident Individual means an individual who is a person resident in India having a minimum net worth of USD 1 Mn/ equivalent in the preceding financial year, determined in a manner as specified by the IFSCA.
Permitted activities

A BU may undertake the following activities, subject to compliance with conditions/guidelines as may be specified by the IFSCA:

► Lend in the form of loans, trade finances and acceptances, commitments and guarantees, carry out credit enhancement, credit insurance, and sale and purchase of portfolios;

► Undertake inter-bank borrowings and lending;

► Undertake investments, including subscribing, acquiring, holding, underwriting or transferring securities or such other instruments, as may be specified by the IFSCA, as principal or agent;

► Extend post-shipment export credit in foreign currency, or engage in factoring and forfaiting of export receivables, subject to the guidelines specified by the IFSCA;

► Undertake equipment leasing, including aircraft leasing;

► Participate in derivative transactions:
  - enter into over the counter derivative contracts for its asset liability management requirements;
  - undertake over the counter derivative contracts for its own account or for its corporate or Qualified individual clients;
  - transact in interest rate and currency derivatives in INR, with settlement in foreign currency, listed on a stock exchange recognized by the IFSCA;
  - undertake derivative or forward contracts in gold for hedging its gold investments; and
  - offer non-deliverable currency contracts involving INR, or otherwise, to persons resident outside India and banks in India having presence in the IFSC.

► Operate as a Foreign Portfolio Investor (FPI):
  - if the Parent Bank is registered with the Securities and Exchange Board of India (SEBI) as an FPI, the BU may carry on activities as an FPI in the IFSC without any separate registration but subject to filing an intimation with the IFSCA in the specified form;
  - if the Parent Bank is not registered with the SEBI, the BU, on registration with the IFSCA can carry on activities as an FPI in the IFSC;
  - such an FPI may offer Segregated Nominee Account Structure\(^\text{10}\) for routing orders of foreign investors.

► Function as a trading member for trading in interest rate or currency derivatives or as a professional clearing member for clearing and settlements in any derivative segment.

It appears that the activities permitted to be undertaken by a BU under the Regulations are more prescriptive and wider in comparison to the Scheme – i.e. investing through the FPI route, undertake equipment leasing, undertake investments, etc.

Know Your Customer (KYC) and Anti-Money Laundering

► A BU shall follow KYC norms, combating of financing of terrorism and other anti-money laundering requirements, including reporting requirements issued by the RBI, unless otherwise specified by the IFSCA.

Operational requirements

Reporting requirements

► A BU shall be required to furnish information in (yet to be) specified manner relating to their operations to the IFSCA, from time-to-time.

► The report shall be submitted in US Dollars, unless otherwise specified by the IFSCA.

Maintenance of books of accounts, records and documents

► A BU shall maintain its books of accounts, records and documents in such freely convertible foreign currency, as may be declared at the time of making an application to the IFSCA.

Maintenance of accounts

► A BU shall be permitted to have an INR account to defray their administrative/statutory expenses/for such other purposes as may be specified by the IFSCA.

► A BU shall maintain separate nostro accounts

---

\(^{10}\) SEBI through its circular SEBI/HO/MRD/DRMNP/CIR/P/2018/83 dated 24 May 2018 permitted Segregated Nominee Account Structure in IFSC, wherein orders of Foreign Investors may be routed through eligible Segregated Nominee Account Providers.
with correspondent banks, distinct from nostro accounts maintained by other branches of the same Parent Bank in India.

**Deposit insurance**

▶ There shall be no centralised deposit insurance scheme for deposits of a BU.

**Netting arrangement**

▶ A BU may exchange margins in a freely convertible currency or permissible listed debt securities and sovereigns with a counter party BU or overseas regulated entity for non-centrally cleared over the counter currency, interest rate, credit and commodity derivative contracts to reflect mark to market exposure under a legally enforceable netting arrangement as may be specified by the IFSCA.

**Other aspects**

▶ From the commencement of the Regulations, the provisions of the Scheme, shall no longer be applicable.

▶ A BU operating in the IFSC prior to the notification of the Regulations, shall comply with additional requirements, introduced by the Regulations, within a period of three months from the date of notification of these Regulations/ within such extended time as permitted by the IFSCA.

---

**Comments**

The Regulations on functioning of banks in an IFSC have replaced the existing framework issued by the RBI.

Besides undertaking banking activities, the Regulations seek to expand the list of ‘permissible activities’ of the BUs to include investment activities including investing under the Foreign Portfolio Route in India. Additionally, the ability of maintaining LCR and NSFR at the Parent Bank level and providing BUs access to capital from resident and non-resident individuals are welcome moves and in line with the recommendations specified in the Committee Report of the IFSC International Retail Business Development Committee.

From a direct tax perspective, income of eligible units in an IFSC from its approved business shall be entitled to a deduction of 100% of such income for any 10 consecutive years [at the taxpayer’s option], out of 15 years, beginning from the year in which permission under relevant laws are obtained (subject to the levy of a Minimum Alternate Tax (MAT) at 9%). Further, being in the Special Economic Zone, the BUs would also be eligible to certain indirect tax benefits/ concessions.
Our offices

Ahmedabad
22nd Floor, B Wing, Privilon, Ambli BRT Road, Behind Iskcon Temple, Off SG Highway, Ahmedabad - 380 015
Tel: +91 79 6608 3800

Bengaluru
6th, 12th & 13th floor “UB City”, Canberra Block No.24 Vital Mallaya Road Bengaluru - 560 001
Tel: +91 80 6727 5000

Ground Floor, ‘A’ wing Divyasree Chambers #11, O’Shaughnessy Road Langford Gardens Bengaluru - 560 025
Tel: +91 80 6727 5000

Chandigarh
Elante offices, Unit No. B-613 & 614 6th Floor, Plot No.- 178-178A, Industrial & Business Park, Phase-I, Chandigarh - 160002
Tel: +91 172 671 7800

Chennai
Tidel Park, 6th & 7th Floor A Block, No.4, Rajiv Gandhi Salai Taramani, Chennai - 600 113
Tel: +91 44 6654 8100

Delhi NCR
Golf View Corporate Tower B Sector 42, Sector Road Gurgoan - 122 002
Tel: +91 124 443 4000

3rd & 6th Floor, Worldmark-1 IGI Airport Hospitality District Aerocity, New Delhi - 110 037
Tel: +91 11 4731 8000

Pune
C-401, 4th floor Panchshil Tech Park Yerwada (Near Don Bosco School) Pune - 411 006
Tel: +91 20 4912 6000

Hyderabad
THE SKYVIEW 10 18th Floor, “Zone A” Survey No 83/1, Raidurgam Hyderabad - 500032
Tel: +91 40 6736 2000

J amshedpur
1st Floor, Shantiniketan Building Holding No. 1, SB Shop Area Bistupur, J amshedpur - 831 001
Tel: +91 657 663 1000

Kochi
9th Floor, ABAD Nucleus NH-49, Maradu PO Kochi - 682 304
Tel: +91 484 433 4000

Kolkata
22 Camac Street 3rd Floor, Block ‘C’ Kolkata - 700 016
Tel: +91 33 6615 3400

Mumbai
14th Floor, The Ruby 29 Senapati Bapat Marg Dadar (W), Mumbai - 400 028
Tel: +91 22 6192 0000

5th Floor, Block B-2 Nirton Knowledge Park Off. Western Express Highway Goregaon (E) Mumbai - 400 063
Tel: +91 22 6192 0000

Download the EY India Tax Insights App

Ernst & Young LLP

EY | Assurance | Tax | Strategy and Transactions | Consulting

About EY

EY is a global leader in assurance, tax, strategy, transaction and consulting services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. For more information about our organization, please visit ey.com.

Ernst & Young LLP is one of the Indian client serving member firms of EYGM Limited. For more information about our organization, please visit www.ey.com/en_in.

Ernst & Young LLP is a Limited Liability Partnership, registered under the Limited Liability Partnership Act, 2008 in India, having its registered office at 22 Camac Street, 3rd Floor, Block C, Kolkata – 700016
© 2020 Ernst & Young LLP. Published in India.
All Rights Reserved.
ED None

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.