

LAW & POLICY UPDATE

BANKING & FINANCE



International Financial Services Centres Authority (Finance Company) Regulations, 2021

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The International Financial Services Centres Authority (IFSCA)¹ has issued the International Financial Services Centres Authority (Finance Company) Regulations, 2021 (**Regulations**) dated March 25, 2021 to provide a framework for finance companies in an International Financial Services Centre (IFSC) in India. The Regulations are aimed at providing a competitive regulatory environment to non-banking financial institutions to complement the role of banking in providing finance, innovative products and services from the IFSC.

Salient features of the Regulations

A Finance Company (FC) or a Finance Unit (FU) can commence business after obtaining the certificate of registration from IFSCA. FCs and FUs are defined as financial institutions under Section 3(1)(c) of the International Financial Services Centres Authority Act, 2019. Whilst a FC can be set up as a separate incorporated entity, a FU is set up as a branch as permitted under the Regulations to deal in one or more of the permissible activities specified under regulation 5(1) of the Regulations, provided that:

- They do not accept public deposit from resident/non-resident as defined under the Regulations
- They are not registered with IFSCA as a Banking Unit²

Setting up of FC or FU

The FC can be set up either as a subsidiary, a JV or as a newly incorporated company under the Companies Act, 2013. Entities set-up as limited liability partnership or trust intending to carry out either one or more non-core activities as mentioned in the Regulations are also eligible to apply. Further, if an investing entity in an FC is carrying out a regulated financial activity in its home jurisdiction, it shall obtain a no-objection certificate from its home country regulator for setting up a FC in the IFSCs.

A FU can be set up if the investing entity or the ultimate parent of the investing entity is carrying out a regulated financial activity in its home jurisdiction and has obtained the no-objection certificate from the home country regulator for setting up a FU in the IFSCs.

An entity seeking registration under the Regulations needs to inter alia fulfil the following conditions:

- In case the applicant is seeking registration as a FC, it shall have and maintain minimum owned fund, depending on the activity proposed to be undertaken by it, OR in case the applicant is seeking registration as a FU, its parent shall provide and maintain minimum owned fund, on unimpaired basis at all times, depending on the activity proposed to be undertaken by the FU, as specified in Schedule of the Regulations, or such other higher amount as may be specified by the IFSCA

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.

² 'Banking Unit' means a financial institution under clause Section 3 (1) (c) of the Act that is licensed by the Authority to undertake permissible activities under International Financial Services Centres Authority (Banking) Regulations, 2020.

- The FC/FU or its promoters, seeking registration, shall be from a Financial Action Task Force (**FATF**) compliant jurisdiction and comply with international standards set by the FATF to combat money laundering and terrorist financing

Prudential regulatory requirements

The FC/FU will be required to adhere to the prudential norms prescribed by the IFSCA. Some of the prudential norms to be complied with are:

- Capital Ratio
- Liquidity Coverage Ratio
- Exposure Ceiling

Permissible activities

- The permissible activities for FC/FU are divided in three broad categories: (i) Specialised activities, (ii) Core activities, and (iii) Non-core activities, which have been listed under Chapter IV of the Regulations
- The FC/FU intending to undertake aircraft lease transactions shall be in conformity to the Cape Town Convention and Protocol
- The FC/FU intending to undertake either a single or a combination of non-core activities, shall fulfil the following conditions:
 - It shall carry out each such activity through separately identifiable department (**SID**)
 - It shall ensure a fire wall between various non-core activities so that no conflict of interest situation arises
 - It shall formulate Board approved grievance redressal and customer compensation policy to deal with such complaints
- The FC/FU may undertake transactions in financial products and financial services as part of permissible activities with both residents and non-residents, subject to compliance of the provisions of Foreign Exchange Management Act, 1999
- The FC/FU carrying out non-core activities may also undertake derivative transactions only for the purpose of hedging their underlying exposures
- The FC/FU shall not undertake or fund any speculative transaction
- The source of funds for FC/FU shall be from residents and non-residents, subject to compliance of the provisions of Foreign Exchange Management Act, 1999

Other compliances

- An FC/FU shall carry out its operations in a freely convertible foreign currency. However, FC/ FU may be permitted to conduct such business, transactions denominated in Indian National Rupee (**INR**) as may be specified by the IFSCA, subject to settlement of those business transactions in freely convertible foreign currency.
- An FC/ FU shall be permitted to have an INR account out of the freely convertible foreign currency to settle their administrative and statutory expenses and for such other purposes as may be specified by the IFSCA.
- Any mergers, acquisitions, takeovers or change in management of a FC, which results in its change in control of at least 20% of total share capital, or of business decisions under an agreement, shall be subject to prior approval and such other requirements as may be specified by the IFSCA. Further, any mergers, acquisitions, takeovers or change in management in the parent of a FU shall be intimated to the IFSCA within a period of 15 days from the date of such event.
- Every FC/FU will follow the know your customer guidelines as specified for Banking Unit in IFSCs.
- Every FC/FU shall adhere to the guidelines on corporate governance and disclosure requirements to be specified by the IFSCA.
- Every FC/FU shall furnish information relating to its operations to the IFSC, in such manner, interval and form, as may be specified by the IFSCA. All such reporting shall be in US Dollar, unless otherwise specified by the IFSCA.

Conclusion

The Regulations on functioning of finance companies in an IFSC are aimed at further strengthening the financial ecosystem in the IFSC by promoting participation of non-banking financial institutions alongside the banking units and provide opportunities to non-banking financial institutions to set up units in the IFSC to undertake a wide range of financial services related activities (including, among others, aircraft / ship leasing). Further, The Regulations seeks to expand the list of 'permissible activities' of the finance companies to include several non-core activities which are connected to the financing activities. Additionally, the ability of maintaining LCR/ prudential norms at the Parent level should provide operational flexibility to the finance companies.

