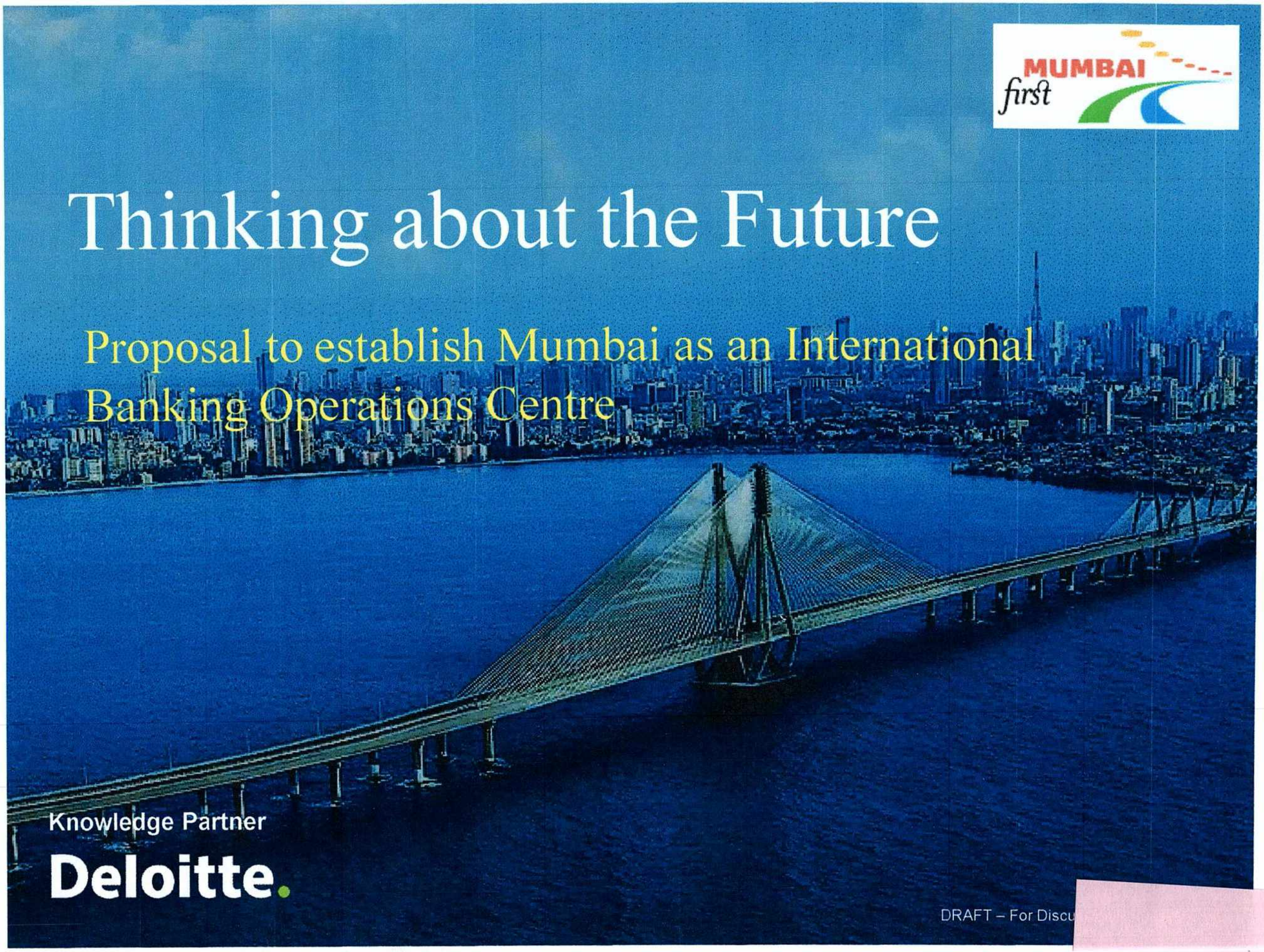

MUMBAI first
Thinking about the Future
Proposal to establish Mumbai as an International Banking Operations Centre
Knowledge Partner
Deloitte.
DRAFT – For Discu

IBOC – Phase I of International Financial Center

- High Powered Expert Committee on Making Mumbai an International Financial Centre introduced the term "International Financial Centre (IFC)" in Indian context in its Report published in 2007
- As per the said report IFC describes 11 activities including:
  - Fund raising,
  - Asset Management and Global Portfolio Diversification,
  - Personal Wealth Management,
  - Global Transfer Pricing & Tax Management,
  - Global / Regional Exchange Trading of Financial Securities,
  - Commodities and Derivatives Contracts in Financial Instruments/ Indices and in Commodities,
  - Global / Regional Mergers and Acquisitions Activity etc.
- IBOC is presented as a first phase of IFC – considering the restricted scope of activities as compared to diverse array of activities of IFC
- Restricted scope has the following objective:
  - Easy to implement and does not require significant legislative changes.

What is an International Banking Operations Center?

- An exclusive operation focused on international banking operations (IBO) with its own set of regulatory and supervisory controls with dedicated IT systems and staff members
- Are usually found in metropolitan area with a high concentration of Banking institutions
- Centralized place for financial transactions for the Nation, Region or World
- Financial market with all financial services and related support service providers e.g. legal, accounting, banking professional, healthcare, logistics, quality of life factors, etc.

Banking Operations Centers – Models

- Trade related centre - and development of associated services – free movement of capital and financial services including for domestic requirements, centre of markets
  - London
  - Hong Kong
  - Singapore
  - New York
  - Tokyo
- Channeling funds to other countries (offshore model)
  - Mauritius
  - Cayman, Bahrain , Jersey, British Virgin Islands etc.

For Mumbai, the first model is proposed

Clustering

- Clustering is a natural phenomenon seen across different sectors
  - Silicon Valley, Bangalore for software
  - Surat for diamonds
  - Ahmedabad, Coimbatore for textiles
- Clustering is the Key driving force behind Banking Centres
  - Increases Sophistication
  - Builds Competence
  - Improves Competitiveness
- While our proposition for an International Banking Operations Centre in Mumbai is location-agnostic, activities will tend to cluster within Mumbai

Advantage Mumbai

- Specifically, Mumbai can emerge as an IBOC based on its unique value proposition

  1. The city accounts for a significant share in deposits mobilization and deployment of credit of scheduled commercial banks.
  2. Mumbai's presence is large amongst Indian cities in the money market, debt market and in foreign exchange transactions
     - BSE & NSE account for over 70% of equity trading volume
     - By value, over 90% of Merchant Banking Transactions happen in Mumbai
  3. Presence of large number of financial market players such as foreign institutional investors, lending institutions, brokerage firms make Mumbai a natural choice for an IBOC.
     - 80% of MFs are registered in Mumbai
  4. Mumbai is the headquarter to regulatory bodies such as RBI, SEBI as well as the countries largest banks and financial institutions etc.
  5. Largest number of cheques cleared, 10 times more than the next highest city, indicating the amount of transactions being routed through Mumbai

Core Proposition and Key Service Offering

1. An exclusive operation focused on international banking operations (IBO) with its own set of regulatory and supervisory controls with dedicated IT systems and staff members;
2. The International Banking Operations Centre (IBOC) will be ring fenced from the domestic banking & financial operations and therefore no domestic laws, regulations need to significantly change within the country;
3. The IBOC will enable the banks and corporates through the banks an easy route to raise & deploy bulk foreign exchange directly from within the country, the capacity for which is lacking currently
4. Out of the range of services offered by "International Finance Centers," as set out in the **Report of the High Powered Expert Committee on Making Mumbai an International Financial Centre,** IBOC can begin immediately by focusing on:
    - Fund Raising – Funding in international convertible currencies will be handled out of the IBOC for companies interested in inbound or outbound investing anywhere in the world
    - Global/Regional Corporate & Financial Sector Treasury Management Operations
    - Regional risk management operations – Focus on asset-liability duration matching, risk management of derivative products for interest rates, swaps, currency and traded derivatives.
    - Regional trading of foreign currency and international securities – Management of derivative contracts on international exchanges
    - Financial Engineering and Architecture for Large Complex Projects
5. Offshore Banking Units with restricted operating licenses for these operations to be given to reputed International & Indian banks based on criteria common to other International Financial Centers (such as New York, London, Hong Kong & Singapore) e.g. capital adequacy requirements

Benefits of the International Banking Operations Centre

- Employment generation potential

  Large direct and indirect employment potential arising from the financial sector firms as well as secondary effects are expected on related industries such as telecom, IT, law, accountancy, hospitality, travel, tourism & related industries and various support services etc. with job opportunities at all levels

  The IBOC offers a large employment potential both direct and indirect arising from growth and expansion of financial sector organizations. For example financial sector jobs grew 28% in Singapore between 1983-96 and accounted for close to 39% of jobs in 2003.

- Will have a spin-off effect in further improving IT and Telecom infrastructure growth, which has a symbiotic relation with the financial sector.

- Cheaper and Increased capital flows for domestic investments

  - Funds from expatriates, HNI

- Increased direct and indirect tax revenue potential for the local bodies and the State.

- Greater opportunities for arranging international finance even for medium sized local banks consistent with prevailing RBI regulations.

Opportunity Lost for Indian Banks if we do not act now

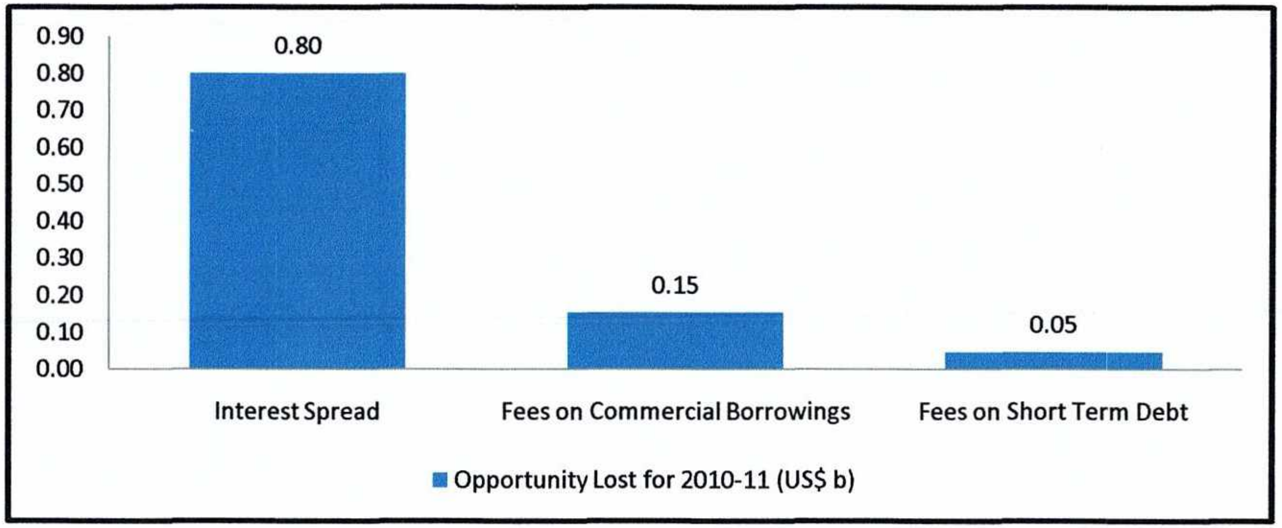
Current position & future estimates of India's external debt

Particulars	Commercial Borrowings (USD Billion)	Short Term Debt (USD Billion)	Total Stock of Debt (USD Billion)
Total outstanding debt as on 31/03/2011	80	54	134
Assumed stock of debt booked in India (1/3rd for Commercial Borrowings & 1/4th for Short Term Debt)	27	13	40
Estimated income booking opportunity lost for the year 2010-11 (Interest spread @ 200 BP)	0.54	0.26	0.80 [A]
Compounded annual growth rate considered for future projections			20%
Estimates of outstanding stock of debt as on 31/03/2020			691
Estimated income booking opportunity loss cumulatively over the period 2011-2020			20.80 [X]

Current position & future estimates of India's foreign exchange gross inflows

Particulars	Commercial Borrowings (USD Billion)	Short Term Debt (USD Billion)	Gross forex inflows (USD Billion)
Gross foreign exchange inflows during 2010-11	23	76	99
Assumed gross foreign exchange inflows booked in India (1/3rd for Commercial Borrowings & 1/4th for Short Term Debt)	8	18	27
Estimated income booking opportunity lost for the year 2010-11 (Fees for Commercial Borrowings @ 200BP & for Short Term Debt @ 25BP)	0.15 [B]	0.05 [C]	0.20
Compounded annual growth rate considered for future projections	35%	40%	
Estimates of cumulative gross inflows into India over the period 2011-2020	1,256	5,306	
Estimated income booking opportunity loss cumulatively over the period 2011-2020	8.40 [Y]	3.30 [Z]	11.70

Opportunity Lost for Indian Banks if we do not act now



- Opportunity lost already during 2010-11 in the absence of IBOC amounts to US$ 1b [A + B + C]
- Expected opportunity lost during the decade of 2011-2020 to be US$ 32.5 b [X + Y + Z]
- In addition, fees on other foreign exchange transactions such as currency conversion, currency swaps, derivatives trading etc. will create powerful revenue streams booked by players in this centre.
- Income generation on ancillary activities such as accounting and law will lead to employment, enhancement of skill sets and revenue generation within the domestic economy.

Action Points

Government of Maharashtra

- Key Initiatives to prevent dispersion to other centres
  - Rationalize stamp duty to a level to maintain parity with competing jurisdictions

Ministry of Finance and RBI

- Rationalize legislation relating to Banking services
- Review tax regime- low tax levels to make IBOC competitive
- Withholding tax on IBOC loans & deposits at levels with competing jurisdictions

RBI: Light Regulations

- Amendment of certain regulations issued under FEMA, 1999 to define and refer to the term "IBOC"
- Relaxation of CRR requirements for IBOC
- Amendment to the BR Act, 1949 to (a)specify permissible business, and (b) issue notification in respect of certain sections to achieve parity with competing jurisdictions

Legislative and Executive Actions

Executive Actions

- RBI action under FEMA:
  - Amendments to Foreign Exchange Management (Foreign Currency Accounts by a Person Resident in India) Regulations, 2000 with respect to regulation 2 to define the term "IBOC Unit" and regulations 4 & 5 (1) to include the term "IBOC Unit"
  - Amendment to Regulation 8 (1) of the Foreign Exchange Management (Deposit) Regulations, 2000
- RBI action under the Reserve Bank of India Act, 1934 to exempt the requirement of maintaining of CRR to maintain parity with competing jurisdictions
- RBI action under the Banking Regulation Act, 1949 to specify the permissible business and notification in respect of sections 11, 12, 17, 18, 21, 24 and 25 to achieve parity with competing jurisdictions
- Maharashtra State Government to issue notifications under the Bombay Stamp Act, 1958 to bring stamp duties on financial instruments involved to a level **to maintain parity with** competing jurisdictions
- Central Government to issue notifications under the Indian Stamp Act, 1899 to bring stamp duties on financial instruments involved to a level **to maintain parity with** competing jurisdictions

Legislative Actions

- Central Government to amend the Income Tax Act, 1961, to exempt all the income earned by an IBOC Unit from all taxes & levies so as to ensure that the income of an IBOC Unit is not treated disadvantageously to the treatment it would receive in competing jurisdiction

(Refer to slides 13 to 16 for detailed discussion on proposed changes in legal regime)

Proposed changes to be incorporated in the legal regime

Foreign Exchange Management (Foreign Currency Accounts by a Person Resident in India) Regulations, 2000

In regulation 2, add (iii a) as follows:

"IBOC Unit" means any banking company or its branch notified as such by the Central Government and holds an authorization issued under clause (a) of sub section (1) of Section 23 of the Banking Regulation Act, 1949 (10 of 1949);

Regulation 4 to be amended as follows:

A person resident in India may open, hold and maintain with an authorized dealer in India, or with an IBOC Unit a Foreign Currency Account to be known as Exchange Earner's Foreign Currency (EEFC) Account, subject to the terms and conditions of the Exchange Earners' Foreign Currency Account Scheme specified in the Schedule.

Clause 1 of Regulation 5 to be amended as follows:

A person resident in India may open, hold and maintain with an authorised dealer in India or with an IBOC Unit, a Foreign Currency Account, to be known as a Resident Foreign Currency (RFC) Account, out of foreign exchange

Foreign Exchange Management (Deposit) Regulations, 2000

Clause 1 of Regulation 8 to be amended as follows:

Subject to compliance with the conditions in regard to raising of external commercial borrowings or raising of resources through American Depository Receipts (ADRs) or Global Depository Receipts (GDRs), the funds so raised may, pending their utilization or repatriation to India, be held in deposits in foreign currency accounts with a bank outside India or with an IBOC Unit.

Proposed changes to be incorporated in the legal regime

The Banking Regulation Act, 1949 ("BR Act")

Section 6(1)(o) of the BR Act provides as follows:

"any other form of business which the Central Government may, by notification in the Official Gazette, specify as a form of business in which it is lawful for a banking company to engage."

Observations: If any of the activities of the IBOC Unit does not fall within the Section 6(1)(a) to 6(1)(n), the Central Government may notify such activities pursuant to Section 6(1)(o) of the BR Act.

Section 53 of the BR Act provides as follows:

"Power to exempt in certain cases. The Central Government may, on the recommendation of the Reserve Bank, declare, by notification in the Official Gazette, that any or all of the provisions of this Act shall not apply to any banking company or institution or to any class of banking companies either generally or for such period as may be specified."

Observations: Pursuant to the powers conferred by the BR Act, the Central Government may in consultation with and on the recommendation of the Department of Banking Operations and Development issue a notification exempting an IBOC Unit to comply with the following provisions of the BR Act or in the alternative the compliance with the following provisions, shall be not less favourable than comparable jurisdictions such as London, Hong Kong or Singapore:

The provisions of the BR Act are as follows:
Section 11: Requirement as to Minimum Paid-up Capital and Reserves;
Section 12: Regulation of Capital;
Section 18: Maintaining Cash Reserve;
Section 24: Maintenance of Assets; and
Section 17: Creation of Reserve Fund;
Section 21: Control over Advances;
Section 25: Assets in India; and

Such other provision as the Reserve Bank may deem fit such as provisions relating to 'Statutory Liquidity Ratio Investments'. Further, the prudential norms applicable to an IBOC Unit should not be less favourable than the competing jurisdictions mentioned above.

Proposed changes to be incorporated in the legal regime

The Reserve Bank of India Act, 1934 ("RBI Act")

If any of the "Scheduled Banks" desires to operate also an IBOC Unit, the Reserve Bank may by virtue of its powers provided in Section 42(7) of the RBI Act may either (a) exempt such IBOC Unit of such "Scheduled Banks" from the requirement of maintaining Cash Reserve Ratio ("CRR") as provided in Section 42 of the RBI Act; or (b) make the CRR requirement of the IBOC Unit of such "Scheduled Banks" no less favourable as compared to competing jurisdictions including with regard to directed /priority sector obligations, etc.

The Indian Stamp Act, 1899

Under Entry 91 of the Union List provided in the Seventh Schedule of the Constitution of India, the Central Government has the power to levy the stamp duty inter alia in respect of bills of exchange, cheques, promissory notes, letters of credit, proxies and receipts. Under Section 9 of the Indian Stamp Act, 1899, the Central Government has the power to reduce or remit duties on instruments under its administration by a rule or order published in the Official Gazette. The Central Government may issue an order to ensure that the stamp duty payable in respect of any and all instruments executed by an IBOC Unit, for conducting its ordinary business is comparable to the stamp duty payable in competing jurisdictions.

The Bombay Stamp Act, 1958

Similarly, the Maharashtra Government has the right to levy stamp duty on various instruments. Under Section 9 of the Bombay Stamp Act, 1958, the Maharashtra Government has the power to reduce or remit duties on instruments under its administration by a rule or order published in the Official Gazette. The Maharashtra Government may issue an order to ensure that the stamp duty payable in respect of any instrument executed by an IBOC Unit for conducting its ordinary business is comparable to the stamp duty payable in competing jurisdictions.

Proposed changes to be incorporated in the legal regime

The Income Tax Act, 1961

In order to ensure the success of the IBOC it would be imperative that all income earned by an IBOC Unit from all its operations is not treated disadvantageously to the treatment it would receive in competing jurisdiction and therefore all the income earned by an IBOC Unit from all its operations shall be made exempt from all taxes & levies; accordingly appropriate provisions may be introduced in the Income Tax Act, 1961 similar to the provisions as applicable to the units established in the Special Economic Zone.

Thank You