

Concept paper on finance SEZs: A welcome initiative

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An increasing amount of business in Indian rupee denominated financial products and other financial products dependent on the performance of the Indian economy is either being conducted offshore or is being shifted to offshore locations such as Singapore and Dubai. As business in these products not only creates jobs in the financial services sector but also in other sectors that benefit the local economy, successive Indian governments have recognized the importance of establishing an international finance centre in India on par with locations such as London and Singapore. The key reasons for conducting such business outside India – world class infrastructure, full capital account convertibility with ease of entry and exit for foreign investment, and efficient resolution of disputes – too have been recognized and given due weight.

A report in 2007 from a “high powered expert committee” constituted by the Ministry of Finance, headed by Percy Mistry, provided recommendations to make Mumbai an international finance centre. The report recommended the urgent reform of the Indian legal system, the consolidation of various financial laws, a unified financial regulator, and substantial opening up of the Indian financial market.

While the report’s recommendations are long-term rather immediate goals, establishing a special economic zone (SEZ) with liberalized financial laws and a comparatively more efficient financial system would be an acceptable medium-term solution. A concept paper on the establishment of finance SEZs, submitted by the National Institute of Public Finance and Policy to the Ministry of Finance, appears to have adopted this view. The ministry is seeking public comment on the concept paper, which it made available on 17 February 2015.

Key features

The concept paper identifies capital controls in India together with the prevailing financial regulation and taxation structures as the causes for the “hollowing out” of Indian financial markets, i.e. most of the global trading in India-related financial products takes place in locations like Singapore and Dubai. As a counter to this, and to improve Indian companies’ access to overseas funds and fund managers, the paper appears to suggest the establishment of a finance SEZ on a model similar to Hong Kong, where Hong Kong, through its established financial system, acts as a conduit for funds for Chinese companies and as a trading centre for securities issued by Chinese companies.

The concept paper explicitly recognizes that consumers of financial products in financial centres like Singapore not only buy financial products, but also “buy” the regulatory structure of such centres. Indeed, the urgent recast of India’s financial laws is one of the cornerstones of the paper. To this end, the paper proposes various measures such as: (a) bypassing the civil court system by establishing a chambers of professional arbitrators to adjudicate financial disputes; (b) modernizing existing courts or setting up new courts with jurisdiction over the finance SEZ to ensure efficient enforcement of arbitral awards; (c) exemption from capital control restrictions under India’s Foreign Exchange Management Act, 1999; and (d) introducing financial products such as certain types of options and exchange-traded derivatives, which are not currently allowed in India.

To further improve dispute resolution, the paper recommends establishing an arbitration centre in the finance SEZ on the lines of centres such as the Singapore International Arbitration Centre, and establishing a new regulatory

authority specifically for the finance SEZ to subsume the functions performed by financial sector regulators such as the Reserve Bank of India and the Securities and Exchange Board of India.

An important recommendation of the concept paper is rationalizing the taxation structure applicable to the finance SEZ. This includes exemption from securities transaction tax, commodities transaction tax and service tax, and the reduction of minimum alternate tax on units operating in the finance SEZ.

Conclusion

The establishment of a finance SEZ must be made a priority by the Indian government, as existing financial centres are already looking at the next evolutionary step. For instance, the European Commission has proposed a plan for streamlining rules applicable to financial markets that would be tantamount to a capital markets union – a move which would place London leagues ahead of other financial centres. Fortunately, news reports indicated that the India’s budget for 2015-16 was likely to contain measures to promote the establishment of finance SEZs, beginning with the Gujarat International Finance Tec-City in Ahmedabad.

The concept paper notes that a finance SEZ can be used as a test case to develop a model for the eventual implementation of a unified financial code on an all-India level, to replace all current financial legislation. This is an important proposal for recasting the Indian financial system to bring it at par with global financial markets, and should be sufficient incentive to implement the finance SEZ.

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