



International Financial Services Centres Authority

F.No.110/IFSCA/Banking Regulation/2020-21/7

December 24, 2020

To All Banking Units

Dear Sir/Madam,

Subject: Instructions and clarifications on circulars issued under the IFSC (Banking) Regulations, 2020

Banking Units (BUs) may please refer to the following circulars and directions, dated December 4, 2020, issued after notification of the IFSC (Banking) Regulations, 2020:

- a) IFSC (Banking) Regulation, 2020 – Directions for implementation
- b) OTC Derivatives at IFSCs
- c) IFSCA (Deposits) Directions, 2020
- d) Directions on business in foreign currency at IFSCs

2. Based on the queries/suggestions received from BUs it has been decided to issue the instructions and clarifications in the Annex to this circular.

3. These instructions and clarifications are to be read with the circulars and directions mentioned above. Instructions and clarifications which amend or extend the existing instructions have been cross referenced through footnotes to the above circulars and directions.

4. BUs are directed to ensure compliance with the provisions of this circular.

Yours faithfully

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1. Licensing requirement of existing BUs

BUs operating at IFSC on the date of issue of the circular “IFSC (Banking) Regulation, 2020 – Directions for implementation” (December 4, 2020) shall be deemed to have been licensed by the Authority and need not reapply for licensing. Parent banks of such BUs shall not be required, for the present, to submit an undertaking to the Authority for providing liquidity to its BU whenever needed. However, the Authority reserves the right to seek such an undertaking in future based on the operations of the BU and/or as a condition for permitting the BU to maintain LCR and/or NSFR at the parent bank level.

2. Offering services to domestic customers/market (e.g. Post shipment credit, Derivatives)

It is clarified that FEMA, 1999 (including regulations, directions etc. issued thereunder) is applicable to transactions between BUs (treated as person resident outside India) and a person resident in India. Therefore, while undertaking any transaction with residents, BUs will have to adhere to the directions issued by the Authority while also being aware of the directions issued by the Reserve Bank of India (RBI) pertaining to transactions that a person resident in India may undertake with a person resident outside India. This requirement has been emphasised in:

- (a) paras 9,10,11 & 12 of the circular “*IFSC (Banking) Regulation, 2020 – Directions for implementation*” (December 4, 2020)
- (b) para 7 of the of the circular on “*OTC Derivatives at IFSCs*” (December 4, 2020)
- (c) proviso to paras 7(i) and 7(ii) and para 8 of the “*Directions on business in foreign currency at International Financial Services Centres(IFSCs)*” (December 4,2020)

3. Applicability of domestic laws to IFSC

Unless specifically exempted, all domestic laws apply to IFSC. BUs may consider obtaining legal opinion on the applicability of specific laws to their business operations and activities in IFSC.

4. Permissible activities of BUs - Credit insurance backed lending, acting as FPI, Wealth Management products

- (a) Detailed directions on BUs acting as a Foreign Portfolio Investor shall be issued separately
- (b) BUs are allowed to avail Credit insurance for their lending operations out of IFSC. The Board of the parent bank of the BU or any duly approved committee may lay down the guidelines for the same.
- (c) Investment Advisory services and Wealth management services are not currently included in the list of permissible activities for BUs under the IFSCA (Banking) Regulations, 2020

5. Ombudsman for individual client complaints

The Banking Ombudsman Scheme, 2006 has been framed and notified by the Reserve Bank of India u/s 35A of the Banking Regulation Act, 1949. The scheme does not apply to the operations of foreign branches of Indian banks. Since IBUs are treated as foreign branches of Indian banks by RBI, therefore Banking Ombudsman Scheme, 2006 shall not be applicable to BUs. The Authority shall consider framing appropriate directions for protecting the interest of individual clients at an appropriate time.

6. Queries on IFSC (Deposit) Directions, 2020

(a) Definition of Bulk deposit

Single term deposit of USD 500000 or above and equivalent amount in any other freely convertible foreign currency shall be treated as "Bulk deposit". The deposit should meet the above threshold on the date of commencement of the deposit.

(b) Deposits with negative interest rates

Deposits with negative interests may be offered subject to compliance with the requirements of the Interest rate framework in para 5 Chapter III of the IFSCA (Deposits) Directions, 2020.

7. Inclusion of IFSC under the definition of "established financial centers" under RBI's circular on "Operations of foreign branches and subsidiaries of the Indian banks – Compliance with statutory/regulatory/administrative prohibitions/restrictions" dated May 12, 2014

The listing of the centers under the term "established financial centers" in the above circular is indicative and not exhaustive. Considering that one of the purposes behind setting up of IFSCs was to allow transactions, including derivative transactions, which are not currently permitted from the domestic market, IFSC may be considered on the same footing as other "established financial centres". However, since the circular in question has been issued by the Reserve Bank of India, the parent Bank of the BU may consider seeking their views regarding offering structured derivative products currently not allowed in India out of IFSC.

8. Offering NDCC to persons resident outside India and in FCY-FCY

As para 6 of the circular on "OTC Derivatives at IFSCs" dated December 4, 2020 clarifies, the default position is that BUs are allowed to undertake derivative transactions with other BUs, Financial Institutions and persons resident outside India. The modification to para 7 of the "Comprehensive Guidelines on derivatives" (in the Annex to the above circular) lists NDCCs in FCY-FCY as a valid derivative that may be undertaken by BUs. Therefore, FCY-FCY NDCCs may be offered to persons resident outside India.

9. Reserve Bank of India (Interest Rate on Advances) Directions, 2016 – applicable provision for BUs

On a review, it has been decided not to make the Reserve Bank of India (Interest Rate on Advances) Directions, 2016 applicable to BUs. Accordingly, the reference to the circular shall be omitted from the Annexure to the circular on "IFSC (Banking) Regulation, 2020 –

Directions for implementation” (December 4, 2020)”.

BU's shall frame a policy on interest rates on advances duly approved by the Board of Directors of its parent bank or any committee of the Board to which powers have been delegated. Subject to such policy, BU's are free to determine the interest rate on advances charged to its customers.

10. Clarity on operations that has to be carried out of GIFT city

Para 6 and 7 of the circular on “IFSC (Banking) Regulation, 2020 – Directions for implementation” (December 4, 2020) requires BUs to conduct Risk management, Compliance and Front office operations out of the BU's infrastructure at GIFT City within six months from the date of issue of the circular. Other operations of such BUs shall be conducted from the BU's infrastructure GIFT City within two years of the date of the circular. For BUs established post the date of the circular, the above periods shall be calculated from the date of commencement of operations.

Based on the feedback received from the BUs and internal deliberation, the Authority has decided to replace the instructions in paras 6 and 7 above with the following with immediate effect:

Para 6

BUs shall provide adequate resources, including in infrastructure and manpower, on an ongoing basis, commensurate with the size and nature of their operations being conducted at IFSCs.

Para 7

The Authority recognises that the diversity of organisational structure and operational arrangements of BUs (and its parent bank) would warrant the assessment of the adequacy of such resource deployment on an individual BU basis. Accordingly, the Authority shall engage with the BUs on an ongoing basis to satisfy itself that the operations of the BUs are adequately resourced.

11. Clarity on INR denominated transactions

It is clarified that all transactions in IFSCs has to be conducted in a freely convertible foreign currency. The Authority, in exercise of the powers under the FEMA (IFSC) Regulation, 2015 may allow transactions denominated in INR in IFSCs provided such transactions are settled in a freely convertible foreign currency. Therefore transactions denominated in INR may be undertaken in IFSC if expressly permitted by the Authority and settlement of such transactions shall be in a freely convertible foreign currency.

The Authority has vide its circulars issued till date permitted the following INR denominated transactions to be undertaken at IFSC:

(a) INR denominated loans, in any form, to persons resident in India and persons resident outside India.

(b) FCY-INR Non-deliverable derivative contracts (NDDCs) with an AD Cat-1 bank in India having a BU, with other BUs and persons resident outside India.

The Authority has also permitted the following derivatives involving INR interest rates to be undertaken at IFSC:

(a) Interest Rate Swap (IRS) (including Overnight Indexed Swaps (OIS)) to persons resident outside India

(b) Forward Rate Agreement (FRA) on INR interest rates to persons resident outside India for the purpose of hedging their interest rate risk.

12. Requirement for proof of underlying transaction in case of FRA on INR for hedging

BUs may devise their own policy, duly approved internally, to satisfy themselves about the presence of the underlying risk that is sought to be hedged using the INR FRA.

13. Granting of advances only against term deposits maintained with the BU

The intent of the provision in para 5(g) of Chapter III of the IFSCA (Deposit) Directions, 2020, is to allow BUs to only grant advances against term deposits maintained with the BU, its parent or foreign branch of the parent of the BU.

14. Allowing BUs to purchase assets like OTC Equity option, OTC commodities option for offering structured deposits to customers

BUs may purchase OTC derivatives on various asset classes for the purpose of offering structured deposits to customers.

15. Exposure norms applicable to IBUs

It is clarified that the exposure norms applicable to BUs shall be those mentioned in para 7 of Chapter III of the IFSCA (Banking) Regulations, 2020 i.e. Single borrower and Group borrower exposure limit. No other exposure limits applicable to banks under the Master Circular – Exposure Norms dated July 1, 2015 (as amended) issued by the Reserve Bank of India shall be applicable to BUs. Thus, BUs are required to follow the instructions in the above circular so far as they pertain to the calculation of the Single borrower and Group borrower exposure.

16. Statutory restrictions on lending

The Master Circular on Loans and Advances - Statutory and Other Restrictions dated July 1, 2015 (as amended) issued by the Reserve Bank of India under the Banking Regulation Act, 1949 applies to all Commercial banks. The circular does not provide any exemption from applicability to the foreign branches of Indian banks. As BUs are treated as equivalent to foreign branches of Indian banks, the provisions contained in this circular will be applicable to them too.

BUs may please note the provision of para 4 of the IFSC (Banking) Regulation, 2020 – Directions for implementation dated December 4, 2020, which clarifies that the directions/circulars/guidelines issued by the RBI and adopted by the Authority shall apply, *mutatis mutandis*, for activities permitted to be undertaken by the BUs.

17. Reporting obligation by IBUs to the Authority

The Authority is in the process of devising the reports that would be required to be submitted by BUs. Till such reports are finalised, BUs have been asked to share with the Authority the soft copy of the reports being submitted to the Reserve Bank of India under the circulars adopted by the Authority. Since the Authority has taken over the functions of the Reserve Bank of India w.e.f from October 1, 2020, BUs are required to share reports submitted on or after such date with the Authority. Further, BUs are also required to submit the above reports submitted to Reserve Bank of India for the half years ending 31.03.2020 and 30.09.2020.

18. ISDA Master agreement for structured deposits

The requirement for signing ISDA master agreement by depositors who are undertaking the structured deposits with BUs would depend on how the transaction is structured. In case, the derivatives used to “structure” the deposit i.e. make the return on the deposit dependent on market factors/indices are offered to the depositor separately from the deposit, BUs may consider entering into ISDA or similar internationally recognised agreements to protect its interests. In case, the deposit and the derivatives used to structure the same is offered as a “package” to the depositor i.e. the depositor is not counterparty to the derivatives used to “structure” the deposit, the question of signing ISDA would not arise.

19. Retail lending

The use of the terms “Qualified Individual” and “Qualified Resident Individual” in the regulations and circulars issued by the Authority pertains only to acceptance of deposits by BUs. BUs may undertake retail lending to persons resident in India (subject to the provisions of FEMA, 1999) and persons resident outside India.

20. Transactions with residents of Nepal and Bhutan

It is clarified that, as BUs are not allowed to undertake transactions in cash, release of foreign exchange by BUs is not admissible for travel to or transactions with residents of Nepal or Bhutan. BUs may also note that as per para 9 of the “*Directions on business in foreign currency at International Financial Services Centres (IFSCs)*” dated December 4, 2020, current account transactions with FIs, persons resident in India and persons resident outside India are subject to the rules issued by the Central Government in respect of current account transactions. Accordingly, as per the provisions of the FEMA (Current Account Transaction) Rules, 2000 issued by the Central Government, drawal of foreign exchange by clients of BUs for a transaction with a person resident in Nepal or Bhutan is prohibited.

21. Dealing in INR OIS via BUs

In addition to NDOIS, BUs may undertake INR OIS with persons resident outside India (including other BUs) so long as the payables/receivables to/from the counterparty and any AD Bank in India are undertaken in a freely convertible foreign currency.

22. Use of Nostro account of the BU

Apart from its own transactions, the Nostro account of the BUs may also be used for

undertaking transactions of the parent bank of the BU or any foreign branch of the parent bank. e.g. collateral for derivative transactions undertaken by the parent or foreign branch of the BU may be placed or received through the Nostro account of the BU.

While allowing its Nostro account to be so used, BUs must ensure that:

- (a) Such transactions are kept distinct from its own transactions and appropriately accounted for
- (b) Necessary documentation, if any, to protect the interest of the BU is entered into with the parent bank or foreign branch of the parent bank before allowing such transactions to be routed through its Nostro account.

23. IFSCA (Deposit) Directions - 2020 - Comprehensive policy on interest on deposit duly approved by Board of Directors

It is clarified that till the requirement of the IFSCA (Deposit) Directions – 2020 for a comprehensive policy on interest on deposit duly approved by Board of Directors is satisfied, BUs may continue to accept deposits under their current policies. BUs shall ensure that the updated policy complying with the Directions is approved at the earliest but not later than 3 months from the date of issue of the directions.