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Securitisation

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Contents

Jerome Merchant + Partners's primary office is located in Mumbai, with associate offices in New Delhi and Bangalore. Its lawyers advise financial institutions and corporates on various aspects related to securitisation and assignment of different portfolios of receivables, including housing, credit card, operational and loan portfolio receivables. The securitisation practice works closely with the M&A and disputes practices in structuring securitisation transactions. Many large portfolio assignment transactions are undertaken by way of a business transfer of the portfolio, associated assets (including employees and technology), and are advised by the firm's financing/securitisation and M&A lawyers. Given the rising levels of distressed assets in the Indian economy, Jerome Merchant's securitisation lawyers increasingly work with its disputes and insolvency teams in advising on the structure for sale and acquisition of debt portfolios which are non-performing and are under different stages of restructuring or insolvency.

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1. Structurally Embedded Laws of General Application

1.1 Insolvency Laws

Introduction

Securitisation of performing financial assets in India is mainly governed by the Guidelines on Securitisation Transactions dated 7 May 2012 and 21 August 2012 (as applicable to all scheduled commercial banks, all India term-lending and refinancing institutions and non-banking financial companies), as amended by the master directions of the Reserve Bank of India (RBI) – collectively referred to as the RBI Guidelines – from time to time.

Securitisation of non-performing financial assets is governed by the:

- Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI);
- RBI regulation in the Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions 2003, as amended;
- RBI notifications on the sale of non-performing assets, issued from time to time.

Banks purchasing/selling non-performing financial assets from/to other banks are required to formulate internal procedures for such purchase/sale, and comply with prudential norms and disclosure requirements stipulated by the RBI under the Guidelines on Purchase/Sale of Non-Performing Assets, dated 13 July 2005.

Securitisations by way of issuance of listed securitised debt instruments are, in addition, governed by the Securities and Exchange Board of India (Issue and Listing of Securitised Debt Instruments and Security Receipts) Regulations 2008 (SDI Regulations).

While undertaking a securitisation transaction, a practitioner must also consider and ensure compliance with the Companies Act, 2013, the Transfer of Property Act, 1881, the Income Tax Act, 1960, the Trusts Act, 1882, the Contract Act, 1872 and state stamp duty laws.

Securitisation in India is mostly undertaken as follows: (i) direct assignment by banks or financial institutions to other banks or financial institutions; (ii) a pass-through structure where securitised paper in the form of pass-through certificates (PTCs), which represent the financial assets transferred to the special purpose vehicle, are issued to investors.

Insolvency Laws and Issues

Securitisation, "true sale" and risk insulation

There should be a "true sale" of financial assets in order to insulate them from the financial risk of the originator. In order to effectively achieve a true sale, the originator will have to have no further risk, liability or rights in the transferred financial assets. The consideration for the transfer should not be deferred and must take place simultaneously with the payment of consideration and execution of the transfer documents.

Section 36 of the Insolvency and Bankruptcy Code, 2016 (IBC) provides that any asset over which a debtor has ownership rights – as evidenced in its balance sheet or on the records of a registry or information utility – forms part of the liquidation estate of the insolvent corporate. Hence, it is essential that the securitisation structure results in the removal of the financial assets from the books of the corporate debtor.

The securitisation transaction should also not qualify as a "preferential transaction" or an "undervalued transaction", as such transfers would be void under the IBC.

Characteristics of true sale v secured loan

On a secured loan transaction, the debtor whose assets are offered as security to the lender to secure the repayment of the dues and performance by the borrower of its obligations ordinarily remains the legal owner of such assets. Section 36 of the IBC provides that encumbered assets of the debtor form part of the liquidation estate of the debtor. Accordingly, the secured creditors are entitled to enforce their security interest or relinquish its security interest, and receive the proceeds from the sale of the secured assets on par with all other secured creditors of the debtor.

In the case of a true sale, the debtor who has transferred the assets ordinarily has no legal or beneficial interest in the assets and hence they do not form part of the liquidation estate of the transferor/debtor.

In the case of a true sale, the transferred assets transfer on to the books of the assignee without any recourse to the originator or transferor.

Opinion of counsel

In India, parties customarily obtain opinions from legal counsel confirming that the tests of a true sale have been satisfied.

The opinions ordinarily confirm the following:

- all rights, titles, interests and benefits in the transferred assets, including underlying security, have been transferred to the assignee;
- creditors of the assignor do not have any right in any way with regard to the transferred assets even in case of bankruptcy of the assignor;

- the assignment documentation does not interfere with the assignee's right and rewards associated with the transferred assets to the extent transferred by it;
- the assignor does not retain any risk or reward associated with the transferred assets;
- all acts necessary for the assignment and/or transfer of the transferred assets have been duly completed, including obtaining the necessary corporate authorisations;
- it is confirmed that the assignment documents have been duly stamped as per the applicable stamp duty laws of India;
- save and except for the filing of certain forms with the applicable registry, if any, in respect of any underlying security, no other filing or registration is required for the assignment and/or transfer of the transferred assets.

In cases where banks and financial institutions are the transferee and the transferor, the following assumptions are included:

- the assignor has owned the transferred assets for the required time period and retained such amounts of the portfolio giving rise to the transferred assets, in the manner stipulated in the RBI Guidelines;
- that the assignee has undertaken a due diligence on the quality of the transferred assets, has confirmed that the assignee has and will continue to comply with minimum retention and holding periods, and has otherwise complied with the provisions of the RBI Guidelines.

Under Indian law, where banks and financial institutions are the assignor and assignee of the transferred assets, it is mandatory under applicable Indian laws to obtain a legal counsel opinion that the transfer is a true sale and in accordance with the provisions of the RBI Guidelines.

Other relevant insolvency law aspects of a bankruptcy-remote transfer

Under Indian law, it is important that the securitisation practitioner expressly establishes a special purpose vehicle (SPV) – also known by terms such as special purpose entities (SPE) – with a distinct set of objects clearly and expressly related only to the transferred assets. The beneficiaries of the transferred assets should be identified in the documentation setting up the securitisation vehicle.

The buyer of the transferred assets will need to show that the assignment/transfer has resulted in a bankruptcy-remote structure with no recourse or liability in respect of the seller. Accordingly, the documentation will need to reflect that the transfer of assets should result in the complete legal separation of the assets from the seller after its transfer. There should be no restriction on the buyer's right to deal with the transferred assets, and it should be free to encumber, sell or deal with the transferred assets in such manner as it may deem fit.

There should be no obligation on the seller or assignor to repurchase the assets or any part thereof, fund the repayment of the assets or part thereof, substitute or provide additional assets.

1.2 Special-Purpose Entities

The transfer of the financial assets for securitisation should be from the originator to a bankruptcy-remote SPV, established for the purposes of creating a bankruptcy-remote vehicle.

Required or desirable aspects of an SPE

The SPE is ordinarily set up as a trust. The trustees are independent from the originator and the beneficiary, whose sole role is to manage and operate the SPE.

The SPE should not conduct any business other than the function of collecting the proceeds of the receivables from the transferred assets, taking steps to protect such assets or enforce their rights in such assets.

The object of the SPE in its constitutional documents should expressly relate only to the management of the transferred assets.

The SPE should not be able to be subjected to insolvency proceedings if it is not able to service the payments of instruments issued against the transferred assets.

The investors in an SPE must have an undivided interest in the transferred assets as against any ownership interest in the SPE.

Ideally, an SPE should be a "tax pass-through" vehicle.

The SPE should be restricted from raising or issuing any other debt.

Ideally, the SPE should not hold multiple assets. However, if the SPE does hold multiple assets, then the constitutional documentation should clearly state that each of the assets are held in trust for the specified beneficiaries who are entitled to it and therefore, no commingling of the assets will be possible.

The trustees/board of managers or directors should be independent from its sponsor/settlor, and therefore there should be no common persons who are trustees of the SPE and also serve as directors or are in control of the promoters/sponsor of the SPE.

In India, it is difficult for any entity other than a trust to actually satisfy the conditions set out in this section, and therefore a trust is the most commonly used vehicle for structuring securitisation and assignment transactions.

Risks of consolidation that endanger the bankruptcy-remoteness of the SPE
Firstly, as discussed above, the parties need to ensure that the principles of a true sale have been satisfied. Ordinarily, if the true sale conditions are satisfied Indian courts would not consolidate the SPE with the originator in an insolvency proceeding or otherwise.

However, it is important to ensure that the assignment is undertaken on an arm's length basis, and that the transaction cannot be challenged on the basis of being undervalued or a preferential transaction.

Further, it is important to ensure that the assignor has obtained the necessary contractual consents and corporate authorisations to effect the assignment so as to not have any challenge being posed at the time of any insolvency of the originator.

Opinion of counsel
One ordinarily obtains a legal opinion on the bankruptcy-remoteness of the SPE entity so that investors may be able to at least review the opinion, and in certain privately placed transactions even rely on the opinion.

The opinion confirms the valid execution of the constitutional document of the SPE, that the constitutional documents expressly states that the assets of the SPE will be held for the express benefit of the investors/beneficiaries who are identified upfront individually or as a class, or will be identified at the time of the transfer of assets to the SPE.

The opinion also examines the valid execution of the transfer documentation so as to ensure that the true sale conditions are met.

The qualifications are customary in nature and assume that the transfer has occurred on an arm's length basis and is not an undervalued or a preferential transaction.

1.3 Transfer of Financial Assets
Other than the legal conditions as set out above, the following requirements need to be undertaken to ensure a valid transfer of the financial assets.

Execution of the assignment agreement/deed: the assignment agreement/deed will have to be stamped as per the stamp duty rates prevailing in the state in which the document is executed.

In India, the creation of a security interest on an asset of a corporate entity or on immovable property is generally registered with the Registrar of Companies (RoC), applicable land registry or the Central Registry of Securitisation and Asset Reconstruction in India, and with 'information utility' companies as prescribed by the IBC. Therefore, if there is any underlying security which is being transferred along with the financial asset, then the parties will need to verify whether the security interest has been registered in the name of the assignor or a trustee for the benefit of all holders of the financial asset. If the registration has been made in the name of the assignor only, then the registrations will need to be modified to reflect the interest of the assignee in such asset.

Please note that, subject to any contract to the contrary, the consent of the debtors is not required for the assignment/transfer of the financial asset. Further, while not obtaining a contractual consent for the transfer may not invalidate the transfer, it is advisable that such consents, if required, are obtained prior to effecting the transfer.

Rights and requirements
Under Indian law, if the assignment document is not adequately stamped, the transfer may still be valid, but the document will not be admitted into evidence in a court of law, until such time as the stamp duty, along with the penalty, is paid.

Under the Companies Act, 2013, if a charge created by a company is not validly registered with the RoC, then such charge will not be considered by a liquidator or by any other creditor. Therefore, it is essential that the assignee verifies the entity in whose favour the charge has been registered so that modifications, if necessary, may be made to such registrations.

Similarly, a transfer of interest in immovable property is not valid if the instrument of transfer is not duly registered within the applicable land registry. Therefore, in the case of a transfer of an underlying mortgage or charge on immovable property, which has been made only in favour of the assignor and not a trustee on behalf of all persons who hold interest the debt being secured by the immovable property, the assignee will also have to register the assignment deed and make the necessary modifications in the records of the land registry.

1.4 Construction of Bankruptcy-Remote Transactions
Other than the pass-through and the direct assignment structures as outlined in the introduction above, other methods of securitisation and creation of bankruptcy-remote structures in the securitisation space are not common. Transactions involving synthetics or other means of securitisation do take place offshore for Indian assets.

2. Tax Laws and Issues

2.1 Taxes and Tax Avoidance
The transfer of the financial asset from the originator/intermediary will be taxed in the hands of the originator as

income tax. Corporate income tax rates in India are generally 30%.

Most securitisation vehicles are structured as pass-through vehicles, and hence the income of the trust vehicle is typically taxed only in the hands of the ultimate investor/transferee.

The Indian government has recently permitted complete pass-through of income tax to certain regulated securitisation trusts. Therefore, the tax incidence on the trustee is not in the nature of a distribution/dividend tax, but a tax deducted at source (TDS).

In addition, any income of a securitisation trust from securitisation is exempt from income tax in the hands of the trust and is only subject to TDS on distribution of income to the ultimate investors. Also, if the TDS has been applied by the borrower at the time of repayment of the dues in respect of the financial asset, then there is no further TDS charged to the investor.

The income payable to a resident investor by a securitisation trust is subject to tax deduction at source at the rate of (i) 25% for individuals, and (ii) 30% for any other person.

The income payable to a non-resident investor by a securitisation trust is subject to tax deduction at source at the rate of approximately 30% (subject to treaty benefits).

For any collection or servicing agent role played by the originator, any fees paid to the originator for such services would be subject to goods and services tax at the rate of 18%.

2.2 Taxes on SPEs
Please see **2.1 Taxes and Tax Avoidance**, above.

2.3 Taxes on Transfers Crossing Borders
Please see **2.1 Taxes and Tax Avoidance**, above.

2.4 Other Taxes
In relation to possible tax issues arising in connection with securitisation transactions, the key is to ensure that the SPV is merely a passive pass-through entity so that the monies received by the SPV are not taxed as income in the hands of the SPV.

2.5 Obtaining Legal Opinions
Tax counsel opinions are normally obtained in securitisation transactions. The qualification for the opinion is that the counsel assumes that the SPV is not involved in any other business activity.

3. Accounting Rules and Issues

3.1 Legal Issues with Securitisation Accounting Rules
Under applicable Indian regulations, securitisation in India generally involves a complete sale of the asset/receivable and the assignor not bearing any further risk in such assigned asset. Other than for limited exceptions – such as representations with respect to title – the asset being assigned/securitised is taken off the books of the assignor and hence is accounted for as a sale in the books of the assignor and not a financing.

As regards the SPE to whom the asset is assigned, the receivables are treated as an asset in its books and the receipt or unit issued to the investors is treated as a contribution payable to the investor in accordance with the terms of the relevant transaction.

3.2 Dealing with Legal Issues
In order to provide an opinion that the asset has been assigned on a true sale basis, legal practitioners ordinarily ensure through the documentation that the assignor bears no risk for the due realisation of the assigned assets and that representations and warranties are limited to title. To the extent that the assignor provides any undertaking to ensure realisation of any of the assets or part thereof, the opinion is qualified to state that the true sale has not occurred to that extent. Hence, the receivables/assets which have not been subject to a true sale will continue to be accounted in the books of the assignor as a receivable.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations
The material laws and regulations governing disclosures in respect of securitisation transactions are (i) the SDI Regulations, and (ii) the RBI Guidelines.

The SDI Regulations govern the issuance of private and publicly placed 'securitised debt instruments' (SDIs). An SDI is defined as any certificate or instrument issued to an investor by a special purpose distinct vehicle, which possesses any debt or receivable, including mortgage debt assigned to such an entity, and acknowledging the beneficial interest of the investor in such debt or receivable.

Disclosures for Public Placement of SDIs:

- the issuer is required to obtain a credit rating from at least two credit rating agencies and disclose the same in the offer document – all unaccepted credit ratings are also to be disclosed;
- description of the instruments being offered;

- description of the asset pool, including transaction type (ie, cash, synthetic, balance sheet repackaging, etc);
- criteria for selection of asset pool, rate of return, recourse to the originator, delinquency information of the originator's asset pool for the preceding five years;
- names of all principal parties to the transaction – originator, issuer, credit enhancement provider, liquidity facility provider, underwriter, servicer, depository, collection and payment bank, etc;
- interest and redemption premium;
- credit enhancement details;
- expected interest and principal repayment dates;
- expected maturity;
- expected prepayments;
- expected pre-mature winding up of the issuer on account of prepayments;
- terms of payment, including distinction between revenue and principal receipts;
- contribution of the issuer/sponsor;
- nature of the receivables – LTV-based, tenure-based, ticket-size based distribution;
- collection period;
- servicer and fees;
- description of swaps, if any;
- portfolio audit;
- minimum holding and retention period;
- waterfall mechanism;
- risk factors – description of assets and debtors, default/credit risk, delinquency risk, dilution risk (ie, deterioration in the credit pool), servicing risk, prepayment risk, liquidity risk, currency, interest and other risks, geographic concentration risk, and any other risk associated with the specific receivables pool;
- sponsors and persons who control the issuer;
- financial information of the originator's assets and liabilities, financial position, profit and losses for the past three years, including unaudited statements 120 days preceding the application for the asset-backed securities becoming effective;
- transaction structure and cash flows;
- details of non-performing loans held by the issuer;
- declaration of net asset value of the issuer within 15 days of the end of each quarter.

Disclosures under the RBI Guidelines:

- for disclosures to be made for securitisation of standard assets, the originator has to disclose to the investors the weighted average holding period of the assets securitised and the level of their minimum retention in the securitisation;
- the originating banks should ensure that prospective investors have readily available access to all materially relevant data on the credit quality and performance of the individual underlying exposures, cash flows and collateral supporting a securitisation exposure as well as such information that is necessary to conduct comprehensive and well-informed stress tests on the cash flows and collateral values supporting the underlying exposures. This information should be made publicly available;
- minimum holding and actual holding period;
- minimum retention and actual retention amount;
- types of retained exposures;
- credit enhancement and liquidity support;
- credit quality of underlying loans;
- extent of security cover available;
- rating-wise distribution of the assets;
- default rates of similar portfolios in the past five years and one year;
- upgradation/recovery/loss rates of similar portfolios;
- other characteristics of the loan pool – industry break up, LTV distribution, geographical distribution, etc.

Principal regulators, violations and penalties of required disclosure

The Reserve Bank of India is the principal regulator for the securitisation of assets and direct assignment of assets, while the Securities and Exchange Board of India is the principal regulator for listing of SDIs.

Banks and non-banking financial institutions are regulated by the Reserve Bank of India. In case of any violation of the guidelines, penalties could involve a fine or even cancellation of licence.

Violations of regulations governing the listing of SDIs could entail fines and suspension from trading or accessing the securities market by the originator, issuer or market intermediary which is found in violation of any provision of the SDI Regulations.

Public market v private market

Please note that despite efforts to boost the public market in securitisation, the listing of SDIs remains muted. A significant number of transactions occur on the private market between banks and financial institutions and asset reconstruction companies. The types of investors in the private market are generally banks and financial institutions and in certain instances corporate players who look to transfer their receivables off their books.

The forms of disclosure and regulatory issues governing the private and public market are set out above. In particular, the emphasis on the private market which is governed by the Reserve Bank of India is to ensure that the quality of assets being transferred or securitised are not defaulted assets and through rules governing minimum retention and minimum holding, the transferor is not offloading bad assets. The assignee is also responsible to conducting proper diligence on the assets being transferred so as to ensure that undue risk is not being assumed by the bank.

The public market looks at more institutional investors taking positions in the securitisation receipts and, therefore, are required to inform themselves of the quality of the assets in the pool based on the information and disclosures provided pursuant to the SDI Regulations.

Obtaining legal opinions as to compliance
Please refer to **1.1 Insolvency Laws**, above.

4.2 General Disclosure Laws or Regulations
See above, **4.1 Specific Disclosure Laws or Regulations**.

4.3 'Credit Risk Retention'
The RBI Guidelines stipulate a minimum holding period and minimum retention requirement that banks and financial institutions are required to comply with while undertaking their securitisation and assignment transactions.

Banks and non-banking financial institutions are regulated by the Reserve Bank of India. In case of any violation of the guidelines, penalties could involve a fine or even cancellation of licence.

For the necessity or advisability of obtaining legal opinions as to such rules, please refer to **1.1 Insolvency Laws**, above.

4.4 Periodic Reporting
Reporting requirements in relation to securitisation transactions are present in the SDI Regulations as well as the RBI Guidelines dated 7 May 2012 and 21 August 2012, and the RBI's Guidelines on Securitisation of Standard Assets, February 2006 (as applicable to all scheduled commercial banks, all India term-lending and refinancing institutions and non-banking financial companies).

The material reporting requirements under the SDI Regulations include the trustee being obligated to:

- call for periodic reports from the originator regarding the performance of the underlying asset pool, at least on a quarterly basis;
- share reports and auditors' certificate, as received from the originator/auditor(s), with the credit rating agency that is rating the SDI;
- collect information and reports from the servicers/originators;
- generate cash flow reports and payment reports, and meet all reporting requirements required under the Security and Exchange Board of India (SEBI) or the Reserve Bank of India's guidelines/circulars;
- the Special Purpose Distinct Entity (SPDE) is required to file such reports or furnish certain information to SEBI as directed by SEBI from time to time.

The material reporting requirements under the RBI Guidelines are as follows:

- disclosures by the originating banks should be made separately for each securitisation transaction in the servicer report, investor report, trustee report or similar published document, and are required to be made at the origin of the transaction, and confirmed thereafter at a minimum half-yearly interval (end of September and end of March), and at any point when the requirement is breached.;
- the bank's audit reports need to be made available for verification by the inspecting officials of the RBI during the annual financial inspections of the purchasing banks.

The material reporting requirements under the RBI Guidelines on Securitisation of Standard Assets are as follows:

- the SPV/trustee is required to publish a periodical report on any reschedulement, restructuring or renegotiation of the terms of agreement effected after the transfer of assets to the SPV, as a part of disclosures to all the participants at quarterly/half-yearly intervals – the authorisation of investors to this effect may be obtained at the time of issuance of securitised paper;
- originating banks of the securitisation transaction are required to report on a quarterly basis to the audit subcommittee of SEBI.

The RBI is the principal regulator and enforcer for the securitisation of assets and direct assignment of assets, while the Securities and Exchange Board of India is the principal regulator and enforcer for listing of SDIs. In case of violation of the RBI Guidelines on Securitisation Transactions, penalties could involve a fine, or a cancellation of licence. In case of violation of the SDI Regulations, penalties could entail fines and suspension from trading or accessing the securities market by the originator, issuer or market intermediary which is found in violation of any provision of the SDI Regulations.

4.5 Activities of Rating Agencies (RA)
The securitisation activities of credit rating agencies are not separately regulated in India. Credit rating agencies in respect of all forms of securities are regulated by SEBI through the Securities and Exchange Board of India (Credit Rating Agencies) Regulations, 1999 (CRA Regulations).

Rating agencies (RA) in India are regulated by the SEBI through the CRA Regulations. The CRA Regulations require RAs to maintain and disclose their ratings in a specific manner, and to maintain copies of their rating notes, ratings issued, terms of engagement, records of decisions of rating committees and fees charged for rating for at least five years. The CRA Regulations require that RAs should have an internal audit, submit information to SEBI whenever required, and be open to inspection and investigation by SEBI.

The CRA Regulations also specify that RAs may be held liable for any contravention under the SEBI Act, or any of the

rules and regulations as specified in them, by way of fines, issuance of warnings, suspension of registration certificates and disgorgement of unlawful gains or loss averted by RAs.

4.6 Treatment of Securitisation in Financial Entities

Basel III norms have been adopted in India and are being implemented in phases by Indian banks.

In India, there are no specific rules on giving capital or liquidity benefit for any transaction if such transaction complies with any specific rules on the substantive quality of the transaction, such as "single, transparent and comparable".

4.7 Use of Derivatives

There is no specific regulation governing the use of derivatives in relation to securitisation transactions.

The use and issuance of derivatives in India is governed by the Comprehensive Guidelines on Derivatives dated 20 April 2007. These regulations permit banks and financial institutions which have a genuine underlying risk to be able to enter into derivative contracts.

The type of derivative products which a bank or financial institution may enter in respect of securitisation transactions is significantly limited. Banks and financial institutions are entitled to enter into 'over-the-counter' derivatives and 'exchange-traded' derivatives. The typical derivative products entered into in relation to securitisation transactions are interest rate swaps, forward rate agreements and interest rate futures.

The regulations governing derivatives in India are regulated by the RBI Exchange traded derivatives and are further regulated by SEBI. However, in the context of securitisation transactions, derivatives are typically over-the-counter products.

4.8 Specific Accounting Rules

Accurate information regarding specific accounting rules requires obtaining appropriate advice from a licensed accounting firm.

4.9 Investor Protection

Provisions governing the protection of investors in relation to securitisation transactions are (i) the SDI Regulations, and (ii) The RBI Guidelines (as applicable to all scheduled commercial banks, all India term-lending and refinancing institutions and non-banking financial companies).

The material terms of the SDI Regulations that provide for investor protection include:

- a certificate of registration to make a public offer of securitised debt instruments or to seek listing of such securitised debt instruments would be granted only on the condition that the trustee shall take adequate steps for redressal of grievances of the investors within one month of the date of the receipt of the complaint and keep the Board informed about the number, nature and other particulars of the complaints received;
- the instrument of trust for the Special Purpose Distinct Entity (SPDE) shall contain such clauses as have been mentioned in Schedule IV of the SDI Regulation and such other clauses as would be necessary to protect the interest of the investor in the SDI;
- clauses in the instrument cannot have the effect of limiting or extinguishing the obligations and liabilities of the trustees or the special purpose distinct entity in relation to any scheme or the rights or interests of investors or indemnifying the trustees or the special purpose distinct entity for loss or damage caused to the investors by their act of negligence or commission or omission;
- a trustee is expected to do such acts as are necessary in the event the security becomes enforceable and supervise the enforcement of the security in the interest of the investors;
- the trustee shall take appropriate measures for protecting the interest of the investors including informing the board about any action, legal proceeding, etc, initiated against it in respect of any material breach or noncompliance by it, of any law, rules, regulations, directions of the Board or of any other regulatory body and ensure that the securitised debt instruments have been repaid or redeemed in accordance with the provisions and conditions under which they were offered to the investors;
- the trustee shall communicate on a quarterly basis to the investors regarding the compliance by the servicer with its obligations and actions taken thereof;
- the trustee shall call a meeting of all the investors on a requisition, in writing and signed by at least one-tenth of investors in value for the time being outstanding or at the occurrence of an event, which constitutes a servicer default or which in the opinion of the trustees affects the interest of the investors;
- the trustee shall ensure that changes in registration status or any administrative, civil or penal action taken by the Board or any material change in financial position that could adversely affect the interest of the investors be promptly informed to the investors;
- the trustee and the SPDE shall ensure timely payment of interest and redemption amounts to the investors;
- the SPDE shall give investors the option of receiving the SDIs either in physical or dematerialised form;
- the credit rating agency rating the SDI is to include reference to the risks and concerns for the investors as well as mitigating factors;
- the offer document of the SPDE or trustee is to contain all material information which is true, fair and adequate for an investor to make an informed investment decision,

and disclose the matters specified in Schedule V of the SDI Regulations;
- the SDI Regulations also specify the manner in which the SDI is to be allotted to the investors;
- in case of a private placement of securitised debt instruments, the application to the recognised stock exchange shall be made along with such information as may be necessary for the investor to make an informed decision regarding the SDI;
- SEBI may inquire into affairs of the SPDE suo moto in the interest of investor protection and, if need be, can order in writing that an inspection of the SPDE or person be taken up without notice;
- SEBI may, in the interest of the investor appoint a valuer, if required for the proper valuation of asset pools acquired or held by an SPDE;
- in the interest of the investors SEBI may also direct refund of money collected under an issue, direct persons associated with securitisation or regulated activity to not engage in such activity or to not access the capital market or deal in securities or SDIs for a particular period, direct the recognised stock exchange to not permit trade in the SDIs or suspend trading in SDIs, or any other direction that the Board deems fit and proper;
- the Trustee is also obligated to obey the Code of Conduct prescribed under Schedule III of the SDI Regulations.

Please also refer to the Offer Document and Disclosures that are listed at Section II(1)(b).

The material terms of the RBI Guidelines that provide for investor protection include:

- that the determination of the Minimum Holding Period (MHP) for assets needs to ensure that the project implementation risk is not passed on to the investors;
- the originating banks have to disclose to their investors the weighted average holding period of the assets securitised and the level of their minimum retention in the securitisation;
- the originating banks should ensure that prospective investors have readily available access to all materially relevant data on the credit quantity and performance of the individual, underlying exposures, cash flows, and collateral supporting a securitisation exposure as well as such information that is necessary to conduct comprehensive and well-informed stress tests on the cash flows and collateral values supporting the underlying exposures. This information should be made publicly available.

The RBI is the principal regulator for the securitisation of assets and direct assignment of assets, while SEBI is the principal regulator for listing of SDIs.

In case of violation of the RBI Guidelines, penalties could involve a fine, or a cancellation of licence.

In case of violation of the SDI Regulations, penalties could entail fines and suspension from trading or accessing the securities market by the originator, issuer or market intermediary which is found in violation of any provision of the SDI Regulations.

4.10 Banks Securitising Financial Assets
Please refer to **1.1 Insolvency Laws,** above.

4.11 SPEs or Other Entities
Please refer to **1.2 Special-Purpose Entities**, above.

4.12 Activities Avoided by SPEs or Other Securitisation Entities
This is not applicable under Indian legislation.

4.13 Material Forms of Credit Enhancement
Credit enhancements in India usually take the form of bank guarantees and cash collaterals. Certain other forms of enhancement also include:

- investments in subordinated tranches;
- over-collateralisation;
- excess spreads;
- credit enhancing interest-only strips;
- insurance policies and letters of credit are not common in securitisations in India.

As a general principle, all securities including insurance policies, if available, are transferred along with the underlying asset pool when entering into the underlying transaction.

4.14 Participation of Government Sponsored Entities
Government sponsored entities do participate in securitisation transactions, essentially to deleverage receivable positions, enhance cash flows and balance sheet restructuring. The Indian Railways Corporation and state utilities companies are examples of government sponsored institutions which participate in the securitisation market.

The applicable laws governing securitisation transactions do not differ for such entities.

4.15 Entities Investing in Securitisation
As discussed earlier, the Indian securitisation market is growing, but is still largely confined to investments by banks and financial institutions. While foreign portfolio investors are allowed to participate in the purchase of securitised receipts/pass-through certificates, under certain conditions, investor participation by such investors is still muted. Foreign portfolio investors are eligible to purchase securitised receipts/pass-through certificates satisfying the following criteria:

- such receipt/certificate is issued by a special purpose vehicle (SPV) set up for securitisation of assets where banks, financial institutions and Non Banking Financial Companies (NBFCs) are originators; and/or
- any certificate or instrument issued and listed in terms of the SDI Regulations.

5. Documentation

5.1 Bankruptcy-Remote Transfers

The following is the standard documentation used in securitisation transactions:

Trust deed

A trust deed for the settlement of the special purpose vehicle will hold the transferred pool of underlying assets. The trust is ordinarily settled by an independent trustee company. The trust deed will set out the manner in which investors may enforce their rights in the special purpose vehicle through the trustee. Such rights include the right to cause the trustee to enforce rights which arise from the underlying asset against the originator or the original debtors.

Deed of assignment

Also required is a deed of assignment of the underlying pool of assets being transferred, executed between the originator and the special purpose vehicle. The deed of assignment is therefore, the principal document which provides the special purpose vehicle with the rights to enforce legal remedies against the originator. In the event of any defect in title, misrepresentation as to the nature of the asset, it is under the deed of assignment that the special purpose vehicle will use to recover its dues or damages from the originator. It is also under the deed of assignment that all rights in the underlying pool of assets, such as security interests are transferred to the special purpose vehicle. Therefore, it is pursuant to the deed of assignment that the special purpose vehicle becomes a beneficiary of the security interest and enforces the security created in its favour under the underlying security documents. Since the regulations governing securitisation transactions require a "true sale" of the assets to the special purpose vehicle, the covenants and representations and warranties are limited to the quality of the assets, that the originator has valid legal title to the assets (free from any encumbrances) and that each party has complied with the laws regulating securitisation in India (as elaborated above).

Information memorandum or offer document

The information memorandum or offer document sets out the terms and conditions of the pass-through certificate / receipt issued by the special purpose vehicle to the investors. Primarily, it forms the basis for issuing an instrument to the investor covenanting to pay the investor the dues received by the special purpose vehicle from the transferred pool of underlying assets. Please refer to Section II 1(a) for the description of the terms set out in the information memorandum / offer document.

5.2 Other Principal Matters

The rights available to the investor in a securitisation transaction are through the special purpose vehicle instituting a suit for recovery against the original debtor, enforcing the security interest created in its favour, instituting insolvency proceedings against the original debtor or exercising rights available under the SARFAESI and taking possession of the underlying secured assets or the management of the secured assets of the original debtor (including the right to transfer by way of lease, assignment or sale and realise the secured asset).

Each of these remedies available to the investor requires the intervention of courts in India and is therefore subject to prolonged time delays for effective enforcement and recovery.

While the provisions of the IBC are intended to expedite resolution/recovery of dues in a time-bound manner, the actual implementation of the IBC is still in its nascent stage and it is not altogether certain, at this stage, whether in practice the time-bound enforcement procedures will be adhered to.

A significant change under the IBC is that upon an insolvency petition being filed by an operational creditor, a financial creditor or a corporate debtor, and until the tribunal determines whether an insolvency resolution plan can be implemented for the debtor or the debtor placed in liquidation, there is a moratorium on the institution or continuation of any suits and any action to foreclose or enforce any security interest created by the corporate debtor, including under the SARFAESI. The management of the corporate debtor is suspended and placed in the hands of resolution professionals and a committee of financial creditors. The moratorium – which may extend to a period between 180 and 270 days – can greatly prejudice the rights of the secured lenders to protect their security interest and secure its value prior to the debtor being placed under severe stress, if it is actually subjected to liquidation.

6. Roles and Responsibilities of the Parties

6.1 Issuers

The issuer of the securities is the SPV entity. A securitisation SPV is usually in the form of a trust. It has independent directors or trustees. The assets to be securitised are bought by the SPV from the originator. The interest and payment collection is the responsibility of the SPV.

6.2 Sponsors
Please refer to our response under **section 1 Structurally Embedded Laws of General Application**, above.

6.3 Underwriters and Placement Agents
Pursuant to the RBI Guidelines, securitisation transactions are typically not underwritten. The SDI Regulations permit underwriters registered under the Securities and Exchange Board of India (Underwriters) Regulations 1993 to underwrite the public issues of SDIs. However, since the SDI market is still at a nascent stage in India, the underwriting of such public issues is not common.

Placement agents or arrangers for large syndicated transactions are appointed from time to time. Such an agent merely plays the role of an arranger and does not have significant fiduciary obligations to the investor; such an agent earns fees from commissions payable by the issuer.

6.4 Servicers
The servicer – who is, in most cases, the originator – collects the payment due on the underlying assets, and after retaining a service fee passes it on to the SPV or the security holder as the case may be, follows up with delinquent borrowers and pursues legal remedies available against the defaulting borrowers. Since it receives the instalments and pays it to the SPV, it is also called the 'receiving and paying agent'. The servicer could also be the collection agent. A servicer appointed by an SPDE has the following obligations under the SDI Regulations:

- to co-ordinate with the obligors, manage the asset pool and collections therefrom;
- to administer the cash flows of such asset pool, distributions to investors, and reinvestment (if any), in accordance with the scheme; and
- to manage incidental matters.

6.5 Investors
Please refer to **4.15 Entities Investing in Securitisation**, above.

6.6 Trustees
Please refer to **4.1 Specific Disclosure Laws or Regulations**, above.

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7. Synthetic Securitisations

7.1 Synthetic Securitisation
As per the RBI's Guidelines, synthetic securitisations are not permitted for banks in India, including their overseas branches, as well as NBFCs.

7.2 Engagement of Issuers/Originators
Please refer to **7.1 Synthetic Securitisation**, above.

7.3 Regulation
Please refer to **7.1 Synthetic Securitisation**, above.

7.4 Principal Laws and Regulations
Please refer to **7.1 Synthetic Securitisation**, above.

7.5 Principal Structures
Please refer to **7.1 Synthetic Securitisation**, above.

7.6 Regulatory Capital Effect
Please refer to **7.1 Synthetic Securitisation**, above.

8. Specific Asset Types

8.1 Common Financial Assets
The most common classes of financial assets securitised in India are:

- home loans;
- commercial vehicle loans;
- microfinance loans;
- credit card receivables.

There is also a growing interest in the securitisation of project receivables in the infrastructure sector and strengthening the securitisation of receivables arising out of distressed assets.

Liberalisation in allowing foreign portfolio investors (FPIs) to invest in securitised debt instruments and 100% Foreign Direct Investment (under the automatic route (without regulator approval) in Asset Reconstruction Companies (ARCs), has given rise to an increased interest by foreign distressed funds and investors in the Indian securitisation market.

In 2016, the RBI also announced regulations related to priority sector lending certificates (PSLC); PSLCs are certificates representing a certain amount of priority sector lending (PSL) credit to the buyer of such instrument. PSLCs allow banks which are not meeting PSL requirements to purchase them from other banks and not to have to undertake securitisation/direct assignment transactions.

8.2 Common Structures
The common structures are as described in the responses given above.