

Chapter 7 Special Purpose Vehicle

7.1 Concept

Securitisation offers higher quality assets to investors by virtue of the fact that the structures insulate investors from the bankruptcy risk of the Originator. In order to ensure that the assets actually achieve the bankruptcy remoteness, it is essential to move them out of the balance sheet of the Originator and park them with another independent entity. Typically an SPV is employed to purchase the assets from the Originator and issue securities against these assets. Such a structure provides a comfort to the investors that they are investing in a pool of assets which is held on their behalf only by the SPV and which is not subject to any subsequent deterioration in the credit quality of the Originator. The SPV is usually a thinly capitalised vehicle whose ownership and management are independent of the Originator. The main objective of SPV is to distinguish the instrument from the Originator.

7.2 SPVs in other Countries

7.2.1 U.S.A.

The US market, which is home to 75% or more of the global securitisation volumes, shows clear division between the MBS & ABS issuance. The MBS market has been subject to successive transformations and presently the three institutions (Fannie Mae, Freddie Mac and Ginnie Mae) act as the principal intermediaries in the market inasmuch as they perform the activity of purchasing mortgages from home loan Originators and selling MBS. Based upon the same, their role could be likened to those of SPVs. However, over a period of time, these institutions have matured and assumed a greater role in the secondary mortgage market. Both Freddie Mac and Fannie Mae deal overwhelmingly in pools of conventional (i.e. not Federally insured) mortgages. In sharp contrast, Ginnie Mae deals only in Federally insured mortgages. However, all three agencies guarantee their issues against default losses. Government sponsorship of Fannie Mae and Freddie Mac contributed significantly to enlarge these institutions' role beyond mere conduits and helped them to become dominant institutions in the residential mortgage market. It was felt that investors would prefer to receive regular payments of principal and interest whether or not the same is collected from the Obligor even though a 100% guaranteed paper would imply lower interest yield. It thus became important for Fannie Mae and others to take on the additional role of guaranteeing the issuance being routed through them. In short, the secondary market scenario even in the most developed markets like the US is characterised by Governmental / regulatory patronage and guarantees. Consequently the securitisation SPV in this segment of the market also displays characteristics which are typical of State facilitation and encouragement. More details of these institutions are given in Chapter 6.

7.2.2 Argentina

- a) SPVs generally take legal forms of Mutual Funds (MFs), trusts or corporations etc. According to the Trust law in Argentina, a trust (similar to SPV) is established when a person (the trustor) transfers the ownership in trust of certain assets to another person (the trustee) who must "manage" the assets for the benefit of the party specified in the trust agreement (the beneficiary), and transfer the trust property upon termination of the trust to the trustor or the beneficiary. The Trust law states that the property transferred in trust constitutes a separate estate from that of either the trustor or the trustee. *Further, the trust property is exempt from any claims of the trustee's creditors and, except in the case of fraud, the trustor's creditors. The obligations of the trust may only be satisfied from the trust property.*
- b) *The trustee is a financial institution or an entity authorised by the CNV (similar to SEBI in India) to act as financial trustee* and the beneficiaries are the holders of certificates of

participation in the trust property ('certificates') or the debt instruments guaranteed by the trust property ('debt instruments').

- c) Financial trustees may be financial entities authorised under Argentine law, entities registered in the Register of Financial trustees held by CNV and the financial institutions chartered by the Central Bank of the Argentine Republic. In order to be included in the Register of Financial Trustees, an entity must be a *corporation* or, in the case of foreign company, must have a branch or other form of representation in Argentina; its legal purpose must include serving as a trustee; it must have a net worth of at least 100,000 pesos; and it must have an adequate administrative organisation to perform its duties as financial trustees, although administrative services may be contracted out.
- d) Further:
- *The trust agreement may not release the trustee or its employees from its responsibility for acts of negligence and wilful misconduct nor from the prohibition on its acquiring assets held by the trust.* Upon or after signing the trust agreement, and in accordance with its terms, the trustee will be the transferee of the assets or rights which are the subject of securitisation and as of that moment, the trustee will be endowed with title, in trust, to the rights to such principal, interest fees, collateral security etc., which title and rights may not be challenged by third parties if the transfer and the registration are carried out in accordance with the formalities required by the applicable law.
 - The portfolio of loans that may be transferred and held by a trustee will at no time be considered part of the trustee's assets for bankruptcy or other purposes.

More details are given in Chapter 6.

7.2.3 Morocco

- (a) In Morocco, the SPVs can be (i) institutional investors in debt or (ii) other entities which are governed by the legislative or regulatory systems of either Morocco or other foreign countries. The SPV is a separate and autonomous body and has the capacity of a natural person. All its functions are administered by its management depository institution, akin to asset management company (AMC) in India. *It has been considered advisable that for each securitisation operation by an Originator, a separate SPV is created exclusively for that operation, although an AMC may be founder and manager of more than one SPV provided that appropriate, precautionary measures are put in place and described in the relevant administrative rules to prevent conflicts of interest and the mixing of funds.*
- (b) Rules of formation of SPV
The minimum framework of rules within which the SPV is founded has been specified in the Act covering the duration of the SPV, particulars of its AMC and the financial intermediary, a description of the planned securitisation operation, nature of assets to be transferred to it, minimum and maximum amounts of intended issue, frequency and nature of mandatory information to be provided to its investors, procedures for meetings with its investors, dissolution of the SPV, etc. As a result of its exclusive purpose for securitisation operation, an SPV cannot undertake any activity or assume any responsibilities other than those prescribed in the rules of its formation.
- (c) Minimum disclosure norms
The Act specifies that the rules of formation of the SPV must include the frequency and the nature of mandatory information to be provided to the investors. Any Originator holding or acquiring direct or indirect interest in the

AMC must disclose the fact in the rules of the SPV and the information to be furnished to the investors. The AMCs are required to furnish a copy of the annual report on the SPV and if required by the rules at a greater frequency, duly certified by an auditor.

- (d) Separation from the assets of its Originator and AMC
The transfer of the receivables is absolute and cannot be cancelled for any reason even if the Originator becomes insolvent or enters liquidation. The receivables once transferred to the SPV are to be removed from the balance sheet of the Originator. Further, there is no guarantee from the Originator about the solvency of the debtors. All its assets are separate from those of the Originator, its management depository institution and its share/bonds holders.
- (e) The SPV is required to follow the *accounting rules* approved by Government in consultation with National Accounting Council or failing this, those, which are in conformity with the accounting rules generally accepted in Morocco. The auditor has been assigned a permanent role in the auditing of the books of the SPV, verification of the consistency and the authenticity of its accounts as also the information related to its financial position prior to its being released.

7.3 SPV in the Indian context

7.3.1 In India too, Originator should have the same flexibility in choosing an appropriate legal structure for the SPV based on its individual requirements whether in form of a company, trust (with or without a company as a trustee), MF, a statutory corporation, a society, firm, etc., in short all possible forms of a business entity that is capable of being formed. Consequently, the provisions of the parent law for incorporation of such entity, i.e., the Companies Act, Trust Act, the Partnership Act, etc. will apply to the formation of such SPVs.

7.3.2 While different forms of SPVs have evolved in various markets, Indian mortgage sector has taken cues from the US market. The securitisation SPV assumes a character different from a mere conduit in US. NHB has now taken upon itself the role similar to that being performed by Fannie Mae and Freddie Mac in the US. NHB is presently engaged in bringing to the market its pilot issue of MBS backed by mortgage pool of four Housing Finance Companies. The pilot issue has been under discussion for two years now and currently the structure and the modalities are being finalised by NHB. Based upon the experience of the issue, NHB is likely to take a longer view of what role it needs to play to give a fillip to the secondary mortgage market in India. Other players in the housing market like commercial banks, HUDCO, State housing boards etc. may also desire to participate in the secondary mortgages market as Originator or SPV or ancillary service providers. For this segment of the market, as well as the segment relating to issuance of ABSs, certain other kinds of SPVs would develop over a period of time.

7.4 Key features desired in an ideal SPV

7.4.1 Based upon the international practices as discussed in para 7.2 above, the WG came to the conclusion that an SPV should, therefore, satisfy the following key characteristics:

- (a) An SPV must be capable of acquiring, holding and disposing of assets.
- (b) It would be an entity, which would undertake only the activity of asset securitisation and no other activity.
- (c) An SPV must be bankruptcy remote i.e. the bankruptcy of Originator should not affect the interests of holders of instruments issued by SPV.
- (d) An SPV must be bankruptcy proof. i.e. it should not be capable of being taken into bankruptcy in the event of any inability to service the securitised paper issued by it.
- (e) An SPV must have an identity totally distinct from that of its promoters/ sponsors/

constituents/ shareholders. Its creditors cannot obtain satisfaction from them.

- (f) The investors must have undivided interest in the underlying asset (as distinguished from an interest in the SPV which is a mere conduit).
- (g) A SPV must be tax neutral i.e. there should be no additional tax liability or double taxation on the transaction on account of the SPV acting as a conduit.
- (h) A SPV must have the capability of housing multiple securitisation. However, SPV must take precaution to avoid co-mingling of assets of multiple securitisation. In case of transactions involving various kinds of assets, they should restrict the rights of investors to the specific pool.
- (i) The SPV agreement may not release its employees or trustees from their responsibility for acts of negligence and a wilful misconduct.

7.4.2 Instrument issued by the an SPV should have the following characteristics:

- (a) Be capable of being offered to the public or private placement.
- (b) Permit free or restricted transferability.
- (c) Permit issuance of pass through or pay through Securities.
- (d) Represent the amounts invested and the undivided interest or share in the assets (and should not constitute debt of SPV or the Originator).
- (e) Be capable of being classified as senior / subordinate by differentiation in ranking of security or in receiving payments.
- (f) May be issued in bearer form or registered in the holder's name, may or may not be endorsable and may be issued in definitive form or book entry form.

7.4.3 *Bankruptcy-remoteness and insolvency laws*

Standard and Poor's¹ has developed the following the 'Special Purpose Entity' criteria which a SPV should satisfy to be deemed as bankruptcy-remote.:

- Restrictions on objects and powers : The purpose of this restriction is to reduce the SPV's internal risk of insolvency due to claims created by activities unrelated to the securitised assets and issuance of rated securities.
 - Debt limitations: An SPV should be restricted from issuing other debt except in circumstances those are consistent with the rated issuance.
 - Independent director: Interlocking directorates between the Directors of the SPV and that of its parent present a potential conflict of interest. If the parent becomes insolvent in a situation where the SPV is performing adequately, there maybe an incentive for the parent entity to voluntarily file the SPV into bankruptcy and consolidate its assets with those of the parent. If the SPV has at least one director who is independent from the parent and this director's vote is required in any board action seeking bankruptcy protection for the SPV, the SPV is unlikely to voluntarily file an insolvency petition.
 - No merger or reorganisation: This requirement ensures that, while the rated securities are outstanding, the bankruptcy-remoteness of the SPV will not be undermined by nay merger or consolidation with a non-SPV or any reorganisation, dissolution, liquidation, or asset sale.
 - Separateness: Separateness covenants are designed to ensure that the SPV holds itself out to the world as an independent entity, on the theory that if an entity does not act as if it had an independent existence, a court may use principles of piercing the corporate veil, alter ego, or substantive consolidation to bring the SPV and its assets into the parent's bankruptcy proceedings.
 - Security interests over assets: A debt security interest opinion is generally required that the issuing SPV can grant a security interest over its assets to the holders of the rated securities. This element helps in reaching the analytic conclusion that an issuer is in fact
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an SPV by reducing the incentives of the parent to involuntarily file the entity. By reducing the practical benefit of insolvency filing, the likelihood of voluntary insolvency is decreased.

Each of these characteristics is important to the overall concept of bankruptcy remoteness and regardless of the specific organizational structure of the SPV, these elements should, generally, be treated in the relevant organisational documents. Such an SPV is regarded as being sufficiently protected against both voluntary and involuntary insolvency risks.

7.5 Company, Trust or MF

Reforms may be necessary in essence to establish that an SPV irrespective of its form meets the desired objectives and has the desired characteristics. While three forms of enterprise namely, company, trust and MF have been examined in the following table, the examination is not by any means conclusive of all of the difficulties that may be encountered in the event one is desirous of utilising such business enterprise as an SPV.

Table 4: Comparative table of the desired features in a Company, Trust or MF

Sr. No.	Topic	Company*	Company as Trustee of a Trust established for securitisation*	MF [constituted as a Trust under SEBI (MF) Regulations]*
(1)	(2)	(3)	(4)	(5)
1.	Capable of acquiring, holding and disposing of assets pursuant to securitisation transactions	Yes	Yes	<i>The position is ambiguous and clarification may be sought from SEBI</i>
2.	Bankruptcy proof SPV	No - Against creditors (i.e. Debt instrument holders) - Against structural bankruptcy	Yes -Subject to suitable provisions in the Trust Deed	Yes -Subject to suitable provisions in the Trust deed and terms of issue of Units under any specific Scheme
3.	Independent corporate existence, limited liability and perpetual succession	Yes	Yes -Subject to suitable provisions in the Trust Deed	Yes -Subject to suitable provisions in the Trust Deed
4.	Tax neutrality	No	Yes -Subject to suitable provisions in the trust deed	Yes
5.	Undivided interest of	No -as a shareholder	Yes -Beneficial owner of the	Yes -Beneficial owner

	investors in the underlying assets	(whether preference or equity only owner of shares of the company and of the assets of the company) -as a debt instrument holder only entitled to the repayment/payment of principal and interest	assets	of the assets (Unitholder has an undivided beneficial interest in the assets comprised in the specific Scheme of the MF)
6.	Housing of multiple securitisation transactions	No	Yes -Subject to suitable provisions in the Trust Deed -The Trustee would be able to enter into different trust deeds for different transactions	Yes - MF can offer multiple schemes
7.	Capable of issuing paper of different maturities, particularly short maturity paper, publicly or privately	Yes	Yes -Subject to suitable provisions in the Trust Deed	Yes <i>-Clarification is however necessary from SEBI whether MFs can make private placements</i>
8.	SPV structures should permit issuance of both “pay through” and “pass through” securities	Yes (in case of structured debt instrument)	Yes -Subject to suitable provisions in the Trust Deed and terms of issue	Yes <i>Clarification is however necessary from SEBI whether two or more classes of units can be issued</i>
9.	Regulator	Yes - Companies as such are regulated by DCA and NBFCs are also regulated by RBI	<i>Could be RBI.</i> NBFC Regulations should not be applicable In case of public issuance of securities, would be subject to SEBI purview	Yes - MFs as such are regulated by SEBI and in case of money market MFs, SEBI and RBI play a role in regulation

* Reforms are desirable to all laws governing the respective entities in all items which renders the particular entity unable to match and meet the essential characteristics.

The pros and cons of various forms of structures for SPV are discussed below

7.6 Company as a SPV

Structuring the SPV as a Company under the Companies Act, 1956, has certain legal and regulatory issues as well as entity level taxation issues.

7.6.1 Bankruptcy Proof

A company formed under the Companies Act, 1956 cannot be bankruptcy proof since the Court under Section 433 of the Companies Act can wind it up. Under Section 434 of the Companies Act, a company shall be deemed to have been unable to pay its debts if a creditor to whom the company is indebted to the extent of Rs 500 has served a notice for payment of the sum and the company does not pay the sum payable within 3 weeks from receipt of such notice or secure the debt or compound the same to the satisfaction of the creditor.

7.6.2 The SPV will leave itself open to a winding up for non payment of a sum as little as Rs 500. Keeping in mind that one of the essential factors of an SPV established for the purpose of securitisation is that the SPV should be bankruptcy proof; a Company may not fulfil the requirement. Upon the company issuing a debt instrument or raising any money in the form of debt, the company leaves itself open to bankruptcy suits.

7.6.3 However, a Company as SPV can remain bankruptcy remote if there is true sale from Originator of SPV.

7.6.4 Instruments that can be issued by the SPV

Characteristics of instruments that can be issued by a Company are set out below:

i) Shares :

Shares may be equity or preference shares.

Equity Shares:

A public company set up for securitisation purposes issuing equity shares will be a single transaction vehicle. Other conditions such as transferability, stamping etc are the same as for preference shares.

Preference Shares:

Allows for the SPV to be a multiple transaction SPV. However, linking returns (i.e. dividends) to a particular asset pool might present practical problems. Also, while the Companies Act allows (by implication) differential dividends on different classes of preference shares, it is not clear whether this encompasses linking dividends on each class to different sources of profits.

Transferability and Tradability

The shares are marketable if listed. Hence, the transfer and marketability would be dependent on whether the shares are listed or unlisted. Shares can also be traded privately.

Stamp Duty on Issue

This is a State subject.

Stamp Duty on Transfer

This is a Central Subject and is charged at 0.75%.

(ii) Debentures :

Transferability and Tradability

The debentures are marketable if listed. Hence, the transfer and marketability would be dependent on whether the debentures are listed or unlisted. Debentures can also be traded privately.

Stamp Duty on Issue

Stamp duty is as specified by the Central Government. It is an *ad valorem* levy and the duties vary depending on the mode of transfer (whether by endorsement/ separate instrument of transfer or by delivery).

Stamp Duty on Transfer

It is a state subject.

(iii) Other Instruments:

To ensure that the Company is bankruptcy proof, the instrument issued by it should not impose an unconditional liability on it to repay the debt irrespective of the realisations from the underlying assets.

Tax efficiency

A Company is subject to entity level taxation and the income generated by a company is subject to tax. This would increase the cost of securitisation and the transaction would not be cost effective. The nature of the SPV is such that it merely houses the receivables and issues papers for investors. In order to achieve this and to make the paper/ instrument attractive to the ultimate investor it is important that there is no tax burden on the SPV.

7.6.5 **Recommended** Reforms for an SPV in form of a Company

- An SPV as a Company should be able to issue a new class of instrument viz. the PTC that is repaid only from the performance of the *identified assets* held by it for the benefit of the investors in the PTC – this would prevent structural bankruptcy.
- This new class of instrument should not be treated as debt obligation of the SPV, but one representing an undivided interest of the investor in the underlying asset.
- The instruments are to be issued against a specified pool of assets. Thus multiple securitisation transactions can be handled since instruments can be issued against separate sets of assets.
- The Company should not be subject to the NBFC registration norms as specified by the RBI. *Instead, RBI may consider some other form of regulation of the SPVs.*
- In the long run, such SPV companies should be declared to be exempt from entity level taxation.

7.7 **Trust of which a Company is a Trustee (Trustee Company as SPV)**

7.7.1 The Trustee Company is similar to a Trust with only the role of the Trustee being undertaken by a Company. With individuals becoming increasingly averse from acting as Trustees (as is happening in the case of MFs), a Company may act as the Trustee and issue the PTCs to the investors.

7.7.2 Characteristics of the Trustee Company

- A Company under the Companies Act, 1956 which would act as the SPV.
- It would acquire the receivables by assignment from the Originator and hold them in its capacity as Trustee.
- The Trust Deed should ensure that the Company can act as the Trustee and also hold in Trust separate tranches of receivables pertaining to different transactions

- The SPV/Trustee are not liable for the good performance of the assets.
- The administration of the SPV's assets for any transaction may be subcontracted back to the Originator or to any other servicer through an Administration Agreement describing the different tasks to be performed by the Originator (in its capacity as Administrator).

7.7.3 The framework of the Trustee Company would be as in the case of a MF Trustee Company. The security issued by the SPV i.e. the PTC would not be a debt obligation of the Trustee Company. The PTCs would constitute certificates notifying ownership on the pool of the assets/receivables being securitised.

7.7.4 A PTC ideally represents a declaration of interest in a pool of assets transferable when a beneficiary changes. The Trust through the Trustees will recognise the change in the beneficiary by endorsing the PTCs. There is no transfer of ownership interest from the Trust, as it would continue to hold the securities in trust for the changing beneficiaries represented as a class.

7.7.5 The PTC would not be treated as a re-assignment of receivables as there is no transfer of property interest from the Trustee to the PTC holder. The Trustee always holds the property for the beneficiaries from inception of the Trust and never sells or reassigns the interest, as the Trust never dissolves. As there is no assignment of interest at the stage of issuance of PTC, there is no re-assignment when the PTC holder changes.

7.7.6 For each securitisation transaction routed through the Trustee company there would be a Declaration of Trust made separately for each pool of receivables. An information memorandum would be drawn up in each instance. It is similar to a MF scheme where the terms of the scheme and the benefits of the unit holders are specifically described and assigned for each scheme.

7.7.7 **Recommended** reforms for the SPV in the form of a Trustee Company

- ❖ There is lack of clarity as to whether securities issued by a trust are capable of being listed on a stock exchange. At present, MFs are the only trusts, which have been specifically empowered to issue such securities. *SEBI could be requested to recognise such trustee companies and permit them to issue marketable securities as has been done for MF units.*
- ❖ Trustee owned assets would be normally treated, as distinct from company owned assets. However, a clarification from tax authorities that such SPV trustee companies would enjoy a tax shield may be necessary.

7.8 MF AS SPV

7.8.1 A MF is legally and factually a trust, being administered by a Trustee Company or a Board of Trustees, and whose assets for each scheme are managed by a separate Asset Management Company (AMC). As discussed above, while examining the trustee company concept, a MF is an existing and established legal structure, which conforms, in general, to the requirements of a securitisation SPV.

7.8.2 The schemes established by a MF are independent of one another. Separate maintenance of accounts of each scheme is required. Further, the unitholders of each scheme are owners of undivided beneficial interest in the assets of the Scheme.

7.8.3 Unless it is an assured return scheme, the Unit holders are only entitled to receive such dividends as may be declared by the AMC or the trustees. Further, in case of loss of initial investment (unit capital), the loss devolves on the investors.

7.8.4 A MF possesses most of the characteristics desirable for a securitisation SPV, namely:

- MFs are structured as trusts under the Indian Trusts Act, 1882. This gives them the flexibility to issue units under different schemes, and keep the funds raised under schemes (and consequently the rights of investors in different schemes) distinct from each other.
- MFs are permitted to issue marketable securities. While normal trusts (i.e., those that are not registered with SEBI as MFs) can borrow funds, it is unclear whether they can raise money by issuing marketable securities i.e. it has not been experimented so far.
- The income earned by MFs is exempt from tax under sec 10(23D) of the Income Tax Act, 1961.

7.9 Further recommendations for different forms of SPV

7.9.1 Company as SPV:

Applicability of NBFC Directions

If the SPV for asset securitisation is set up as a joint stock company under Companies Act, the activities undertaken by the SPV would appear similar to those of an investment or loan company and the following issues would arise. However, as explained later, the SPV in effect would only be undertaking an activity akin to trading in debt.

- (i) It would require registration with RBI under Section 45-IA of the RBI Act and it should have the statutorily prescribed minimum capital funds and the present requirement is Rs. 200 lakh for a new company and this may not be possible. However, in view of the fact *that it would be a company which would undertake only the activity of asset securitisation and no other activity*, all the companies incorporated for the purpose could be treated as a class of companies and would be regulated by one or the other Regulatory Authority viz. RBI or SEBI. The Reserve Bank of India in exercise of its powers under section 45NC of the RBI Act could exempt all such companies from the applicability of core provisions of RBI Act as has been done in case of the Stock Broking Companies.
- (ii) The SPV raises funds through issue of Pass Through Certificates or Pay Through Certificates (PTCs) and such monies may or may not be treated as public deposits. If so, the SPV would be governed by the comprehensive regulatory framework like capital adequacy requirement, credit/investment concentration norms. However, the FIs proposing to securitise their asset portfolio may transfer beneficial interest on assets in favour of the SPV, which in turn issues PTC against the backing of assets / future cash flows from these assets. Therefore, PTCs could be treated as a secured instrument and the NBFC Directions should not be applicable. The debentures/bonds, which are fully secured by the assets of the company in respect of which a charge has been created in favour of the trustees for such debenture holders/bond holders, are exempted from the description of public deposits. On the other hand, if the PTCs were treated as near to equity, the NBFC Directions would not cover them because raising of money by contribution to capital is exempt from the definition of deposit.

- (iii) If the SPV company is floated by an NBFC as the Originator, it could be reckoned as a company in the same group or its subsidiary and the Net Owned Fund of the Originator NBFC would be severely affected because of the exposure to the group companies. The SPVs promoted for infrastructure development are presently facing the same difficulties. This is a larger issue and the Originators should have an arm length relationship with the SPVs promoted by them and should not have more than the substantial interest. Alternatively, in order to give encouragement to the NBFCs to promote SPVs for the purpose of asset securitisation, RBI would also need to clarify that such SPVs will not be treated as the companies/entities in the same group/subsidiaries of the Originator NBFC because it would have no beneficial interest in the SPV except to the extent of its shareholding or the investments made in the instruments issued by the SPV. It would encourage the NBFCs to promote the SPVs without an adverse impact on their Net Owned Fund.
- (iv) If the SPV company were promoted by a bank, it would require prior approval of RBI under the B. R. Act, 1949 for investing more than 30 percent of the paid up capital of the bank or the investee company. The banks could, however, own less than 30 per cent of the equity of the SPV and float the company in association with other financial institutions.

7.9.2 Trust as SPV:

An option that could be examined is the exercise of inherent powers of the Government of India under the Constitution of India and the Government of India Act, 1935, to notify a requisite scheme (akin to the SEBI (MF) Regulations, 1996, under which securitised paper can be issued by a trust established for the purposes of securitisation. Similar steps have been taken in the past by the Government of India, e.g., the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipts Mechanism) Scheme, 1993. The Government of India could under such scheme/regulations (for issue of securitised debt receipts through the securitisation fund) designate an appropriate authority for administration of the scheme/regulations.

7.9.3 MF as SPV

The MF in its current form, however, cannot be used to perform the role of a securitisation SPV due to the following reasons:

- ❖ A MF cannot buy into assets and actionable claims. The entire SEBI (MF) Regulations mention only 'security' – whether it is in the context of the role of the AMC or in the accounting and valuations aspects.
- ❖ The existing set of regulations includes, to a large extent, directives that are vital to normal MFs but redundant as far as securitisation SPVs are concerned. The amendment of every clause of the existing regulations to encompass all the activities of the SPV would be a laborious task since the entire spirit and focus of the MF regulations is on regulating activities very different in nature from that of a securitisation SPV. Re-writing a fresh set of regulations for securitisation might prove to be less cumbersome and easier to understand.

7.9.4 Unincorporated bodies (Partnership firm/ society, etc. as SPV - applicability of NBFC guidelines)

- (a) In view of the fact that securitisation is a financial activity, the unincorporated body (i.e., individual, firm, HUF, association of persons) undertaking such activity would be deemed to be engaged in financial business and the provisions of Chapter III C of the Reserve Bank of India Act, 1934 would be attracted to such activities. The unincorporated entity is, *inter alia*, not allowed to raise deposits from other than the relatives and institutions specified in the Reserve Bank of India Act, 1934.
- (b) The bonds, debentures or any other instruments near to equity can be raised only by joint stock companies. The unincorporated entities can, therefore, issue only the PTCs. In so far as they issue PTCs to the specified institutions, *viz.*, FIs, statutory corporations, cooperative societies, companies incorporated under the Companies Act 1956 etc., these borrowings or moneys received through issue of PTCs would be exempt from the purview of 'deposits' and to that extent these entities could act, unhindered, as SPV for issuing securitised papers. In the usual course, initially, the investors are the institutions or corporates only, and the provisions of Chapter III C of the Reserve Bank of India Act, 1934 would not be attracted. There could, however, be instances of unincorporated entities acquiring the PTCs by their purchase in the secondary market. The situation emanating therefrom could be unintended by the issuers and could be an aberration. These should therefore be ignored for the purpose of compliance with the Reserve Bank of India Act, 1934.
- (c) There are no regulations on the unincorporated bodies investing in the securitised papers. They can acquire hold, transfer, purchase, repurchase etc., in the usual course of their business and subject to the compliance to the other applicable statutes.

The observations will also apply to SPV as a Trust or MF.

7.9.5 Further, the Working Group discussed whether SPV should be one time entity (transaction specific) or an on-going entity. It was also suggested that a few SPVs might cater to the needs of particular industry and thus acquire specialisation in securitising assets pertaining to a given sector of economy. Another view was that the co-mingling of asset pools from various Originators might not be an appropriate strategy till the system stabilises. The day to day functions of SPV may be performed by an administrator / servicer for a fee.

7.10 Conclusion

7.10.1 The fact remains that the MF is the closest available existing and regulated entity, which carries out an activity similar to securitisation. While it may not be feasible to accommodate the spirit of securitisation in its entirety within the MF Regulations, ***SEBI could be prevailed upon to frame a suitable set of guidelines for regulating the securitisation activity on the lines of the MF Regulations.*** A point to note is the recent issuance of Guidelines for collective investment schemes, which again have many aspects in common with securitisation schemes. SEBI's experience in handling similar legal structures involving aggregation of investments (public or private) would help the activity arrive in market in a regulated form.

7.10.2 While the SPV would be incorporated & registered as an entity under its parent legislation, for e.g., a company would be registered with the Registrar of companies; for such a Company to engage in the activity of public issuance of securities, it may be desirable for the entity to be registered with the capital market regulator also. This may be kept in view by SEBI while framing the guidelines for regulating the securitisation activity.

7.10.3 For securitisation to realise its true potential in the infrastructure / housing and other capital deficient sectors, widespread participation in securitisation schemes is highly desirable and should be encouraged. SPV should therefore be capable of issuance of

securities to a large variety of investors. The concerns relating to investor protection will be adequately taken care of by the capital market regulator.

7.10.4 Since investor participation in securitised paper will be from both the private placement markets as well as by public issuance, it is desirable that both the activities are regulated from a common point. This is particularly so in view of:

- ❖ Common set of guidelines which will rule out duplicity of regulations.
- ❖ The informed investor i.e. FIs/mutual funds, etc. will help the activity take off initially by subscribing to the scheme. Other investors like pension funds, insurance companies, etc can gain confidence and participate through the secondary market.
- ❖ Likely widening of the potential investor base right from inception in view of the above.

¹ Standard & Poor's Legal Issues in rating Structured Finance transactions : April 1998, page 30.