

## Note

# Constitutional forms of SPVs in securitization transactions

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The note below addresses the concerns - whether an SPV constituted as a company, for giving effect to a securitisation transaction will tantamount to being an NBFC and will require RBI registration. Irrespective of the regulatory stand currently being taken, the Note also gets into why it does not serve the purpose of the extant policy, to restrict organisational form of SPVs to “trusts” only.

## 2006 Guidelines

The RBI Guidelines on Securitisation of Standard Assets, 2006 define SPV to mean:

*'SPV' means **any company, trust, or other entity constituted or established for a specific purpose - (a) activities of which are limited to those for accomplishing the purpose of the company, trust or other entity as the case may be; and (b) which is structured in a manner intended to isolate the corporation, trust or entity as the case may be, from the credit risk of an originator to make it bankruptcy remote. (emphasis ours)***

Therefore, an SPV can be a company which is incorporated with the limited purpose, in the present case that of undertaking the securitisation transaction. The purpose of an SPV is to be able to isolate the assets from the originator's credit risk and create bankruptcy remoteness. In essence, RBI recognises a corporate entity formed with a limited purpose to be an SPV. Internationally as well, a special purpose vehicle is created for the purpose of securitisation transactions and holds assets transferred by originator for the benefit of the investors and to meet the intent of achieving bankruptcy remoteness. Globally, SPVs are organised in different constitutional forms, depending on the need of the transaction and the law of the country. SPVs are formed as trusts, companies, LLPs, LLCs, etc.

### Features of a securitisation SPV

Special purpose vehicle has the following features:

- a. It is not an operating company;
- b. It is formed for a limited purpose, i.e. of securitization;
- c. The SPV is holding the assets (acquired from the originator) for and on behalf of the investors. It would not be incorrect to say that the SPV is a mere congregation of the assets acquired from the originator.
- d. The SPV is a mere intermediary, sometimes a conduit between the originator and the investors and creates a structural and legal façade.
- e. The SPV cannot undertake any business other than of holding the receivables for and on behalf of the investors.
- f. The purpose of the SPV extinguishes once the securitization transaction comes to an end.
- g. The charter documents of the SPV clearly lay down that the objects of the SPV is limited to undertaking the securitization transaction.

Therefore any acquisition of the receivables by the SPV is in fiduciary capacity and not to undertake any business of acquisition/ selling of the receivables or any other financial assets.

### SPV not an NBFC

Apart from the fact that the RBI guidelines of 2006 recognise an SPV to be a company without specifying conditions requiring RBI consent or acquiring certificate of registration as an NBFC, we must understand whether an SPV is undertaking any financial activity for it to qualify as an NBFC in nature and spirit. RBI while drafting the 2006 guidelines, has not specified any requirement for SPVs to be registered as NBFCs with RBI.

In light of the characteristics of an SPV explained in the previous section an SPV is acquiring the receivables with the intent of isolation of the receivables from the originator and also it holds the receivables for the benefit of the investors. The acquisition of the receivables is not for the purpose of on-lending.

Section 45I (c) of the RBI Act defines financial institutions to mean

*any non-banking institution which carries on as its business or part of its business any of the following activities, namely:–*



- (i) *the financing, whether by way of making loans or advances or otherwise, of any activity other than its own:*
- (ii) *the acquisition of shares, stock, bonds, debentures or securities issued by a Government or local authority or other marketable securities of a like nature:*  
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The SPV is not engaged in the business of making loans or advances or is not carrying out financial activity in its ordinary course. As is evident from the definition of SPV stated in the 2006 guidelines, they have a limited purpose with which they are created.

Further, wold-over SPVs are thinly capitalised entities which do not carry on any operative business and are bankruptcy remote themselves.

#### **Desired Clarification that SPVs will not be NBFCs:**

Currently we understand that no SPV is formed as a company. Most of the SPVs used in securitisation transactions are in trust form.

Depending on the purpose of the transactions, a transaction may find the corporate form of SPVs better than a trust form. Among other things, one of the primary motives in using the corporate form is to be able to issue various types of securities, including debt securities.

Now that the tax issues concerning securitisation, in form of distribution tax, has been proposed to be removed by the Finance Bill 2015, we expect the market to get into a buoyant mode. We expect the markets to start trying several innovative forms of securities, as being globally issued. Globally, securitised debt instruments take various forms, such as bonds, notes, certificates, etc.

Therefore, it is only keeping in line with the RBI's own Guidelines of 2006 to permit SPVs to be formed as companies, without raising any issues as to regulation of such companies as NBFCs.

There is no policy reason as to why SPVs should continue to be formed as trusts. While trusts are simpler to form, however trusts are unregulated entities. We list down several reasons due to which a policy-maker will rather like to encourage the market to use companies or LLPs rather than using the trust form:

- Trusts are unregulated. Companies are regulated.

## **INDIAN SECURITISATION FOUNDATION**

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- Trusts do not require audits or annual filing. Companies are audited, their records are on public registry system.
- The identification of ultimate beneficial owner (UBO) in case of trusts is always a challenge. In case of companies, companies have clear UBOs in view of shareholding position.
- In case of companies, based on the nature of securities issued by the company, there are defined controls, in form of provisions of the Companies Act on private placements, debentures, etc. In case of trusts, there is virtually no regulation, leaving open possibilities of foul play.
- The penalties and prosecutions for violations under the Companies Act are well defined. In case of trusts, a breach of trust leads to a criminal offence, for which the implications come under usual IPC provisions.

In any case, a regulator may like to leave the choice of the form of the SPV to the marketplace rather than directly or indirectly affect the level playing field.

### **Our recommendation:**

The RBI may appropriately clarify its stand. We are of the view that there is no case for treating an SPV, restricting its objects solely to that of subserving the purpose of a securitisation transactions, and clearly laying in its MoA that the company will not do any lending or any other financial activity, should not be regarded as an NBFC.

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