

# Issues : Legal and Regulatory

Mona Bhide

*DAVE & GIRISH & CO*

# ***DAVE & GIRISH & CO***

- Law firm established 1978
- Banking/Structured Finance:  
1991
- Mumbai and Bangalore
- Banks, NBFCs and HFCs

# Regulatory /legal compliance authorities

- RBI
- SEBI
- Income Tax/Service Tax
- Stamp Duty
- Registration authorities

# Relevant Statutes for domestic transactions:

- RBI Guidelines on Securitisation and Direct Assignments
- NHB Draft Guidelines
- Stamp Act : different in different states
- SEBI Guidelines for Listing of Securitised Debt Instruments
- Finance Act, 2016

# MBS transaction

- NHB Guidelines
- Stamping
- Registration issues
- When does the registration become necessary: **only in case of enforcement**

# Stamp Laws

- Maharashtra Stamp Act, 1958:
- Article 25 (a) relates to movable properties.
- The notification remitting the stamp duty on assignment documents is made under Article 25 (a) and therefore a view is taken by some law firms that it would not cover Mortgage loan Securitisation/assignments.
- RESULT:
- Expenses of up to Rs. 9,00,000/- are paid in Rajasthan (600000+300000) against Rupees 1,00,000/- in Mumbai
- Recommendation: Revisions to the State laws

# Stamp Act Notifications

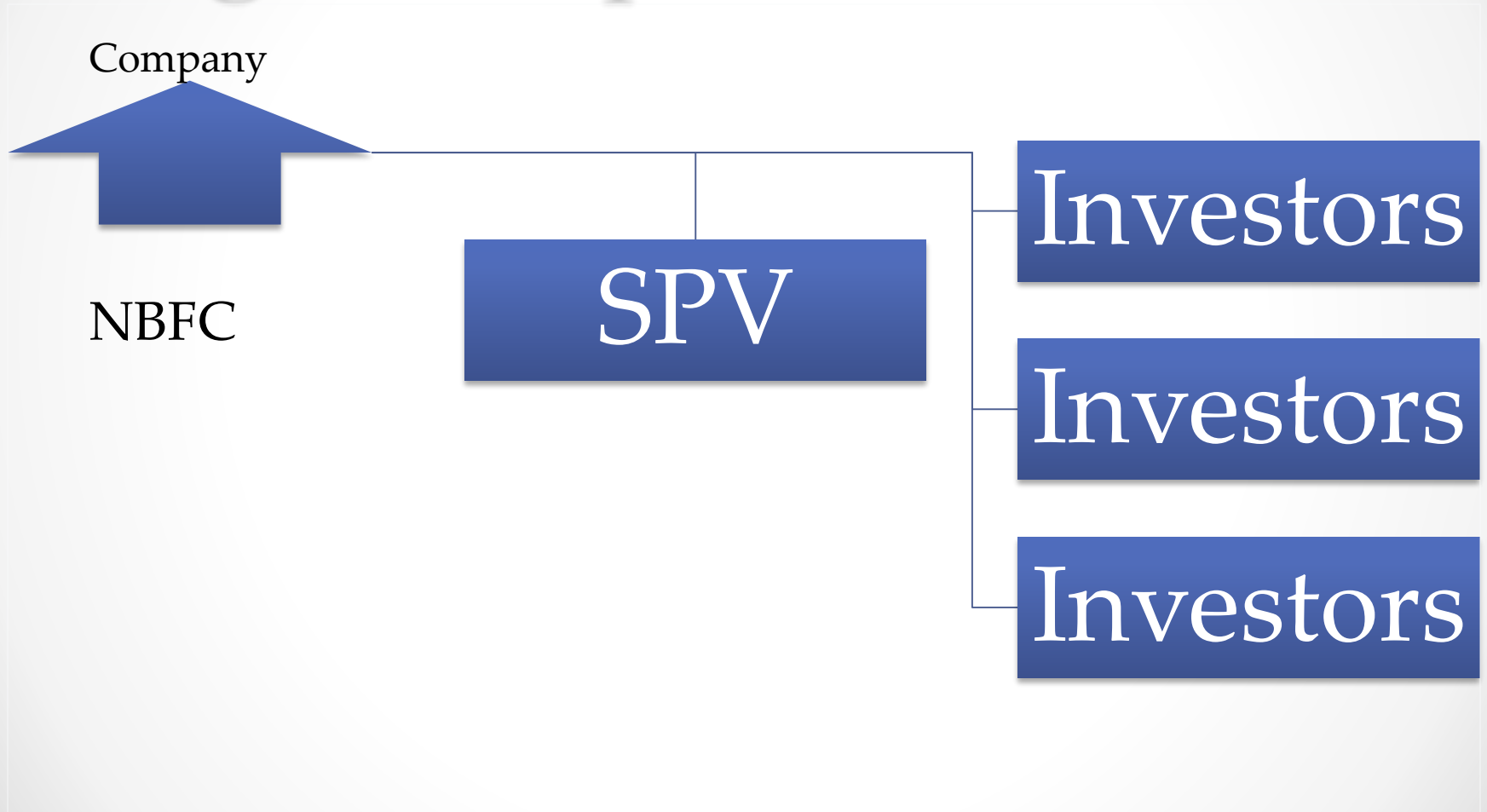
- Notifications under the Bombay Stamp Act:
- 2002/875/C.R. 173-M-1
- In exercise of powers conferred by clause (a) of Section 9 of the Bombay Stamp Act, 1958 and in supersession of the Government Notification, Revenue and Forests Department No. 1094/C.R. 369/(c ) M-1 dated the 11<sup>th</sup> May 1994 the government of Maharashtra reduces with effect from 1<sup>st</sup> May 1994, the duty with which an instrument of securitization of loans or of Assignment of Debt with underlying securities is chargeable under Article 25 (a) of schedule 1 to the said Act, to fifty paise for every 500 Rupees or part thereof, of the loan securitised or debt assigned with the underlying securities subject to maximum of Rupees One lakh and in case of instrument of assignment of Receivables in respect of use of credit cards to 2 Rupees and 50 paise for every 500 Rupees or part thereof.

# RBI Guidelines on Securitization

- Do not allow:
- credit card receivables/trade receivables/PF/Pension
- Sell down of assigned assets/securitisation
- Synthetic Securitisation: tranches with different degrees of credit risks
- Loans with bullet repayments
- Revolving structures: with rights to the borrower to change the repayments/drawn amounts



# Single Corporate loan sale



# RBI- securitisation guidelines

- Mandatory Minimum Holding period:
- The Pool has to comprise of loans for which the Minimum number of installments are paid before securitisation.
- Problem:
- Additional compliance issue

# RBI securitisation guidelines

- Minimum Retention Requirement:
  - Complex credit enhancement options/requirements: First Loss and Second Loss
  - Subordinated Cash flows/over collateralisation
  - First loss: Seller or a third party
  - Second loss: treated as credit substitute for capital adequacy purposes
- Amortisation of cash profit during the life of the trnxn
- Very strict compliance requirements
  - Guidelines need to be simplified and clarified

# Issues with the RBI Guidelines

- Onus on NBFCs to provide analysis, valuation methods and records
- NBFCs have to follow strict credit monitoring requirements so as to be able to spot bad loans earlier
- Reports to be made for 30, 60, 90, 120 and 180 days past over due loans
- Time consuming and cost additions

# Issues on due diligence

- NBFCs are required to carry out the due diligence and for that purpose have “skilled resources”
- Policies for DD should be formulated
- Due diligence cannot be outsourced
- Selection of loans: responsibility on selling NBFC

# True Sale Criteria

- Transfer of all risks/rewards and rights/obligations:
- no economic interest in the assets after its sale:
- what about the MRR?
- Excess Interest Spreads?

Legal Opinion certifying that all rights, title, interest and benefits are transferred.

A seller is required to notify RBI of all instances where it “has agreed” to replace assets sold to another Financial entity or pay damages.

# Non Compliance

- NBFCs cannot enter into purchase agreements with respect to assigned assets
- Non compliance:  
Risk weightage of 667% to the assignment exposures

# Taxation Issues

- Past ambiguity with respect to incidence of 1% interest on the “additional income tax” is now removed with the Finance Act, 2016.
- Rationalizes the regime and provides for “*tax pass through treatment*”
- Income of Securitization Trust is now exempt from tax
- Income passed to investors will be taxable in the hands of the investors



# Central registry of Securitisation Asset

## Reconstruction and Security Interest of India.

CERSAI is a Section 25 company that is owned by NHB and some Public sector banks.

Registration of transfer of Loan receivables and creation of security whether movable or immovable.

Issue: the website does not function well

# ABS/MBS

- Act provides for enforcement of security by Financial Institutions (FI) without going to Court/Tribunal
- If a qualifying FI acquires assets from another NBFC (which does not qualify) under SARFAESI which law would apply at enforcement? SARFEASI would apply
- If a non qualifying NBFC (which does not qualify under SARFAESI) acquires assets from an FI which law would apply for enforcement? SARFEASI will not apply

# Relevant Statutes: Cross border transactions

- RBI Master Circulars: Exports
- FEMA (absence of restrictions)
- Debt Instruments / CDS/ FCCBs / Green Bonds
- Evidence Act amendments: 65A and 65B

# FEMA

- There is no particular restriction under FEMA with respect to Cross border securitisation/Direct Assignments.
- RESULT:
- Confusion on whether cross border securitization/assignment of receivables is allowed or not.

# Cross border transactions

- Master Circular on Export Financing: does not allow assignments
- Cross Border Bill Discounting: Has to be carried out only through an AD Bank
- Cross Border Factoring: AD Bank+ other Issues
- Cross border securitisation: no clarity

# Thank You

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