35

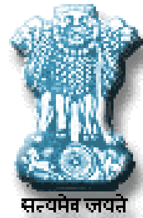
STANDING COMMITTEE ON FINANCE

FOURTEENTH LOK SABHA

MINISTRY OF FINANCE
(DEPARTMENT OF ECONOMIC AFFAIRS)

THE SECURITIES CONTRACTS (REGULATION) AMENDMENT BILL, 2005

THIRTY FIFTH REPORT



LOK SABHA SECRETRIAT
NEW DELHI

May, 2006/Jyaistha, 1928 (Saka)

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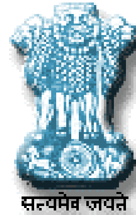
Presented to Lok Sabha on 22 May, 2006
Laid in Rajya Sabha on 22 May, 2006



LOK SABHA SECRETRIAT
NEW DELHI

May, 2006/Jyaistha, 1928 (Saka)

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COMPOSITION OF STANDING COMMITTEE ON FINANCE – 2005-2006

Maj. Gen. (Retd.) B.C. Khanduri - Chairman

MEMBERS

LOK SABHA

2. Shri Jaswant Singh Bishnoi
3. Shri Gurudas Dasgupta
4. Shri Bhartruhari Mahtab
5. Shri Shyama Charan Gupta
6. Shri Gurudas Kamat
7. Shri A. Krishnaswamy
8. Shri Bir Singh Mahato
9. Dr. Rajesh Kumar Mishra
10. Shri Madhusudan Mistry
11. Shri Rupchand Pal
12. Shri Danve Raosaheb Patil
13. Shri Shriniwas D. Patil
14. Shri K.S. Rao
15. Shri Jyotiraditya Madhavrao Scindia
16. Shri Lakshman Seth
17. Shri G.M. Siddeshwara
18. Shri Ajit Singh
19. Shri M.A. Kharabela Swain
20. Shri Vijoy Krishna
21. Shri Magunta Sreenivasulu Reddy

RAJYA SABHA

22. Shri M. Venkaiah Naidu
23. Shri Yashwant Sinha
24. Shri Chittabrata Majumdar
25. Shri S.P.M. Syed Khan
26. Shri Amar Singh
27. Shri C. Ramachandraiah
28. Shri Mangani Lal Mandal
29. Shri Santosh Bagrodia
30. Smt. Shobhana Bhartia
31. Vacant

SECRETARIAT

1. Dr. (Smt.) P.K. Sandhu - Additional Secretary
2. Shri A. Mukhopadhyay - Joint Secretary
3. Shri S.B. Arora - Deputy Secretary
4. Shri T.G. Chandrasekhar - Under Secretary

INTRODUCTION

I, the Chairman Standing Committee on Finance having been authorised by the Committee to submit the Report on their behalf present this Thirty-Fifth Report on the Securities Contracts (Regulation) Amendment Bill, 2005.

2. The Securities Contracts (Regulation) Amendment Bill, 2005 introduced in Lok Sabha on 16 December, 2005 was referred to the Committee on 23 December, 2005 for examination and report thereon, by the Hon'ble Speaker, Lok Sabha under Rule 331E of the Rules of Procedure and Conduct of Business in Lok Sabha.

3. The Committee obtained written information on various provisions contained in the aforesaid Bill from the Ministry of Finance (Department of Economic Affairs), who also briefed them at their sitting held on 19 January, 2006.

4. Written views/Memoranda were received from the Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI), Indian Banks' Association (IBA), National Housing Bank (NHB), State Bank of India (SBI), Housing Development Finance Corporation of India (HDFC), ICICI Bank Ltd., Life Insurance Corporation of India (LIC), Prognosis Capital Advisors, Bombay Stock Exchange (BSE) and National Stock Exchange (NSE).

5. The Committee, at their sitting held on 20 April, 2006, heard the views of the representatives of Reserve Bank of India and Securities Exchange Board of India.

6. At their sitting held on 1 May, 2006, the Committee heard the views of the representatives of Indian Banks' Association, State Bank of India, Life Insurance Corporation of India and Housing Development Finance Corporation.

7. The Committee took oral evidence of the representatives of the Ministry of Finance (Department of Economic Affairs) on 10 May, 2006.

8. The Committee, at their sitting held on 19th May, 2006 considered and adopted the draft report and authorised the Chairman to finalise the same and present it to Parliament.

9. The Committee wish to express their thanks to the Officers of the Ministry of Finance, (Department of Economic Affairs), representatives of the RBI, SEBI, IBA, NHB, LIC, SBI, HDFC, ICICI Bank Ltd. and other Organisations/Associations for their co-operation in placing before them their considered views and perceptions on the provisions of the Bill and for furnishing written notes and information that the Committee had desired in connection with the examination of the Bill.

10. For facility of reference, the observations/recommendations of the Committee have been printed in thick type.

New Delhi;
_19_May, 2006
29 Jyaistha, 1928 (Saka)

MAJ. GEN. (RETD.) B.C. KHANDURI
Chairman
Standing Committee on Finance

REPORT

BACKGROUND

The Finance Minister in the Budget Speech, 2005-06, proposed to :

- amend the definition of 'securities' under the Securities Contracts (Regulation) Act, 1956 so as to provide a legal framework for trading of securitized debt including mortgage backed debt; and

- appoint a high level Expert Committee on corporate bonds and securitization to look into the legal, regulatory, tax and market design issues in the development of the corporate bond market.

2. The report of High Level Expert Committee on Corporate Bonds and Securitization appointed by the Government was submitted on December 23, 2005.

3. The amendments to the Securities Contracts (Regulation) Act, 1956 proposed through the Securities Contracts (Regulation) Amendment Bill, 2005 are:

(i) to include securitisation certificates or instruments under the definition of "securities". Accordingly, a new sub-clause (ie) is proposed to be inserted in clause (h) of section 2 of the SCR Act, 1956. This brings any certificate or instrument (by whatever name called), -

(a) issued to an investor by any special purpose distinct entity which possesses any financial asset representing debt or receivable by such entity and acknowledging the beneficial interest of such investor in such financial asset; and

(b) which may, by general or special order, be specified by the Securities and Exchange Board of India;".

- within the definition of "securities" under the SCR Act.

(ii) Further, the Bill provides for obtaining approval from SEBI for issue of the proposed certificate or instrument and procedure for such issue. Accordingly, it proposes to insert for the said purpose a new section 17A in the SCR Act, 1956.

(iii) It also provides for the manner in which contents of such certificates or instruments, are to be disclosed.

4. Securitization is a form of financing involving pooling of financial assets and the issuance of securities that are re-paid from the cash flows generated by the assets. This is generally accomplished by actual sale of the assets to a bankruptcy remote vehicle, that is, a Special Purpose Vehicle, which finances the purchase through the issuance of bonds. These bonds are backed by future cash flow of the asset pool. The assets for securitization transactions include, mortgages, credit cards, auto and consumer loans, student loans, corporate debt, export receivables, off-shore remittances, etc.

A) Residential Mortgage Backed Securitization (RMBS) Transactions:

5. Residential Mortgage Backed Securitization (RMBS) Transactions are the more common of the securitization transactions. The stages or processes involved in such transactions are delineated as follows from the information furnished to the Committee:

(i) Assignment and Transfer of a pool of housing loans along with the underlying mortgages, from the primary lending institution to Special Purpose Vehicle (SPV).

(ii) On acquiring the pool along-with the underlying mortgages, the SPV packages the cashflows of the pool of mortgages and designs instruments of securitization such as Residential Mortgage Backed Securities (RMBS) which may be in the form of Pass Through Certificates (PTCs), Debt Obligations or any other forms.

(iii) The SPV then issues RMBS to potential investors in Capital Market.

(iv) The investors in the RMBS then rely on the repayments in respect of the underlying mortgage loans for redeeming their investments and realising

the returns thereon.

6. Details of the activities involved in the securitisation process include:

(i) Selection of Pool of Housing Loans:

The pool of housing loans is selected by the Primary Lending Institution from its existing housing loans based upon a 'pool selection criteria' stipulated by the purchaser i.e. the SPV.

(ii) *Due Diligence Audit:*

A due diligence audit of the loan accounts is conducted by a firm of Chartered Accountants to ensure that each of the housing loans in the pool conforms and satisfies the selection criteria laid down by the SPV.

(iii) *Rating and Credit Enhancements:*

Rating of the instruments reflects the level of probability that the principal and interest will be paid/repaid in time and in accordance with the indentures of the transaction. This is considered necessary to build up investor confidence in the instrument and help them assess risks associated with the instrument. The Rating Agencies accord their rating grades on the basis of perceived adherence to payment schedules of the financial obligations based on the strength of the cash pool flows, the credit enhancement mechanism, payment structure, pool originator profile and track record and collateral quality.

In order to maintain a specified rating grade and to improve the performance of the pool as also to ensure uninterrupted cash flow for yielding the indicated coupon interest to the purchaser or subsequent investors in the RMBS paper, the Rating Agency (or even the SPV) may insist for additional credit support (called credit enhancement) under the transaction. The credit enhancement may be provided in various forms such as setting aside a cash pool (called cash collateral account), limited corporate guarantee, third party guarantee, setting aside an additional mortgage pool (called over-collateralisation), investment in sub-ordinated RMBS paper (in the event of

securitisation) etc. In the event of securitisation of mortgage debt ab-initio, credit support is sought on the basis of recommendation of the credit rating agency.

(iv) Valuation of the Pool and Consideration of Assignment:

The SPV makes payment of consideration for the purchase of mortgage debts (for holding it in its own book or for the purpose of securitization *ab initio*) after issue of allotment letters to investors or after execution of the legal documents relating to the transaction or on such date as mutually agreed to between the buyer and the seller.

The purchase consideration to the Primary Lending Agency may be decided based on the valuation of the pool of mortgages utilising any of the following methodologies:

a) Par Pricing Methodology:
The consideration payable to the Primary Lender for transferring the pool is equal to the total future outstanding principal balances of the individual loans on a Cut-Off Date.
b) Premium Pricing Methodology: The consideration paid to the Primary Lender for transferring the pool is decided and paid on the basis of discounting of future stream of net cash flows relating to the pool. It shall normally be higher than the total outstanding principal balances of the individual loans on a Cut-Off Date as the discounting rate used shall be lower than the weighted average coupon of the pool.
c) Discount Pricing Methodology: The consideration paid to the Primary Lender for transferring the pool is lower than the total outstanding principal balances of the individual loans on a Cut-Off Date as the discounting rate used shall be higher than the weighted average coupon of the pool due to higher risk perception.

(v) *Appointment of Servicing and Paying Agent(s)*

The SPV appoints a Servicing and Paying Agent to handle Post-Issue Servicing Operations which includes Custodial services (for holding mortgage

documents), Loan Administration and Recovery operations, Appropriations of the Payments to Investors and Service Providers, Management Information System and Reporting, Maintenance of Accounts and Records.

7. The SPV finances the financial assets transferred to it by the issue of securities/agreements which may be in the form of Pass Through Certificates (PTCs), Debt obligations, or other forms of mortgage backed securities which are generally monitored by Trustees or the Managers of the SPV.

8. The SPV may issue two or multiple classes or tranches of RMBS, sliced from cashflows of the same underlying pool of residential mortgages.

9. As seen from the information furnished to the Committee, the National Housing Bank's (NHB) RMBS issues typically involve two classes of PTCs viz. the "Senior Class" and the "Subordinated Class" sliced from cashflows of the same underlying pool of residential mortgages. The PTCs are in the nature of trust certificates of beneficial interest. Each PTC represents a proportionate undivided beneficial interest in the pool of housing loans and in the securities thereof, issued pursuant to the various documents entered into by and between different parties to the transaction of securitization.

10. From the information delineated above the touchstones of securitisation can be listed out as under:

- Legal true sale of assets to an SPV with narrowly defined purposes and activities
- Raising of funds by the SPV by issue of securities to the investors, either representing beneficial interest in the underlying assets ("pass through securities") or representing a senior or subordinated interest in the cash flows realized from the underlying assets ("pay through securities")
- Reliance by the investors on the performance of the assets for repayment - rather than the credit of their Originator (the seller) or the issuer (the SPV)
- Consequent to the above, "Bankruptcy Remoteness" from the Originator.

B. Disclosure Requirements and Credit Enhancement Facilities:

11. In February, 2006, the Reserve Bank of India, issued comprehensive Guidelines providing the regulatory framework on Securitisation of standard assets as applicable to banks, financial institutions and non-banking financial companies. The guidelines have been grouped under various categories or headings viz. true sale, criteria to be met by SPV, Provision of credit enhancement facilities, disclosures etc.

12. On the disclosure requirements to be fulfilled by the SPV/ trustee, as per the information furnished by the Ministry, 'such' entities are required to make available to the regulatory authorities, as and when required, a copy of the trust deed, the financial accounts and statement of affairs, its constitution, ownership, capital structure, size of the securitization issue, terms of offer including interest payments/yield on instruments, details of underlying asset pool and its performance history, information about originator, transaction structure, service arrangement, credit enhancement details, risk factors etc'.

13. As for the specifics of the disclosures to be made by the SPV/Trustee partaking in securitization transactions, the Reserve Bank's Guidelines inter alia provide as follows:

> " The SPV/trustee is required to provide continuing disclosures by way of a Disclosure Memorandum, signed and certified for correctness of information contained therein jointly by the servicer and the trustee, and addressed to each securities holder individually at periodic intervals (maximum 6 months or more frequent). In case the securities holders are more than 100 in number then the memorandum may also be published in a national financial daily newspaper. In addition to the above, data may be made available on websites of the SPV/trustee. The contents of the memorandum would be as under:
>
> a) collection summary of previous collection period;
>
> b) asset pool behavior - delinquencies, losses, prepayment etc. with details;
>
> c) drawals from credit enhancements;

d) distribution summary:

-in respect of principal and interest to each class of security holders;

- in respect of servicing and administration fee, trusteeship fee etc;

e) payments in arrears;

f) current rating of the securities and any migration of rating during the period; and

g) any other material / information relevant to the performance of the pool.

The SPV/trustee is also required to publish a periodical report on any re-schedulement, restructuring or re-negotiation of the terms of the 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 authorization of investors to this effect may be obtained at the time of issuance of securitized paper."

14. As regards the 'Originator', the following disclosures, as notes to accounts, presenting a comparative position for two years are required to be made in terms of the Guidelines:

(i) total number and book value of loan assets securitized;

(ii) sale consideration received for the securitized assets and gain/loss on sale on account of securitization; and

(iii) form and quantum (outstanding value) of services provided by way of credit enhancement, liquidity support, post-securitization asset servicing, etc.

15. In addition to the above, balance sheet disclosures, Originating institutions of the securitisation transactions are required to provide the various disclosures as stated in the Guidelines to the Audit Sub-Committee of their Board, on a quarterly basis.

16. On the credit support that a SPV may require as protection against potential losses, and for ensuring uninterrupted cash flow for yielding the

indicated coupon interest to the purchaser or subsequent investors in 'securitization instruments', the 'guidelines' inter alia provide for:

- A "first loss facility" which represents the first level of financial support to a SPV as part of the process in bringing the securities issued by the SPV to investment grade. The provider of the facility bears the bulk (or all) of the risks associated with the assets held by the SPV;
- A "second loss facility" which represents a credit enhancement providing a second (or subsequent) tier of protection to an SPV against potential losses;

C. Securitization: International Trend and Indian experience:

17. The evolution of Residential Mortgage Backed Securitization in USA – as seen from the information furnished - has been facilitated by large scale Government intervention in the initial stages to increase the volume of loan originations from primary market financial institutions, bringing about market discipline and the development of the market in an organized manner. In USA, the Government is said to be playing a defining role in creation of Specialized forms of Secondary Market Intermediation through the creation of Secondary Mortgage Market Institutions (SMMIs) viz. Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) (both are better known as Government Sponsored Enterprises (GSEs)) and Government National Mortgage Association (Ginnie Mae) which is a department of the Government.

18. On the development of residential mortgage based securitization in the USA vis-à-vis, the policy measures pursued in this direction in India, a written note furnished by the Ministry, inter alia reveals as follows:

> "NHB has in its promotional role been actively involved in building up long term stakes in this segment, exploring appropriate institutional mechanism for supporting, sustaining and expanding the secondary mortgage market. Keeping in view the specific Charter on securitization as envisioned for the Bank under the National Housing Bank Act, 1987 (as amended till date), and in the light of various reports and recommendations in the context of securitization of residential mortgages in India, NHB is in the process of

> commissioning a study by an experienced consultant on developing a road map for promoting securitization operations on larger scale akin to the model of Fannie Mae/Ginnie Mae of the USA. The above Study proposes to undertake a detailed analysis of the various issues pertaining to securitization and evolve a model for securitization mechanism for issuance of RMBS in India supported by a Secondary Mortgage Institution along similar lines as GSEs in USA."

19. The Committee, in the course of evidence of the representatives of the Ministry of Finance and the National Housing Bank pointed out inter alia that in countries such as the United States and Canada, mortgage backed securitized debt instruments are backed by either full or partial government guarantees. Questioned specifically whether the NHB would be playing a similar role of extending guarantees on mortgage backed securitized instruments, the Executive Director, NHB responded by stating inter alia as follows:

> "If you go by the US example or Canadian model, there we have the backing, implicit or explicit, by the Federal Government on these papers which are issued by the Government-sponsored entities. In the US context, it is Fannie Mae, which is a government-sponsored entity. Then, we have Ginnie Mae, which is 100 per cent government sponsored and all their papers are 100 per cent and explicitly insured by the Federal Government. They are serving a public housing programme. Then, their private sector counterpart, which is Freddie Mae, is also securitizing big size loans."

20. Elaborating further on the role being played or proposed to be played by NHB on ensuring guaranteed returns to the investors in mortgage backed debt instruments, the Executive Director, NHB also added:

> "…I may submit that we have structured different designs for these instruments over a period of time and learning from our experience on every issue, about a year back, we introduced a new structure where NHB was providing partial guarantee to these papers as a measure of credit enhancement. There, we are actually transferring the cost of credit enhancement from the lenders to the NHB itself and we are providing partial guarantee to the papers which are ultimately invested by the institutional investors. This guarantee mechanism is not 100 per cent guarantee, but through adequate disclosures, we are telling the institutional investors what amount of risk is embedded in these transactions and these structures. To a certain extent their interest is protected. If it passes through certificate, whatever amount is received from the borrower, that is passed through to the investors. In case the

> borrowers are defaulting, then we have credit enhancement measures which take care of the protection of the investors' interest. In that, if we have 100 per cent protection to the investors, that can have a high cost. So, we have to balance out the experience, the finality of the mortgages. That is why, we pick those mortgages which are seasoned and which are known to perform well. We securitise those assets so that the investors' risk is minimized and whatever risk is there, that gets covered through credit enhancement."

21. On the issue of following the US and Canadian system of providing the backing of guarantee to the investors, the Executive Director informed as follows:

> "As regards those entities, we are working on those models, but those entities have an implicit or explicit guarantee from the Federal Government."

22. On issues relating to extending government guarantee on returns to the investors in securitized debt instruments, a representative of the Ministry stated as follows during evidence:

> "… the idea is not to give a guarantee because here the State does come into the picture. There is an individual private entity, which is securitizing its receivables, and it is making an issue, which is completely based on disclosure exactly like an equity issue. Therefore, any potential investor does an assessment of the risks and the conditions of this particular instrument, and then buys or does not buy based on his assessment of that risk."

D. Initiatives for development of Securitization Market:

23. Two major initiatives for development of the securitization market, which have been taken in the past are, the amendment of the National Housing Bank Act, 1987 (NHB Act) in 2000; and enactment of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

(a) National Housing Bank Act, 1987

24. The National Housing Bank (Amendment) Act, 2000 has, inter alia entrusted NHB to undertake securitization of residential mortgages originated by different housing finance institutions and banks and ensure the development of

secondary market for residential mortgages. The enabling provisions in NHB Act – as they presently stand - for Mortgage backed Securitization and secondary market include:

(i) Section 14 (ea) of the Act, which specifically authorises NHB to purchase, sell, or otherwise deal in any loans or advances secured by mortgage or charge on the immovable property relating to Scheduled Banks or Housing Finance Institutions (HFIs);

(ii) Section 14 (eb), which allows NHB to create one or more Trusts and transfer loans or advances together with or without securities therefor to such Trust(s) for consideration;

(iii) Section 14 (ec), which authorises NHB to set aside loans or advances, and issue or sell Mortgage Backed Securities (MBS) based on such loans or advances so set aside, in the form of debt obligations, Trust Certificates of beneficial interest or other instruments whatever name called, and to act as Trustee for the holders of such securities.

(iv) Section 18A, which facilitates the transfer of MBS issued by National Housing Bank to securitise the loans granted by Scheduled Banks and HFIs, without Compulsory Registration, both at the time of issue of securities by NHB and at the time of their transfer by the investors.

(v) Further, in terms of Section 18B of the NHB Act, the Bank acting as a trustee or otherwise in the transaction relating to securitization of loans has been authorised to recover the dues as arrears of land revenue for instilling confidence among the investors in the Securities issued by NHB.

(b) SARFAESI Act:

25. The amendments in the NHB Act were followed by the enactment of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act), an act enacted to regulate, inter alia, the business of securitization. The provisions under the SARFAESI Act, inter alia provide that on securitization of an asset, the securitization company is placed in the same position as if it was the original lender. Besides this, the Act

amended the definition of “securities” as given in the Securities Contract Regulation Act, 1956 to include security receipts issued by a securitization company.

26. The legislative measures cited above are said to have not fully helped in achieving the desired result of securing a deep and liquid securitised debt market owing to the absence of the facility of trading on stock exchanges. The securitization instruments under NHB are not covered under the definition of “securities” in the SCR Act. Under the SARFAESI Act, while “security receipts” have been covered under the definition of “securities”, the Act restricts sale and purchase of such ‘receipts’ only amongst qualified institutional buyers. Moreover, the “security receipts” under the SARFAESI Act can be issued only by a securitization company or a reconstruction company registered with the Reserve Bank of India. This is perceived to limit the interest in the instrument and the market has not taken off at all.

E. Constraints to the development of securitisation market:

27. As brought out above, since securitised papers are not included under the definition of ‘securities’ under the Securities Contract (Regulation) Act, 1956, such instruments are not permitted to be listed in the stock exchanges, and consequently, the trading is restricted.

28. As per the information furnished to the Committee, the NHB has, till date completed securitisation transactions involving over 38,000 housing loans amounting to Rs. 763 crore. Currently, selection of housing loans for securitisation is confined to six states, which have fixed the stamp duty in respect of ‘instruments of securitisation’ at 0.1% of the size of the securitised assets.

29. Stamp duty is perceived as one of the major hindrances to the development of securitisation in India. As mortgage debt is regarded as ‘immovable property’ its transfer can be affected only by means of an instrument in writing. Such a transfer deed attracts stamp duty as a ‘conveyance’ and is required to be stamped on ad valorem basis at the rates prescribed under the relative provisions of the stamp laws of the concerned states, and is also

required to be registered with the concerned Sub-Registrar of Assurances under the Indian Registration Act, 1908.

30. The varying stamp duty rates on 'securtisation transactions', which range from 0.1 per cent to 8 percent and varies from state to state; the registration charges applicable under the Indian Registration Act, 1908; as well as issues relating to taxation of income of various entities of securitisation transactions have a direct bearing on the economics of mortgage backed securitisation market.

F. The Securities Contracts (Regulation) Amendment Bill, 2005

31. The Securities Contracts (Regulation) Amendment Bill, 2005 was introduced in Lok Sabha on 16.12.2005 and referred to the Standing Committee on Finance on 23.12.2006 for examination and report. The rationale behind the amendment proposals of the Bill, which seek to enable secondary market liquidity for securitised debt instruments, as furnished by the Ministry are delineated as under:

(i) Under the existing legal framework, Securitisation transactions cannot be listed and traded on stock exchanges as these transactions are not included in the definition of "securities" in the Securities Contracts (Regulation) Act, 1956.

(ii) At present, securitization transactions are being structured under Trust law and are transacted among a few financial institutions on private placement basis. Listing and trading on stock exchanges would allow wider participation of investors, both of retail and institutional investors.

(iii) In the absence of the facility of trading on stock exchanges, potential buyers of securitized instruments get discouraged by the possibility of having to hold the certificate or instrument in respect of securitisation transactions till maturity. This, in turn, restricts the growth of business of housing finance companies and banks.

(iv) The entire institutional, supervisory and regulatory architecture of securities law could be made applicable to securitization transactions also.

(v) Investment by institutional investors seek would be possible only when these instruments are eligible instruments for investment which in turn requires an active secondary market and appropriate regular disclosure about the quality of assets including recovery mechanism in case of default. The institutional participation would help in further developing the securitized debt market.

32. The amendments to the Securities Contracts (Regulation) Act, 1956 proposed through the Bill are:

(i) to include securitisation certificates or instruments under the definition of "securities". Accordingly, a new sub-clause (ie) is proposed to be inserted in clause (h) of section 2 of the SCR Act, 1956. This brings any certificate or instrument (by whatever name called), -

(a) issued to an investor by any special purpose distinct entity which possesses any financial asset representing debt or receivable by such entity and acknowledging the beneficial interest of such investor in such financial asset; and

(b) which may, by general or special order, be specified by the Securities and Exchange Board of India;".

- within the definition of "securities" under the SCR Act.

(ii) Further, the Bill provides for obtaining approval from SEBI for issue of the proposed certificate or instrument and procedure for such issue. Accordingly, it proposes to insert for the said purpose a new section 17A in the SCR Act, 1956.

(iii) It also provides for the manner in which contents of such certificates or instruments, are to be disclosed.

33. The Committee received written views/suggestions on the various provisions of the Bill from (i) Reserve Bank of India, (ii) Securities and Exchange Board of India, (iii) Prognosis Capital Advisors, (iv) National Housing Bank, (v) National Centre for Advocacy Studies (vi) ICICI Bank Ltd., (vii) SBI, (viii) LIC, (ix) HDFC and (x) Indian Banks' Association. The Committee also had personal

hearings of the views of the representatives of RBI, SEBI, IBA, ICICI, SBI, LIC and HDFC.

34. The Committee, upon considering the various aspects of the securitisation market in the Country, observe that despite the initiatives taken earlier towards development of the market, which include, the amendment to the National Housing Bank (NHB) Act in 2000 for facilitating securitization of residential mortgages originating from housing finance institutions and banks, and enactment of the SARFAESI Act in 2002, trading of securitized papers has been rather restricted. While the securitized instruments issued under the NHB Act are not covered under the definition of 'securities' in the Securities Contracts (Regulation) Act, 1956 for enabling listing and trading of such instruments on the stock exchanges, 'security receipts' issued under the SARFAESI Act, 2002, though categorized as 'securities', can be sold and purchased only by qualified institutional bidders, thereby precluding the possibility of listing of such instruments.

35. Enabling for listing and trading of securitized debt on the stock exchanges by including securitization certificates/instruments under the definition of 'securities' through the proposed Bill viz., Securities Contracts (Regulation) Amendment Bill, 2005 is expected to result in improved liquidity by providing an exit option to the investors and increase the volume of funds for further lending. The Committee, after having considered the various viewpoints expressed, recognize the need for listing and trading of such instruments on the stock exchanges and express their agreement with the broad objectives of the amendment proposals. However, in the course of their deliberations, various issues pertaining to the legal framework envisioned in the proposed Bill for trading of securitised instruments, the disclosure norms and rating requirements of such instruments, ensuring assured returns to the investors stability in the capital market, as well as the structure of stamp duty and registration charges etc., which are conceived to be hindrances to the development of securitization market were discussed. These issues and the observations/recommendations of the Committee are dealt with in the subsequent paragraphs of the report.

AMENDMENTS PROPOSED BY GOVERNMENT:

Clause 2 (Amendment of Section 2) and Clause 3 (Insertion of new section 17 A)

36. Clause 2, which seeks to include 'securitisation certificate or instrument' under the definition of 'Securities' by inserting for the purpose, a new sub-clause (ie) in clause (h) of Seciton 2 of the SCR Act, 1956 reads as under:

(1) In section 2 of the Securities Contracts (Regulation) Act, 1956(42 of 1956) (hereinafter referred to as the principal Act), in clause (h), after sub-clause (id), the following sub-clause shall be inserted, namely:--

"(ie) any certificate or instrument (by whatever name called),--

(a) issued, to an investor by any special purpose distinct entity which possesses any financial asset representing debt or receivable by such entity, and, acknowledging the beneficial interest of such investor in such financial asset; and

(b) which may, by general or special order, be specified as such by the Securities and Exchange Board of India;".

37. Clause 3, which stipulates the 'due process' or lays down the legal framework by way of which the 'certificates' or 'instruments' (securities) referred to in Sub-clause (ie) of Clause (h) of Section 2 are to be issued provides as follows:

After section 17 of the principal Act, the following section shall be inserted, namely;--

"17A. Approval of Securities and Exchange Board of India for securities referred to in sub-clause (ie) of clause (h) of section 2.--(1) Without prejudice to the provisions contained in this Act or any other law for the time being in force, no securities of the nature referred to in sub-clause (ie) of clause (h) of section 2 shall be issued to any investor or trade on any recognised stock exchange unless such securities have been approved by the Securities and Exchange Board of India.

(2) Every special purpose distinct entity referred to in sub-clause (ie) of clause (h) of section 2 shall--

(a) make an application, for specifying any certificate or instrument under sub-clause (ie) of clause (h) of section 2, as securities, to she

Securities and Exchange Board of India, in such form and manner as may be specified by regulations;

(b) file along with an application made under clause (a) the draft of the certificate or instrument which such entity proposes to issue to the investor as securities of the nature referred to in sub-clause (ie) of clause (h) of section 2

(3) The Securities and Exchange Board of India may, to protect the interest of investors in the securities of the nature referred to in sub-clause (ie) of clause (h) of section 2, specify by regulations,--

(i) the contents of the certificate or instrument to be filed under clause (b) of sub-section (2) and to be issued as securities of the nature referred to in sub-clause (ie) of clause (h) of section 2, to the investors;

(ii) the manner in which such contents shall be disclosed in the certificate or instrument to be issued as securities of the nature referred to in sub-clause (ie) of clause (h) of section 2".

38. An instrument or certificate issued to an investor by a 'Special Purpose Distinct Entity' (SPE), which possesses financial assets representing debt or receivable and acknowledges the beneficial interest of the investor in such financial assets would be construed as a 'security' in terms of the proposed Section 2 (h) (ie) subject to the condition that it is specified as such by a 'general' or 'special' order of SEBI.

39. For the purpose of 'issue' and trading on any stock exchange, the instrument or certificate (Security) – referred to in the proposed Section 2 (h) (ie) – has to be approved by SEBI in terms of the proposed Section 17 (A) (I). The process relating thereto, as per the stipulations of the proposed Section 17 (A) (2) involve inter alia, making an application by the 'Special Purpose Distinct Entity' to SEBI along with a draft of the certificate or instrument. Further, in terms of the proposed Section 17 (A) (3), SEBI may, in the interest of the investors, specify by regulations, the 'Contents of the certificate or instrument' proposed to the issued and the manner in which such contents 'shall be disclosed in the certificate or instrument'.

40. With the amendments proposed separately to Section 31 (2) of the SCRA Act (Clause 4), SEBI is to be conferred with powers to make regulations relating to :

- the form and manner in which an application shall be made under clause (a) of sub-section (2) of section 17A;
- the contents of the certificate or instrument under clause (I) of sub-section (3) of section 17 A;
- the manner in which such contents shall be disclosed in the certificate or instrument under clause (ii) of sub-section (3) of section 17 A."

ISSUE OF SECURITIES (SECURITIZATION INSTRUMENTS/CERTIFICATES):

41. The amendment proposals envisaged vide Section 17 (A) (I) inter alia stipulate that the securitization certificates/instruments referred to in the proposed Section 2 (h) (ie) shall not be issued to 'any investor or traded on any recognised stock exchange unless approved by SEBI'. In this regard, the institutional participants in the secrutisation market, as well as SEBI, in their Memoranda and also in the course of making oral submissions before the Committee, opined that the proposals, as envisaged, would imply that no securitised debt could be issued in the country without SEBI's approval. As most of the securitisation deals were done on private placement basis through bilateral negotiations involving Qualified Institutional Buyers (QIBs), it has been emphasised that in a manner similar to issue of debt and equity securities, the requirements of approval by SEBI for issue of 'securitisation instruments/certificates' to investors need to be made applicable only for public issue of such securities.

42. Questioned about the consequential effect of the amendment proposals of the Bill, as envisaged, whereby it could be implied that private placement of securitised debt would be possible only with SEBI's approval, the Ministry of Finance, in a written reply, inter alia stated as follows:

> "it would be clarified in the legal drafting of the Bill that issue of security type to investor "through public issue" will be possible only after SEBI's approval."

43. The Ministry, in a subsequent reply, specified the changes proposed in Section 2 (h) (ie) and Section 17 (A) (I) to mandate that the issue of securtised debt to investors through a public offer will need SEBI's approval, meaning thereby that private placement of securitised can continue to take place without such approval by SEBI. The changes in the provisions as proposed by the Ministry, read as follows:

i) Section 2 (h) (ie) (Clause2):

"(ie) any certificate or instrument (by whatever name called)-

(a) issued to an investor **through a public offer** by any special purpose distinct entity which possesses any financial asset representing debt or receivable by such entity, and, acknowledging the beneficial interest of such investor in such financial asset; and

(b) which may, by general or special order, be specified as such by the Securities and Exchange Board of India."

ii) Section 17 (A)(1) (Clause 3) – without prejudice to the provisions contained in this Act or any other law for the time being in force, no securities of the nature referred to in sub-clause (ie) of clause (h) of section 2 shall be issued to any investor **through a public offer** or traded on any recognised stock exchange unless such securities have been approved by the Securities and Exchange Board of India.

SEBI'S PERCEPTION/SUGGESTIONS ON THE PROPOSALS OF THE BILL:

44. Apart from the issue relating to the perception that the Bill, as introduced, gives that private placement of 'securitised debt' too would require SEBI's approval – which has been sought to be rectified with the changes proposed, as indicated in the preceding paragraphs - SEBI, in a written memorandum raised certain issues on the 'provisioning' proposed in the Bill. Some of the issues raised by the capital market regulator are delineated in brief as under:

i) The Securtisation instrument/certificate to be issued by the SPE – in terms of the proposed Section 2 (h) (ie) could either be defined comprehensively in the Securities Contracts (Regulation) Act or alternatively, the attributes of such instrument enumerated by Regulations instead of providing for a scheme of specification of such instruments by SEBI by means of a 'general' or 'special order';

ii) The 'approval' based approach envisaged for enabling issue 'Securitization instruments' in terms of the proposed Sections 17 (A) (I) and (2) was not in consonance with SEBI's guidelines/regulations governing 'issues', which are disclosure based;

iii) As per the proposed provisions, the disclosures to be specified by SEBI would appear on the 'certificate' or 'instrument' itself, which would be unworkable inter alia by hindering 'transferability' of the instruments, and disappearance of the disclosures in the event of dematting;

iv) Regulation making power should be conferred on SEBI for addressing matters such as, eligibility criteria of issuers, procedural requirement for public offer, minimum size of the offer for public etc.

45. SEBI also furnished to the Committee, a modified version of the Bill as proposed by them to address inter alia the concerns expressed, as enumerated above in brief.

46. The Chairman, SEBI as well as a representative of SEBI, in the course of evidence, dwelt at length inter alia on the issues raised on the proposed provisioning of the Bill as contained in the memorandum submitted to the Committee.

47. The suggestions made/ issues raised by SEBI on the provisioning of the Bill vis-à-vis, the response/perception of the Ministry of Finance thereon are discussed in brief in the subsequent paragraphs.

48. The view-point expressed to enable for enumerating the attributes of 'Securitised debt instruments', instead of providing for SEBI to specify such instruments in terms of a 'general' or 'special order', as envisaged in the proposed Section 2 (h) (ie), has been responded to as under by the Ministry, in a written reply :

"Securitised debt is a special class of security as it combines attributes of both debt and equity. Since securitisation structure admits of product innovation, it is not conceivable to think about all the securitisation products."

"…the attributes of securitisation instrument would be specified in the regulations. However, SEBI will still have powers to approve specific securitised debt instruments on the same analogy on which SEBI approves specific derivative contracts as there can be complex securitisation structures. The main statute should be time invariant and should not try to conceive of all possible products."

49. Asked to clarify the framework envisaged for deciding on the tradeability of securitisation instruments by means of a 'general' or 'special' order, the Ministry, in a subsequent reply, informed as under:

> "Through the "General" or "special order" by SEBI, it is envisaged that only the tradability aspect of a securitized instrument would be listed out. Since the securitized instruments are innovative products, one cannot, in an exhaustive manner visualize what attributes it would have. In case such a new instrument is envisaged by market players which is not covered under the rubric of "general" order of SEBI, it is being granted powers under the "special order" route to provide legal sanction for its trading."

50. The principal contention of the regulator has been that the 'due process' envisaged for listing of the 'securities' – which, as per the 'memorandum' submitted involved a double approval, one under Section 2 (h) (ie) read with Section 17 (A) (2) and the other under Section 17 (A) (I) – was not in consonance with the Guidelines/Regulations governing issues, which were mainly disclosure based and not approval based. In this regard, the Ministry, in a written reply continued as follows:

> "Presently there could be some simple vanilla type products, which may be subsumed under a category and could be issued to investors as a part of some generic category of securitisation. On the other hand, there could be some highly structured products which may require

specific approval before these are offered to investors. The word approval has been used deliberately in the Bill so that only "securities" which could be construed as liquid securities or have other desirable attributes of good credit rating or credit enhancement etc. only pass the SEBI approval test. Since the securitised debt is not pure equity, there is a need to have some kind of quality check before these securities are offered to investors. The approval involved by SEBI is not double, but only single. Only single process is stipulated whereby the special purpose entity, which wants to issue securitised debt to instruments, applies to SEBI with a draft of the certificate or instruments giving the salient features of such instruments. SEBI, with a view to protecting interest of investors would specify by regulations the contents of the certificates or instruments and the manner in which such contents shall be disclosed to investors in the form of regulations. If the securitised debt passes the general approval test under the regulations, it can be deemed to have been approved by SEBI. However, in other cases, where a new instrument is offered to investors, SEBI will have specific power to approve of such instruments."

51. The Ministry also added as under in this regard:

"Even under the existing SEBI Act, 1992 though SEBI allows issue of shares subject to disclosure based regulation, it exercises power to disapprove a public issue under sub-section (4) of Section 11 of the SEBI Act. So the present scheme of the Bill allows both general approval of securitised debt through disclosure based regulation as well as specific approved based regulation.

SEBI has been approving specific derivative contracts and securities, which are being traded on the stock exchanges. So, it is not correct to say that SEBI does not approve of the securities, which are traded on the stock exchanges. SEBI's approval for derivative securities is necessary only because these are complex contracts and they should have some public purpose of hedging before these are allowed. In the same manner, there could be complex securitised debt contracts, which will require specific approval of SEBI."

52. Questioned about the processes followed in respect of specific derivatives contracts and securities, the Chairman, SEBI inter alia stated as under during evidence:

"I think it is a question of what it is that we approve. After the futures and options segments come, subject to certain eligibility being fulfilled, certain stocks are allowed to be traded and that is something that we tell the exchanges that we have not been objecting if these are traded. It is not that every instrument gets cleared by us. The market is now in its nascent stage. There could be a situation where everyday there would be 20 to 25

applications filed with us saying that we intend to do this and you please give us approval for these documents."

53. In this regard, the Chairman, SEBI, also stated as under during evidence:

> "When the Ministry talks in terms of our approving specific products in the F&DO segment which is relatively new in India, there are products which we initially started in the stock futures, and then we started with index futures and stock options, etc. But these are not company specific products that we approve. If we have to approve this, then tomorrow one institution will come with an application requesting to please approve this and somebody else will come with an application and this can multiply and we will be doing just that.
>
> …If we prescribe what ought to be the qualities of the issuer and what ought to be the category underlying disclosures, if we state that the underlying consists of so many assets of this quality, then that is something which is in the document that is filed with us. We satisfy ourselves as in the case of IPOs that all disclosures are in place."

54. When asked whether SEBI were in a agreement with the Statement and Objects of the Bill viz., to provide a legal framework for trading of securitised debt, the Chairman, SEBI responded by saying as follows:

> "As far as the Statement of Objects and Reasons is concerned, I think it fully details the felt need ….. we fully subscribe to that it is necessary to give these people an exit option. It also adds further depth to the market. Therefore, it is clearly something that SEBI supports."

55. Questioned about the interactions that SEBI may have had with the Ministry in formulating the legal framework envisaged in the Bill for trading of 'securitised debt', the Chairman, SEBI said:

> "No….When the draft Cabinet note was prepared, our officer who was attending the meeting associated with its preparation raised these issues. But somehow they were not heard. Since I have an opportunity to make submissions before this Committee, I thought that before it becomes a law, we need to state the facts."

56. As regards the perception that the Bill gives that the 'disclosures' to be specified would appear on the 'offer document', which, as per SEBI, would be unworkable, the response received from the Ministry, reads as under:

> "This is true of the existing equity shares also as all the disclosures are given by the issuer company in the form of prospectus. However, after this there are mechanisms of continuous disclosure in the form of regular filings by the company and dissemination of this information through the stock exchanges. The equity shares also dematerialized so initial disclosure on the certificate and continuous disclosure there are exchanges run two mechanisms of disclosure for equity shares. The same mechanisms would be used for disclosures for the securatised debt also."

57. Questioned whether it was not essential to specify in the Bill the aspect of the SPV proposing to issue a 'Securitization instrument' requiring to file an offer document (apart from making an application) disclosure requirements relating to which are to be determined by SEBI, the Ministry, in reply, stated as under:

> "The contents of "offer document" of a company going in for public issue of "securities" are mentioned in the SEBI (Disclosure and Investor Protection) (DIP) Guidelines. These Guidelines have been framed in exercise of SEBI's powers under Section 11 of the SEBI Act, 1992. The same power can be used by SEBI to provide for disclosure requirements in the offer document incase of securitization instruments. These may not be specified in the Act as securitized debt would be subsumed under the word 'securities'."

58. As per the Ministry's response, the initial disclosures would be made in the offer document and the 'special purpose entity' issuing the certificates and the stock exchanges would be continuously giving disclosures about such instruments to investors as is the case with shares.

59. As informed by SEBI, matters pertaining to continuous disclosure and other continuous listing requirements are proposed to be covered in a new listing agreement that would be devised for such instruments under the general provisions available under section 11A(2) of the SEBI Act, 1992 and Section 21 of the Securities Contracts (Regulation) Act, 1956.

60. As regards the disclosure requirements to be fulfilled by the SPVs in terms of Reserve Bank's Guidelines on 'Securitisation of Standard Assets', the Deputy Governor, Reserve Bank, in the course of evidence, stated as under:

> "what should be the structure of the SPVs and what would be the obligations, what would be the transparency and disclosure

requirement of the originating institutions as well as the SPVs. We have laid down dislcosure requirement for both the banks and the SPVs. These could be usefully adopted even when framing regulations under the proposed legislation."

61. The Committee, in the course of evidence of the representatives of Ministry of Finance, specifically questioned the representatives on the variation in perception with SEBI on the proposed provisioning of the Bill to enable listing and trading of securitization instruments. In response thereto, a representative of the Ministry stated as under:

> "I would like to clarify this. Here again, the issue of instruments will continue to be disclosure-based. If you recall, when the derivative instruments were introduced in the Indian market, the movement was very similar to this. In fact, in our written response to the Committee we have mentioned this. SEBI approved in the case of derivative contracts index futures as a category in May, 2001; index option as a category in June 2001; single stock options in July, 2001 single stock futures in November, 2001; interest rates futures in June, 2003. So, the attempt here is an identical regime. The actual issue will be disclosure based. Individual instruments need not be approved. The idea here is a generic category of instruments. That is why we have used both general and special order and that has been clarified in our response."

62. Asked to specify whether it was not essential to have a re-look at the provisioning of the Bill, as proposed to assess the need for carrying out modifications/changes to clearly bringing out the aspect of each securitization instrument not requiring the approval of SEBI, the representative of the Ministry stated: "we will do that", The Secretary, Department of Economic Affairs also assured the Committee that the matter would be examined by holding wider consultations.

63. Subsequently, the Ministry of Finance, in a post evidence communication dated 15 May, 2006 informed the Committee that the matter relating to definition of securitized instruments, as proposed in the Bill was discussed at a meeting with SEBI on 13 May, 2006. The communication from the Ministry, inter alia reveals as follows:

> "After detailed discussion, it was felt that the issue of securitized instruments would be subject to disclosure based regulation to be made by SEBI. Since the issue process would be supervised by SEBI, it may not be necessary for SEBI to specify or approve each such instrument by any

general or special order. Hence part (b) of the clause 2 (h) (ie) could be dropped. This would, however, require consequential amendments in 17A and 31 to enable SEBI to govern the issue and trading of such instruments by Regulations."

VIEWS OF THE RESERVE BANK ON THE PROPOSALS OF THE BILL

64. The Reserve Bank in a Memorandum submitted to the Committee inter alia suggested that the word 'possesses' in Clause 2 (A) (a) needed to be replaced with the words 'has acquired'. The substitution of the word has been proposed, as per the memorandum, as the 'assets or receivables are usually acquired by the Trust or SPE' owing to which, it has been felt that the expression 'possession' would not be appropriate.

65. By way of giving the rationale for the proposed substitution of the words, the Deputy Governor, Reserve Bank, in the course of evidence stated:

> "We had suggested that the word 'acquired' could be used instead of 'possessed' because possession could mean constructive possession. We will then get into issues whether how do you possess all financial loans and if a loan is to be transferred how do you possess a loan etc. The word 'possession' has something to do with tangible assets. We do feel that probably the word possession does not fully reflect the range of assets or the securities that could be securitised. Therefore, we have suggested the word 'acquisition' rather than 'possession'."

66. Questioned on the viewpoint expressed by the Reserve Bank, the Ministry, in reply stated as under:

> "The word "possesses" appearing in Clause 2 (1) (a) need not be replaced by the words "has acquired" as the Special Purpose Vehicle, when it issues the securitised debt papers to investors, is already in possession of the financial assets. The stage of acquisition gets over when the securities are issued to investors. So, the expression "possesses" is an appropriate expression."

67. The Reserve Bank also suggested that it may be appropriate to empower the Central Government to make rules to provide for the contents of both the documents to be filed with SEBI {by Trusts or SPV for listing the certificates or instruments to be issued by them} and the documents to be issued

to the investors by such Trusts or SPV as the requirement to be complied with for listing.

68. In response to a query posed in this regard, the Ministry responded as under in reply:

> "The suggestion of prescribing listing conditions for securitised debt is valid. However, the contents of the securitised debt or manner in which these contents would disclosed to investors are already provided for in clause (c) and (d) of the sub-section (2) of Section 31 of the proposed Securities Contracts Regulations (Amendment) Bill, 2005. Since securitised debt is a form of "securities," listing requirements can be stipulated by SEBI under SEBI Act, 1992 and Section 21 of the SCRA by the stock exchanges. There is no need to prescribe the listing requirements under rules framed by the Government."

69. The Reserve Bank also suggested that the essential difference between 'securitised paper' and other corporate debt securities needed be addressed while designing the listing and disclosure requirements; and that care should be taken to ensure that no restriction was placed – while designing the listing requirements – on the OTC transactions in such instruments.

70. In response to the related issues, the Ministry, in a written reply inter alia stated as follows:

> "The difference between securitised paper and corporate debt securities would be addressed while designing the listing and disclosure requirements by SEBI under the regulation making power under the proposed Bill. This does not have a bearing on the Securities Contracts (Regulation) Amendment Bill 2005 as such.
>
> The entire objective of the Bill is to create secondary market liquidity and develop the market for securitised debt. Listing is a key strategy for development of this scheme. SEBI will be making the disclosure requirements for investors keeping in mind the investor protection mandate. The listing requirements would be framed by the stock exchanges keeping in mind the broad policy framework of the disclosure regime. Neither SEBI nor stock exchanges have any regulatory jurisdiction over the transactions, which are outside the exchanges or Over-the-Counter (OTC).Again, this issue is not connected with the legislative amendments."

71. By way of giving the rationale for expressing the need to address the difference between 'securitised paper' and other corporate debt securities, and ensuring that no restrictions were placed on OTC transactions while devising the listing requirements, the Reserve Bank, in a post-evidence reply inter alia stated:

> "…The disclosure and reporting requirements from corporates are not suitable for securitization issues since such requirements do not elicit relevant information about securitization issues. For instance, there are no management, financial or business structures in the case of securitization issues on which information to the market regulator or investors would be of relevance. There would be rather information about performance of underlying asset pools, securitization structure, service providers and rating of different tranches of the securitization issues etc. which would be more relevant. Therefore, the registration and disclosure requirements are required to be distinctly designed for securitization."

72. It was also added:

> "Since the securitization market is essentially driven by institutional investors like banks, it may be advisable not to limit secondary market trading to any specific platform like exchanges. Allowing such transactions also in OTC market would go a long way in development of securitization markets."

73. The Committee note that the stipulations of the proposed Section 17 A whereby no such securities (securitised instruments) can be issued 'to any investor unless approved by SEBI' could be inferred to mean that every securitization transaction inclusive of private placement deals would necessarily require the approval of SEBI. The Ministry have, in response to the questioning in this regard, sought to address the issue by specifying in the proposed sections [2 (ie) (a) and 17 (A)] that the issue of securitized debt to investors 'through a public offer' will need to be approved by SEBI. Incorporation of the words, 'through a public offer' after 'to any investor' in the related sections, as proposed, would make it clear that private placement of securitized debt outside the stock exchanges could continue to take place without SEBI's approval. The Committee, therefore, endorse the same.

74. With regard to the legal framework or procedure per se for issue of securitized instruments, the Committee note that there has been a variation in the perception of the Ministry of Finance and the capital market regulator, SEBI. While the proposed provisioning, inter alia envisions the tradable securitised instruments to be specified by a 'general' or 'special' order, [Section 2 (ie) (b)] and involves approval of the applications for issue of such instruments (Section 17 A), SEBI has emphasized on a regulatory framework which would be in consonance with the disclosure based guidelines/regulations governing issue of securities.

75. At the insistence of the Committee, the Ministry of Finance have, after having detailed consultations with SEBI, informed in clear terms that the issue of securitised instruments on the stock exchanges would be subject to

'disclosure based regulations'. Consequently, it has been proposed to drop Section 2 (h) (ie) (b) relating to specification of the tradable securitized instruments by SEBI by means of a 'general' or 'special' order. As the issue process of securitized instruments is to be supervised on the basis of 'disclosure based regulations', the Committee note that it would not be necessary for SEBI to specify or approve each such instrument by a 'general' or 'special' order. The Committee, therefore, express agreement with the proposal to drop Section 2(h) (ie) (b).

76. The Committee, however, note that for enabling SEBI to govern the issue and trading of securitized instruments by regulations, consequential changes would also be required in Sections 17 A (approval process) and 31 (regulation making power). Mainly on account of witnessing varied interpretation of the proposed provisions of the Bill, the Committee are inclined to recommend that the consequential changes be carried out by holding wider consultations, particularly with the capital market regulator, and by taking into consideration the specifics of securitised instruments vis-à-vis other securities traded on the stock exchanges.

77. From the information furnished, the Committee also note that SEBI proposes to address issues relating to continuous disclosures relating to securitised instruments by devising a new listing agreement. The disclosure norms and rating will be the touchstones on the viability and performance of securitised instruments. In terms of the Reserve Bank's guidelines on 'securitization of standard assets' as applicable to banks etc. the disclosure requirements to be fulfilled involve, inter alia, furnishing a summary account of

collection of receivables, drawals from credit enhancement, details of asset pool behavior etc. The disclosure related guidelines formulated by the Reserve Bank could serve as an aid for devising the disclosure norms for securitized instruments traded on the stock exchanges. Also, as pointed out by the Reserve Bank, the Committee feel the need to emphasize on ensuring that the specific characteristics of securitised instruments as distinct from corporate bonds are taken into consideration while stipulating the disclosure norms for such instruments.

ISSUES RAISED BY THE COMMITTEE

78. In addition to the suggestions/observations on the provisioning of the Bill delineated above, the Committee also feel it to be essential to delve upon some other issues, which have a bearing on the development and growth of securitization market.

79. As touched upon in brief in the earlier part of the report, stamp duty and registration charges as well as taxation related issues significantly impact the market for mortgage backed securitization in particular.

80. Asked about the impact of these issues on the economic viability of securitization, the Ministry, in a written reply inter alia stated as under:

> "The rates of stamp duty and registration have a direct bearing on the economics of mortgage backed securitization transactions and can make the securitization transaction unviable. The viability of the transactions depends upon the extent to which these transaction costs can be reduced and the amount of spread that is available to the transaction stakeholders.
>
> The stamp duty and registration charges being State subjects vary significantly across the country. Currently, there are only six states which have lowered the stamp duty in respect of instruments of securitization to 0.1% of the size of the securitized assets. Selection of housing loans for securitization is done specifically from these above states so as to keep the process costs to the minimal. This significantly restricts the size of the housing loans to be taken up for securitization.
>
> In order to facilitate the growth of securitized debt market from the investors point of view, fiscal incentives by way of tax exemption on the interest income on the securitized instruments or the gains arising out of sale may be considered which can effectively be passed on to the ultimate borrowers in terms of lower cost funds. These tax incentives to the investors will result in lower coupon on the instruments resulting in lower cost of funds. Such tax concessions may be considered in the context of public policy programmes where the funds mobilized through such instruments (with tax incentives) are deployed only for ESW/ LIG/ rural housing etc. Several countries have adopted the fiscal route for addressing the public programmes for housing."

81. While the outstanding housing loans of banks and HFCs is estimated to the tune of Rs. 1,48,000 crore, less than 5% of this amount has been securitized so far. As brought out earlier, NHB has securitized housing loans of banks and HFCs to the order of Rs. 763 crore. Further, there have been

other transactions to the order of Rs. 2000 crore. The quantum of outstanding housing loans is indicative of the potential of MBS in the Country.

82. Questioned specifically about the recommendations of the High Level Expert Committee on Corporate Debt and Securitization on measures relating to resolution of taxation and stamp duty issues for enabling the growth of mortgage backed securitization, the Ministry, in a written reply, stated as follows:

> "The recommendations of High Level Expert Committee on Corporate Debt and Securitization relating to resolution of taxation and stamp duty issues for enabling the growth of mortgage backed securitization are:
>
> (a) The Central Government should consider establishing an appropriate institutional process to evolve a consensus across the States on the affordable rates and levels of stamp duty on debt assignment, Pass Through Certificates (PTCs) and security receipts (SRs).
>
> (b) The Central Government should provide an explicit tax pass through treatment to securitization Special Purpose Vehicles (SPVs) and NPA Securitization SPVs (namely, trust SPVs set up by ARCs registered with RBI under SARFAESI) on par with the tax pass through treatment applied under the tax law to SEBI registered Venture Capital Funds under section 10(23FB) read with section 115U of the Income tax Act. RBI and SEBI may frame appropriate regulations in this regard.
>
> (c) Recognizing the wholesale and Qualified Institutional Buyers (QIB) character of investors in securitization trusts, there should be no withholding tax requirement on interest paid by the borrowers (whose credit exposures are securitized) to the securitization trust and on distributions made by the securitization trust to its PTC and/or SR holders."

83. The Committee note that the stamp duty and registration charges applicable on mortgage backed securitised instruments significantly impact the economics of such transactions. As mortgage debt is regarded as 'immovable property', its transfer can be effected only by way of a 'transfer deed', which attracts stamp duty at the rates prescribed under the stamp laws of the States as well as registration charges under the Indian Registration Act. Less than 5% of the total outstanding housing loans of banks and HFCs, which is currently estimated to be of the order of Rs. 1,48,000 crore have been securitized thus far, with the transactions restricted to six States which have lowered the stamp duty applicable on securitization instruments to 0.1% of the size of securitized assets. The recommendations made by the 'High Level Expert Committee on Corporate Bonds and Securitization' for resolution of stamp duty and taxation issues to further the growth of mortgage backed securitization include, establishing an institutional process by the Central Government for evolving a consensus across the States on rationalizing the stamp duty rates to an uniform level, and according favorable tax treatment to securitised instruments. The Committee expect the Government to urgently act on the recommendations of the High Level Expert Committee, which would give an impetus to the growth of the securitized debt market.

84. As brought out in the Statement of Objects and Reasons of the Bill, securitization is a complex process of pooling of financial assets, which may or may not have the same characteristics. The market is presently institutional driven, who perform their internal due diligence procedures before investing in such instruments.

85. An issue brought before the Committee by SEBI in this regard is that on the lines of the restrictions applicable to derivatives transactions, where an investor cannot enter into a transaction whose value is less than Rs. 2 lakhs – in the interest of the retail investors in particular – it would be preferable to stipulate the minimum value of such securities (Securitization instruments/certificates), which an investor may trade in the stock market.

86. Questioned on the need felt for fixing the minimum value of 'securitization transactions', which an investor may trade in the stock market, the Ministry, in their reply, stated as follows:

> "… the issue of contract size of 'securitization transactions' would be specified in the trading rules/circulars or guidelines of SEBI and is a matter of detail which can be stipulated outside the main statute, as is the case with derivatives transactions"

87. Keeping in view the complexities of the securitization process, and the fact that this market is mainly institutionally driven, as pointed out by SEBI, the Committee feel that it may be preferable to fix a threshold limit on the value of such securities, which an investor may trade in the stock exchanges. The Committee, therefore, expect that on the lines of the restrictions applicable on derivative transactions where an investor can not enter into a transaction of less than Rs. 2 lakhs, serious consideration be given to the need felt for pegging a limit on the value of securitization transactions that an investor may trade in the stock exchanges.

New Delhi;
19 May, 2006
29 Vaisakha, 1928 (Saka)

MAJ. GEN. (RETD.) B.C. KHANDURI
Chairman
Standing Committee on Finance

NOTE OF DISSENT

Submitted by Shri Rupchand Pal, MP

Since the Finance Minister in his Budget Speech 2005-06 proposed to amend the definition of securities under the Securities Contract (Amendment) Act in order to provide a legal framework for trading of securitised debt including mortgaged debt, the situation in the Indian capital market has changed a lot and there are serious fluctuations in the market largely influenced by external factors.

The Indian capital market by all indications has not matured enough to leave any healthy space for the proposed instruments and in spite of recommendations by two important JPCs pertaining to two previous Scams – one of Harshad Mehta variety and other Ketan Parekh variety, the Indian capital market is heavily afflicted by scores of manipulations and influence of foreign institutional investors operating through dubious routes.

Despite the limited endeavors to monitor and continue surveillance, the SEBI as regulator has not been successful enough and even the steps taken by SEBI in the process of monitoring and control have been too little and sometimes very late and then again many of the decisions of SEBI have been turned down by the concerned Appellate Authority. The overall situation is detrimental to the interest of the investors. In such a scenario the entry of the proposed instruments will lead to a further complicated situation and lot of distortions will follow.

Since the Finance Minister had come out with the above proposal, the role of the Indian bank vis-à-vis Home Loans and Real Estate has been a matter of concern to RBI also and the latest caution by RBI to Banks is only corroboration of widespread apprehension prevailing about the questionable Home Loans and Real Estate involvement in chunks of Bank loans for some time.

In view of the above disturbed situation, the proposed venture to facilitate trading of securitised debt including mortgage etc. is not welcome measure atleast for the present.

Hence my Note of Dissent.

-Sd/-
(Shri Rupchand Pal)

Minutes of the Fifteenth sitting of Standing Committee on Finance

The Committee sat on Thursday, 19th January, 2006 from 1030 to 1210 hrs and 1225 to 1305 hrs.

PRESENT

Maj. Gen (Retd.) B.C. Khanduri - Chairman

MEMBERS

LOK SABHA

2. Shri Jaswant Singh Bishnoi
3. Shri Bhartruhari Mahtab
4. Shri Danve Raosaheb Patil
5. Shri Shriniwas D. Patil
6. Shri K.S. Rao
7. Shri Jyotiraditya Madhavrao Scindia
8. Shri M.A. Kharabela Swain

RAJYA SABHA

1. Shri Jairam Ramesh
2. Shri Mangani Lal Mandal

SECRETARIAT

1. Shri A. Mukhopadhyay - Joint Secretary
2. Shri T.G. Chandrasekhar - Under Secretary

WITNESSES

Ministry of Finance
(Department of Economic Affairs)

1. Shri Ashok K. Jha, Secretary
2. Shri Vinod Rai, Addl. Secretary
3. Shri Amitabh Verma, Joint Secretary

National Housing Bank

1. Shri R.V. Verma, Executive Director

2. At the outset, the Chairman welcomed the representatives of Ministry of Finance and invited their attention to the provisions contained in Direction 55 of the Directions by the Speaker.

PART – I
(1030 - 1210 hours)

3.	XX	XX	XX	XX
	XX	XX	XX	XX

PART – II
(1225 – 1305 hours)

4. Then, the representatives of the Ministry of Finance briefed the Committee on the various provisions contained in the Securities Contracts (Regulation) Amendment Bill, 2005. The Members asked clarificatory questions which were replied to by the representatives. The Chairman, then, directed the representatives that the information with regard to queries of the Members which was not readily available with them might be furnished to the Committee later on.

5. The briefing was concluded

6. A verbatim record of proceedings has been kept.

The witnesses then withdrew

The Committee then adjourned.

Minutes of the Twenty-third sitting of Standing Committee on Finance

The Committee sat on Wednesday, 20th April, 2006 from 1030 to 1315 hrs and 1430 to 1630 hrs.

PRESENT

Maj. Gen.(Retd.) B.C. Khanduri - Chairman

MEMBERS

LOK SABHA

2. Shri Bhartruhari Mahtab
3. Shri Bir Singh Mahato
4. Shri Jyotiraditya Madhavrao Scindia
5. Shri M.A. Kharabela Swain

RAJYA SABHA

6. Shri C. Ramachandraiah
7. Shri Mangani Lal Mandal
8. Smt. Shobhana Bhartia

SECRETARIAT

1. Dr. Smt. P.K. Sandhu - Additional Secretary
2. Shri A.M. Mukhopadhyay - Joint Secretary
3. Shri S.B. Arora - Deputy Secretary
4. Shri T.G. Chandrasekhar - Under Secretary
5. Smt. Anita B. Panda - Under Secretary

Part – I
(1030 to 1145 hrs.)

2. XX XX XX XX XX

(1400 to 1430 hrs.)

3. XX XX XX XX XX

Part – II
(1430 to 1510 hrs.)
WITNESSES

RESERVE BANK OF INDIA

1. Smt. Shyamala Gopinath, Deputy Governor
2. Shri S.R. Kolarkar, Legal Advisor
3. Shri K. Damodaran, General Manager (Deptt. of Banking Operations and Development)
4. Shri T. Rabi Shankar, Deputy General Manager

SECURITIES & EXCHANGE BOARD OF INDIA

1. Shri M. Damodaran, Chairman
2. Shri G. Anantharaman, Whole Time Member
3. Shri Amarjeet Singh, Regional Manager

2. At the outset, the Chairman welcomed the representatives of Reserve Bank of India (RBI) and Securities & Exchange Board of India (SEBI) and invited their attention to the provisions contained in Direction 55 of the Directions by the Speaker.

3. The Committee then took oral evidence of the witnesses on the Securities Contracts (Regulation) Amendment Bill, 2005. The Members asked clarificatory questions which were replied to by the representatives. The Chairman, then, directed the representatives that the information with regard to queries of the Members which was not readily available with them might be furnished to the Committee later on.

4. The evidence was concluded

5. A verbatim record of proceedings has been kept.

The witnesses then withdrew

Minutes of the Twenty-fourth sitting of Standing Committee on Finance

The Committee sat on Monday, the 1st May, 2006 from 1030 to 1215 hrs.

PRESENT

Maj. Gen (Retd.) B.C. Khanduri - Chairman

MEMBERS

LOK SABHA

2. Shri Jaswant Singh Bishnoi
3. Shri Gurudas Dasgupta
4. Shri Bhartruhari Mahtab
5. Shri Bir Singh Mahato
6. Dr. Rajesh Kumar Mishra
7. Shri K.S. Rao
8. Shri Jyotiraditya Madhavrao Scindia
9. Shri M.A. Kharabela Swain
10. Shri Vijoy Krishna

RAJYA SABHA

1. Shri Yashwant Sinha
2. Shri Chittabrata Majumdar
3. Shri Mangani Lal Mandal
4. Smt. Shobhana Bhartia

Secretariat

1. Shri A. Mukhopadhyay - Joint Secretary
2. Shri S.B. Arora - Deputy Secretary
3. Shri T.G. Chandrasekhar - Under Secretary

WITNESSES

1. Indian Banks' Association

(i) Shri S.C. Gupta, Chairman, Punjab National Bank and Deputy Chairman, Indian Banks' Association

2. State Bank of India

(i) Shri T.S. Bhattacharya, MD & Group Executive
(ii) Shri N. Raja, Chief General Manager (Treasury)

3. Life Insurance Corporation of India

(i) Shri T.S. Vijayan, MD
(ii) Shri V.K. Kukreti, Chief (Investment)

4. Housing Development Finance Corporation (HDFC)

(i) Ms. Renu Karnad, Executive Director
(i) Shri Sudhir Jha, Head, Legal

2. At the outset, the Chairman welcomed the representatives of the Indian Banks' Association, State Bank of India, Life Insurance Corporation of India and Housing Development Finance Corporation (HDFC) to the sitting of the Committee and invited their attention to the direction 55 of the Directions by the Speaker, Lok Sabha.

3. The Committee then took oral evidence of the representatives in connection with the examination of the Securities Contracts (Regulation) Amendment Bill, 2005. The Chairman then asked the representatives to furnish written notes on certain issues on which clarifications were sought by the Members, in respect of which information was not readily available with them.

4. The evidence was concluded.

5. A verbatim record of the proceedings has been kept

The witnesses then withdrew

The Committee then adjourned

Minutes of the Twenty-Fifth sitting of Standing Committee on Finance

The Committee sat on Wednesday, the 10th May, 2006 from 1500 to 1645 hrs.

PRESENT

Maj. Gen (Retd.) B.C. Khanduri - Chairman

MEMBERS

LOK SABHA

2. Shri Bhartruhari Mahtab
3. Shri Madhusudan Mistry
4. Shri Rupchand Pal
5. Shri Jyotiraditya Madhavrao Scindia
6. Shri Ajit Singh
7. Shri Vijoy Krishna

RAJYA SABHA

8. Shri Yashwant Sinha

SECRETARIAT

1. Shri A. Mukhopadhyay - Joint Secretary
2. Shri S.B. Arora - Deputy Secretary
3. Shri T.G. Chandrasekhar - Under Secretary

WITNESSES

1. Shri Ashok Jha, Secretary
2. Shri K.P. Krishnan, Joint Secretary
3. Shri R.V. Verma, Executive Director, National Housing Bank
4. Shri M.S. Sahoo, Director (Capital Market)

2. Before the start of the meeting, the Chairman made a reference to the sad demise of S/Shri Mahboob Zahedi, A.B.A. Ghani Khan Chowdhury and Pramod Mahajan, sitting Members of Parliament. The Members mourn the loss of their esteemed colleagues and stood in silence for a while as a mark of respect to the deceased.

3. The witnesses then called in and the Chairman welcomed the representatives of the Ministry of Finance (Department of Economic Affairs) and invited their attention to the provisions contained in the Direction 55 of the Directions by the Speaker.

…..2/-

4. The Committee then took oral evidence of the witnesses on the provisions of the Securities Contracts (Regulation) Amendment Bill, 2005. The Members asked clarificatory questions which were replied to by the representatives of the Ministry of Finance. The Chairman, then, directed the representatives that the information with regard to queries of the Members which was not readily available with them might be furnished to the Committee at the earliest.

5. The evidence was concluded

6. A verbatim record of proceedings has been kept.

The witnesses then withdrew

The Committee then adjourned.

Minutes of the Twenty-sixth sitting of Standing Committee on Finance

The Committee sat on Wednesday, 19 May, 2006 from 0930 to 1030 hrs.

PRESENT

Maj. Gen (Retd.) B.C. Khanduri - Chairman

MEMBERS

LOK SABHA

2. Shri Bhartruhari Mahtab
3. Dr. Rajesh Kumar Mishra
4. Shri Madhusudan Mistry
5. Shri Rupchand Pal
6. Shri Jyotiraditya Madhavrao Scindia
7. Shri M.A. Kharabela Swain
8. Shri Vijoy Krishna

RAJYA SABHA

9. Shri S.P.M. Syed Khan
10. Shri Santosh Bagrodia

Secretariat

1. Dr.(Smt.) P.K. Sandhu - Additional Secretary
2. Shri A. Mukhopadhyay - Joint Secretary
3. Shri S.B. Arora - Deputy Secretary
4. Shri T.G. Chandrasekhar - Under Secretary
5. Smt. Anita B. Panda - Under Secretary

2. At the outset, the Chairman welcomed the Members to the sitting of the Committee.

3. The Committee first took up for consideration the draft report on Securities Contracts (Regulation) Amendment Bill, 2005 and adopted the same without any amendment. However, one Member desired to submit note of dissent on certain proposals of the Bill. The Chairman informed him that he could send the note at the earliest.

4. XX XX XX XX
XX XX XX XX

(i) XX XX XX XX

(ii) XX XX XX XX

(iii) XX XX XX XX

(iv) XX XX XX XX

(v) XX XX XX XX

5. The Committee authorised the Chairman to finalise the Reports in the light of modification as also to make verbal and other consequential changes arising out of the factual verification and present the same to both the Houses of Parliament.

The Committee then adjourned.

THE SECURITIES CONTRACTS (REGULATION) AMENDMENT BILL, 2005

[Bill No. 162 of 2005]

A

BILL

PREAMBLE

further to amend the Securities Contracts (Regulation) Act, 1956.

BE it enacted by Parliament in the Fifty-sixth Year of the Republic of India as follows:--

1. Short title.--

This Act may be called the Securities Contracts (Regulation) Amendment Act, 2005.

2. Amendment of Section 2.--

(1) In section 2 of the Securities Contracts (Regulation) Act, 1956(42 of 1956) (hereinafter referred to as the principal Act), in clause (h), after sub-clause (id), the following sub-clause shall be inserted, namely:--

"(ie) any certificate or instrument (by whatever name called),--

(a) issued, to an investor by any special purpose distinct entity which possesses any financial asset representing debt or receivable by such entity, and, acknowledging the beneficial interest of such investor in such financial asset; and

(b) which may, by general or special order, be specified as such by the Securities and Exchange Board of India;".

3. Insertion of new section 17A.--

After section 17 of the principal Act, the following section shall be inserted, namely;--

"17A. Approval of Securities and Exchange Board of India for securities referred to in sub-clause (ie) of clause (h) of section 2.--(1) Without prejudice to the provisions contained in this Act or any other law for the time being in force, no securities of the nature referred to in sub-clause (ie) of clause (h) of section 2 shall be issued to any investor or trade on any recognised stock exchange unless such securities have been approved by the Securities and Exchange Board of India.

(2) Every special purpose distinct entity referred to in sub-clause (ie) of clause (h) of section 2 shall--

(a) make an application, for specifying any certificate or instrument under sub-clause (ie) of clause (h) of section 2, as securities, to she Securities and Exchange Board of India, in such form and manner as may be specified by regulations;

(b) file along with an application made under clause (a) the draft of the certificate or instrument which such entity proposes to issue to the investor as securities of the nature referred to in sub-clause (ie) of clause (h) of section 2

(3) The Securities and Exchange Board of India may, to protect the interest of investors in the securities of the nature referred to in sub-clause (ie) of clause (h) of section 2, specify by regulations,--

(i) the contents of the certificate or instrument to be filed under clause (b) of sub-section (2) and to be issued as securities of the nature referred to in sub-clause (ie) of clause (h) of section 2, to the investors;

(ii) the manner in which such contents shall be disclosed in the certificate or instrument to be issued as securities of the nature referred to in sub-clause (ie) of clause (h) of section 2".

4. Amendment of section 31.--

In section 31 of the principal Act for sub-section (2), the following sub-section shall be substituted, namely--

"(2) In particular, and without prejudice to the generality of the foregoing power, such regulations may provide for all or any of the following matters, namely:--

(a) the manner in which at least fifty-one per cent, of equity share capital of a recognised stock exchange is held within twelve months item the date of publication of the order under; sub-section (7) of section 4B by the public other than the shareholders having trading rights under sub-section (8) of that section;

(b) the form and manner in which an application shall be made under clause (a) of sub-section (2) of section 17A;

(c) the contents of the certificate or instrument under clause (1) of sub-section (3) of section 17A;

(d) the manner in which such contents shall be disclosed in the certificate or instrument under clause (ii) of sub-section (3) of section 17A"

STATEMENT OF OBJECTS AND REASONS

During the Budget Session of Parliament in the current year 2005, it was proposed to amend the definition of "Securities" in the Securities Contracts (Regulation) Act, 1956 (the SCR Act) so as to provide a legal framework for trading of securitised debt including mortgage backed debt.

2. Securitisation is a form of financing involving pooling of financial assets and the issuance of securities that are re-paid from the cash flows by the assets. This is generally accomplished by actual sale of the assets to a bankruptcy remote vehicle, that is, a special purpose vehicle, which finances the purchase through the issuance of bonds. These bonds are backed by future cash flow of the asset poof. The most common assets for securitisation are mortgages, credit cards, auto and consmer loans, students loans corporate debt, export receivables, off-shore remittances, etc.

3. Besides other advantages, securitisation (a) allows banks and financial institutions to keep these loans off their balance-sheet, thus reducing the need for additional capital; (b) provides the hanks and financial institutions with alternative forms of funding risk transfer, a new investor base, potential capital relief and capital market development; (c) can reduce Sending concentration, improve liquidity and improve access to alternate sources of funding for banks and financial institutions; (d) facilitates attainment of funding at lower cost as a result of isolating the assets from potential Bankruptcy risk of the originator; (e) facilitates better matching of assets and liabilities and the development of the long-term debt market; (f) provides diversified pools of uniform assets; and (g) has the advantage of converting non-liquid loans or assets which cannot, be easily sold to third party investors into liquid assets or marketable securities. Lower funding costs are also a result of movement of investments from less efficient debt markets So more efficient capital markets through the process of securitisation.

4. In India, the securitisation market remains underdeveloped. Although two major legislative initiatives, namely, (a) the amendment to the National Housing Bank Act, 1987 (NHB Act) in the year 2000; and (b) the enactment of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, (SARFAESI Act), have been taken, the market has not picked up because of the absence of the facility of trading on stock exchanges, The potential buyers get discourged by the possibility of having to hold the certificate or instrument in respect of Securitisation transactions till maturity. This, in turn, restricts the growth of business of housing finance companies and banks.

5. The Securitisation transactions under the NHB Act are not covered under the definition of "securities" under the SCR Act. As such, trading in certificates or instruments relating to such transactions cannot take place on stock exchanges

and buyers of such securitised financial certificates or instruments are left with few exit options. Under the SARFAESI Act, while "security receipts" have been covered under the definition of "securities", the provisions of the said Act restrict sale and purchase only amongst qualified institutional buyers. Besides, the "security receipts" under the SARFAESI Act can be issued only by a Securitisation company or a reconstruction company registered with the Reserve Bank of India. This obviously limits the interest in such receipts and the market has not taken off at all.

6. Keeping in view the potential of the securities market for the certificates or instruments under Securitisation transactions, international trends and consultations held with major institutional participants and market experts, it has been decided to amend the SCR Act, inter alia.--

(i) include Securitisation certificate or instrument under the definition of "securities" and to insert for the said purpose, a new sub-clause (ie) in clause (h) of section 2 of the SCR Act, 1956;

(ii) to provide for obtaining approval from the Securities and Exchange Board of India for issue of the proposed certificate or instrument and procedure therefor and insert for the said purpose a new section 17A in the SCR Act, 1956; and

(iii) to provide for the manner in which contents of such certificate or instrument, being the securities" and acknowledging beneficial interest shall be disclosed.

7. The Bill seeks to achieve the above objectives.

P. CHIDAMBARAM

NEW DELHI;

The 7th December, 2005.

MEMORANDUM REGARDING DELEGATED LEGISLATION

Clause 4 of the Bill proposes to amend section 31 of the Securities Contracts (Regulation) Act, 1956 so as to confer power upon the Securities and Exchange Board of India to make regulations on the matters such as specifying the form and manner in which an application shall be made under clause (a) of sub-section (2) of section 17 A; specifying the contents of the certificate or instrument under clause (i) of sub-section (3) of section 17 A and the manner in which such contents shall be disclosed in the certificate or instrument under clause (ii) of sub-section (3) of section 17A.

2. The regulations made by the Securities and Exchange Board of India shall be laid, as soon as may be, after they are made, before each House of Parliament.

3. The matters in respect of which regulations may be made are generally matters of procedure and administrative details and it is not practicable to provide for them in the Bill itself. The delegation of legislative power is, therefore, of a normal character.