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Legal Updates

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1. **BANKING & FINANCE**

RBI's new directives on Transfer of Loan Exposures and Securitizations of Standard Assets

The Reserve Bank of India ("**RBI**") had, on June 08, 2020, issued two draft documents viz. the 'Draft Framework for Securitization of Standard Assets' and 'the Draft Comprehensive Framework for Sale of Loan Exposures' for public comments.

Based on the public comments received, RBI has issued the Master Directions namely – Reserve Bank of India (Securitization of Standard Assets) Directions, 2021 dated September 24, 2021 ("**Securitization of Standard Assets Directions**") and Master Direction – Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021 dated September 24, 2021 ("**Transfer of Loan Exposures Directions**"), which has come into force immediately, as on the date of issue.

This framework of RBI to separate the regulatory guidelines for direct assignment transactions from the securitization guidelines and treat it as a sale of loan exposure can be considered a much appreciated step to create a robust secondary market in loans for management of credit exposures by lending institutions and also create additional avenues for raising liquidity and further to treat securitization transactions as an important facilitator in a well-functioning financial market that it improves risk distribution and liquidity of lenders in originating fresh loan exposures.

A. Salient Features of the Securitization of Standard Assets Directions

The directions shall be applicable to securitization transactions undertaken subsequent to the issue of the directions.

i. Minimum Retention Requirement (MRR)

The MRR is primarily designed to ensure that the originators have a continuing stake in the performance of securitized assets so as to ensure that they carry out proper due diligence of loans to be securitized. The originators should adhere to the MRR as detailed below while securitizing loans leading to issuance of securitization notes other than residential mortgage-backed securities:

a For underlying loans with original maturity of 24 months or less, the MRR shall be 5% of the book value of the loans being securitized.

b For underlying loans with original maturity of more than 24 months as well as loans with bullet repayments, the MRR shall be 10% of the book value of the loans being securitized.

ii. Limit on Total Retained Exposures by Originators

The total exposure of an originator to the securitization exposures belonging to a particular securitization structure or scheme should not exceed 20% of the total securitization exposures created by such structure or scheme. However, the exposure of originators to credit enhancing interest only strip shall be excluded from this limit.

iii. Credit enhancement facilities

Credit enhancement is the process of enhancing credit profile of a structured financial transaction through provision of additional security/financial support, for covering losses on securitized assets in adverse conditions. The enhancements can be broadly divided into two types viz. internal credit enhancement and

external credit enhancement. A credit enhancement which, for the investors, creates exposure to entities other than the underlying borrowers is called the external credit enhancement. For instance, cash collaterals and first/second loss guarantees are external forms of credit enhancements. Investment in subordinated tranches, over collateralization, excess spreads, credit enhancing interest-only strips are internal forms of credit enhancements.

B. Salient Features of the Transfer of Loan Exposures Directions

i. Applicability

a. The directions are applicable to all loan transfers undertaken by the lenders, including sale of loans through novation or assignment, and loan participation. In cases of loan transfers other than loan participation, legal ownership of the loan shall be mandatorily transferred to the transferee(s) to the extent of economic interest transferred.

b. In respect of transferee(s) other than lenders mentioned in the directions and Asset Reconstruction Companies (ARCs), which are also financial sector entities, the prudential norms, including asset classification and provisioning post the transfer shall be as per the respective regulatory frameworks laid down by the respective financial sector regulators.

ii. Requirement of a Board approved policy

As per the Transfer of Loan Exposure Directions, the lenders shall prepare a comprehensive Board approved policy for transfer and acquisition of loan exposures laying down the minimum quantitative and qualitative standards relating to due diligence, valuation, requisite IT systems for capture, storage and management of data, risk management, periodic Board level oversight, etc. Further, the policy must also ensure independence of functioning and reporting responsibilities of the units and personnel involved in transfer / acquisition of loans from that of personnel involved in originating the loans.

iii. General Conditions applicable for all loan transfers

a. In loan participation transactions, by design, the legal ownership completely remains with the transferor even after economic interest has been transferred to transferee(s). In such cases, the roles and responsibilities of the transferor and transferee(s) shall be clearly delineated contractually.

b. A transferor cannot re-acquire a loan exposure, either fully or partially, that had been transferred by the entity previously, except as a part of a resolution plan under the Reserve Bank of India (Prudential Framework for Resolution of Stressed Assets) Directions, 2019 or as part of a resolution plan approved under the Insolvency and Bankruptcy Code, 2016.

c. The transferor shall have no obligation to re-acquire or fund the re-payment of the loans or any part of it or substitute loans held by the transferee(s) or provide additional loans to the transferee(s) at any time except those arising out of breach of warranties or representations made at the time of transfer. The transferor should be able to demonstrate that a notice to this effect has been given to the transferee(s) and that the transferee(s) have acknowledged the absence of such obligation.

iv. Minimum Holding Period

The transferor can transfer loans only after a minimum holding period (MHP), which is counted from the date of registration of the underlying security interest:

a. Three months in case of loans with tenor of up to 2 years;

b. Six months in case of loans with tenor of more than 2 years.

v. <u>Transfer of Stressed Assets</u>

a. The transfer of stressed loans must be done through assignment or novation only; loan participation is not permitted in the case of stressed loans. In general, lenders shall transfer stressed loans, including through bilateral sales, only to permitted transferees and ARCs.

b. The transferor shall ensure that subsequent to transfer of the stressed loans, they do not assume any operational, legal or any other type of risks relating to the transferred loans including additional funding or commitments to the borrower / transferee(s) with reference to the loan transferred. Subsequently, fresh exposure may be taken on the borrower after a cooling period laid down in the respective Board approved policy of the transferor, which in any case, shall not be less than 12 months from the date of such transfer.

2. INFRASTRUCTURE & ENERGY

Supreme Court resolves the decade long jurisdictional conflict on electricity derivates sector

The Hon'ble Supreme Court in the case of *Power Exchange India Ltd. v. Securities and Exchange Board of India*[1] *vide* its consent order dated October 06, 2021, approved the terms delineating the respective jurisdictions of Securities and Exchange Board of India and the Central Electricity Regulatory Commission ("**CERC**") which were originally formulated by the Committee on Efficient Regulation of Electricity Derivatives ("the **Committee**") constituted by the Ministry of Power on October 26, 2021, thereby resolving the decade long dispute challenging the decision of Hon'ble High Court of Bombay.

The impugned order by the Bombay High Court held that certain parts of the CERC (Power Markets) Regulations, 2010 relating to future and forward contracts will be inoperative and held that neither the Forward Market Commission (as it then was) nor CERC, or the authority/commissions under their authority have sole or exclusive jurisdiction to regulate and control forward trading/future contracts in electricity.

Basis the aforementioned consent order of the Hon'ble Apex Court, the Ministry of Power *vide* its press release dated October 07, 2021[2] issued the major recommendations of the Committee based on which both SEBI and CERC have come to an agreement that CERC will regulate all the physical delivery based forward contracts whereas the financial derivatives will be regulated by SEBI.

The recommendations are as follows:

1. All Ready Delivery Contracts and Non-Transferable Specific Delivery ("**NTSD**") Contracts as defined in the Securities Contracts (Regulation) Act, 1956 ("**SCRA**") in electricity, entered into by members of the power

[1] Civil Appeal Nos.5290-5291 Of 2011
[2] https://pib.gov.in/Pressreleaseshare.aspx?PRID=1761701

exchanges, registered under CERC (Power Market) Regulations, 2010, shall be regulated by CERC subject to the following conditions, namely:-

(a) the contracts are settled only by physical delivery without netting;

(b) the rights and liabilities of parties to the contracts are not transferable;

(c) no such contract is performed either wholly or in part by any means whatsoever, as a result of which the actual delivery of electricity covered by the contract or payment of the full price therefor is dispensed with;

(d) no circular trading shall be allowed and the rights and liabilities of parties to the specific delivery contracts shall not be transferred or rolled over by any other means whatsoever;

(e) the trading shall be done only by authorized grid connected entities or trading licensees on behalf of grid connected entities, as participants;

(f) the contracts can be annulled or curtailed, without any transfer of positions, due to constraints in the transmission system or any other technical reasons, as per the principles laid down by CERC in this regard. However, once annulled, same contract cannot be reopened or renewed in any manner to carry forward the same transaction.

(g) all information or returns relating to the trade, as and when asked for, shall be provided to CERC, who shall monitor the performance of the contracts entered into on the power exchanges.

2. Commodity Derivatives in electricity other than NTSD Contracts as defined in SCRA shall fall under the regulatory purview of SEBI.

3. The Central Government reserves the right to impose additional conditions from time to time as it may deem necessary.

4. A Joint Working Group between SEBI and CERC shall be constituted with Terms of Reference as agreed in the Report of the Committee.

The anticipated effects of this are:

1. Introduction of longer duration delivery-based contracts in the power exchanges which has been currently restricted to only 11 days due to the pendency of the case.

2. Discoms and other large consumers will be able to plan their short-term power procurement more efficiently.

3. The commodity exchanges can now introduce financial products and this will enable the Discoms and other large consumers to effectively hedge their risks of power procurement.

4. It is estimated that this will further deepen the power market from the present level of approx. 5.5% of the volume to the targeted volume of 25% by 2024-25.

3. INCOME TAX

Global Minimum Taxation[3]

In a recent landmark development in International Tax system, major reform took place at Organization for Economic Co-operation and Development (‘**OECD’**) bringing together 136 countries and jurisdictions representing more than 90% of the global GDP to a landmark deal on global minimum tax. This deal will reallocate more than USD 125 billion of profits from about 100 of the world’s largest and most profitable multinational enterprises (“**MNEs**”) to countries worldwide, ensuring that these MNEs pay a fair share of tax wherever they operate and generate profits. This reform will ensure that MNEs will be subject to a minimum 15% tax rate from 2023 if the reforms are implemented successfully.

Following the years of intensive negotiations to bring the international tax system into 21st century, 136 jurisdictions (out of 140 members of OECD/G20 Inclusive framework on BEPS) joined the statement on the two pillar solution to address the “Tax Challenges Arising from the Digitalization of the Economy”.

The global minimum tax agreement does not seek to eliminate tax competition, but puts multilaterally agreed limitations on it, and will see countries collect around USD 150 billion in new revenues annually. Pillar one will ensure a fairer distribution of profits and taxing rights among countries with respect to the largest and most profitable MNEs. It will re-allocate some taxing rights over MNEs from their home countries to the markets where they have business activities and earn profits, regardless of whether firms have a physical presence there. Specifically, MNEs with global sales above EUR 20 billion and profitability above 10% will be covered under the new rules, with 25% profit above 10% threshold to be reallocated to market jurisdictions.

Our Comments: The global minimum tax of 15% is bad news for countries who act as a tax haven and for MNEs who are engaging in aggressive tax planning.

Additionally implementation of Pillar One require countries to restrain from introducing new unilateral measures and withdrawing already introduced digital taxes. Thus, India may have to give up equalization levy introduced by it recently.

4. GST

Follow up recommendation to the GST Council’s recommendation in 45th Meeting in Lucknow held recently.

The major recommendation in the Press Release dated 18 September 2021are as follows:

A. Clarifications on GST rate on certain services[4]:

(a) Coaching services to students provided by coaching institutions and NGOs under the central sector scheme of Scholarships for students with Disabilities is exempt from GST;

(b) Overloading charges at toll plaza are exempt from GST being akin to toll; and

(c) Alcoholic liquor for human consumption is not food and food products for the purpose of the entry prescribing 5% GST rate on job work services in relation to food and food products.

B. Other recommendations

[3] https://www.oecd.org/tax/international-community-strikes-a-ground-breaking-tax-deal-for-the-digital-age.htm

[4] Circular No. 160/16/2021-GST dated 20 September 202

The Council has decided to set up a Group of Ministers ("**GoM**") to examine the issue of correction of inverted duty structure for major sectors, rationalize the rates and review exemptions from the point of view of revenue augmentation, from GST. It was also decided to set up a GoM to discuss ways and means of using technology to further improve compliance including monitoring through improved e-way bill systems, e-invoices, FASTag data and strengthening the institutional mechanism for sharing of intelligence and coordinated enforcement actions by the Centre and the States.

C. Measures for streamlining compliances in GST

(a) Aadhaar authentication of registration to be made mandatory for being eligible for link refund claim and application for revocation of cancellation of registration;

(b) Late fee for delayed filing of Form GSTR-1 to be auto-populated and collected in next monthly/ quarterly return in Form GSTR-3B;

(c) Refund to be disbursed in the bank account, which is linked with same PAN on which registration has been obtained under GST; and

(d) Rule 36(4) of CGST Rules, to be amended, once the proposed clause (aa) of section 16(2) of CGST Act, is notified, to restrict availment of ITC in respect of invoices/ debit notes, to the extent the details of such invoices/ debit notes are furnished by the supplier in Form GSTR-1/ IFF and are communicated to the registered person in FORM GSTR-2B.

(e) Aadhaar authentication of registration to be made mandatory for being eligible for filing refund claim and application for revocation of cancellation of registration;

(f) It has been clarified that w.e.f. 01 January 2021, the issuance date of debit notes shall determine the relevant financial year; and

(g) Further, ITC on the debit notes issued after the 01 January 2021 will be eligible as per the amended provision of Sect ion 16(4) and for the debit notes raised before 01 January 2021. ITC applicability will be determined based on the provision of Section 16(4) as it existed before the amendment. Physical copy of invoices not required if invoice generated as per Rule 48(4)

(h) No physical copy of invoices is required in cases where invoice has been generated by the supplier in the manner prescribed u/r 48(4) of the CGST Rules and production of the QR code having an embedded IRN electronically, for verification by the proper officer, would suffice;

(i) Scope of 'subjected to export duty' explained qua Section 54(3) of the GST Act. In cases where there is no export duty and supplies are at NIL rate such transactions shall not be covered by the restriction imposed under the first proviso to sec 54(3) of the CGST Act.

5. CORPORATE/ FOREIGN INVESTMENT

100% FDI allowed in Telecom Sector under automatic route except for the investments from or the beneficial owner of such investment situated in countries sharing borders with India which will be under government route.

The Department for Promotion of Industry and Internal Trade ("**DPIIT**"), in harmony with the Cabinet approval last

month for measures to salvage the stressed Telecom Sector, has vide Press Note 4 (2021 Series) dated October 06, 2021 raised FDI from 49% to ***100% under automatic route*** with following conditions:

(a) The licensing, security and any other terms and conditions as specified by Department of Telecommunications from time to time, shall be observed by licensee/entities providing telecom services as well as investors.

(b) All foreign investments in the Telecom sector from countries sharing their borders with India or where the beneficial owner of such investments is situated in, can invest only under the government route in terms of Press Note 3 (2020 Series) dated April 17, 2020 issued by DPIIT for curbing opportunistic takeovers/acquisitions of Indian companies due to the current COVID-19 pandemic

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