

**FINAL REPORT**

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# **Asset Securitization By The Financial Institutions In Bangladesh**

*Prepared for*

THE WORLD BANK  
DHAKA OFFICE

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**RESTRICTED CIRCULATION**

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# Asset Securitization By The Financial Institutions In Bangladesh

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## A. Regulatory and Policy Issues

### 1. Legal Framework

Since Bangladesh does not have any separate or dedicated regulatory regime for asset securitization, one of the oft-repeated questions in any securitization attempt has been the necessity of considering the applicability of existing law, rules and regulations of Bangladesh. We may hasten to add that the securitization transactions can very much be done under the existing laws of the country as it has been made possible in other common law jurisdictions. There is also no impediment for issuance of any securitized instruments under the Public Issue Rules, the Contract Act and the Companies Act. Moreover, the concept of securitized debt instruments are not inconsistent with the provisions of the Trust Act, Bankruptcy Act, Registration Act, Negotiable Instruments Act, the general securities market regulatory regime or any other pertinent legislation, including the listing rules of the stock exchanges. In fact there is no compelling reason for a special legal framework or even regulatory intrusion preceding development of the market. What actually poses the challenge to securitization in Bangladesh is the scarcity or uncertainty of precedence to define the parameters of law and consequences.

Followings are the major topics of discussion on issuing securitized instruments that may rely on legal interpretations:

- a. Establishment of Special Purpose Vehicle (SPV)
- b. Characterization of the transfer of assets
- c. Eligibility of transfer of receivables

#### 1.1 Establishment of SPV

It is possible under existing Bangladesh laws to establish a SPV in the form of a society, company or trust or even government corporation in the form of a statutory body. The different forms of SPVs are governed under different set of laws - the Societies Registration Act 1860, the Voluntary Social Welfare Agencies (Registration & Control) Ordinance 1961, the Companies Act 1994, the Trust Act 1882 and the Registration Act 1908.

- a. *SPV as society*: This form of SPV is a quasi-legal entity and quite simplistic. However, as it appears the activities of the entity would be limited only within the members of the society. Therefore, issuance of securities to non-members, i.e.

general public would not be possible. SPV as a society may lack adequate regulatory control, which brings about low credibility in the eyes of the investors of the securities issued by the SPV.

- b. *SPV as company*: SPV may be created in the form of a (subsidiary or independent) company under the Companies Act 1994 and registered with the Registrar of Joint Stock Companies & Firms (RJSC). Although this is a legal entity, it cannot have limited or predetermined life without going through usual liquidation process and it also involves comparatively higher establishment and registration cost contingent upon authorized capital. The entity can also be established as a company limited by guarantee under section 29 of the Act and also there is a possibility to be a non-profit entity under section 28 of the Act. It should also preferably have Directors independent of the Originator(s).

It should also be noted that such a company SPV is required to be established as a 'Public Limited Company' with at least seven shareholders, including minimum of three directors, as against a 'Private Limited Company' since private companies are barred from issuing securities for public subscription.

Additionally, a company SPV issuing securities in excess of Tk 10 million shall have to procure prior consent from the SEC against payment of applicable fees @ 0.1% on the total capital and Tk 5,000 application fees, under the SEC (Capital Issue of Public Limited Company) Rules 2001<sup>1</sup>.

The company SPV would require frequent statutory and periodic reporting requirement as well as filling of returns with the RJSC and also a compulsory minimum meetings of the Board of Directors and holding of Annual General Meetings. Additionally, it involves comparatively high operating cost. Company SPV also entails a comparatively complex organizational structure, which imposes maximum obligation to the sponsors. With company SPV multi-SPV securitization structure will not be easy to establish as it calls for creating multiple subsidiaries.

- c. *SPV as Trust*: An SPV formed as a trust is not a separate legal entity and accordingly, its trustees will contract and be responsible for its activities in accordance with the provisions specified in the trust deed. SPV trust can be established with Trustees independent of the Originator under the Trust Act 1882 and registered with the Sub-Registrars' Office under Registration Act 1908. SPV trusts are usually flexible and can take shape of a perpetual, limited or predetermined maturity entity. Its' establishment, registration and operating costs are also low. Registration cost is only Tk 2,500, which is fixed irrespective of capital<sup>2</sup>. It is also viewed that, under a strict reading, securities issued by a SPV trust may not attract consent and fees payment requirement under the SEC (Capital Issue of Public Limited Company) Rules 2001, since the particular notification deals with securities issued by a limited liability company. This could be one another reason to favor the trust form of SPV over the corporate form. It is quite possible for the trust to secure income tax exemption if declared and

<sup>1</sup> SEC Notification No. SEC/CFD-71/2001/Admin/07 dated March 28, 2001 read with Notification No. SEC/CFD-71/2001/Admin/10 of even date.

<sup>2</sup> Circular No. 143 R-6/1M-5/99 dated April 3, 2000 of the Ministry of Law Justice & Parliamentary Affairs, Government of the Peoples' Republic of Bangladesh.

structured as non-profit entity. Also the trust does not require any statutory or periodic reporting to the registering authority like that of a company.

SPV trust is a simple organization involving minimum obligation of the sponsors/settlers and is ideal especially for a multi-SPV structure. This is the most wide and globally practiced form of SPV. Additionally, it is customary in Bangladesh to issue debt instruments under a trust. All listed debentures in Bangladesh approved by the SEC have Trustees and the SEC has also selected this form for mutual funds in Bangladesh<sup>3</sup>. The SEC has already formally accorded approval to AIMS of Bangladesh Limited, a local private asset management company, to act as the Trustee of a SPV in the form of a trust for a securitized transaction in Bangladesh with public float option<sup>4</sup>.

Considering the issues in each form stated above, it is obvious that the trust form of SPV carries few comparative advantages over the other forms. Moreover, the SPV trust is the form most conforming to the existing practice as well as laws of Bangladesh, in relation to issuance of debt securities and mutual funds. Understandably, we recommend the originators to prefer the SPV trust form to securitize their receivable assets. However, it remains the prerogative of the originator to choose the form most suiting their purpose and it may not be desirable to limit or restrict the options through any precondition. A detail comparison among the three possible SPV forms is annexed to the report<sup>5</sup>.

**Regional experience:** Almost in all transactions of the developing countries under common law jurisdiction that we came across, the SPV is formed as a trust. Where the SPV is a corporate body there is also a debenture/securities trustee. In Sri Lanka all the transactions have been done through SPV Trust. The commercial bank, usually a multinational or joint-venture, that has structured the issue or provided some kind of guarantee and also holds the depository and collection accounts of the originator usually acts as the Trustee of the SPV. In India the trust form is the prevalent form of SPV which is the case in Pakistan<sup>6</sup> as well. Thailand does not have a Trust Act therefore the SPVs are either in the form of a corporate entity or mutual fund (essentially with characteristics of a trust where beneficial interest are held and represented by the 'Bond Representatives', in place of the trustees<sup>7</sup>). However, realizing the deficiencies they are now engaged in drafting a Trust Law, which is expected to be enacted within the year.

## 1.2 Characterization of the Transfer of Assets

The principal legal concern for securitization pertains to the characterization of the transfer of assets to the SPV. The transfer may be characterized as having been either a 'true sale' or having resulted in investors obtaining a 'first perfected security interest' in the assets transferred. It is the generally held view that in order to structure the SPV as a bankruptcy-remote entity it is necessary to achieve 'true sale' status on the sale of assets by the originators i.e., the receivables should be made isolated from the insolvency of the originator. It can be attempted through constructing and construing

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<sup>3</sup> SEC ( Mutual Fund) Rules 2001

<sup>4</sup> See Annex XI for details.

<sup>5</sup> See Annex II for details.

<sup>6</sup> See Annex IX for details.

<sup>7</sup> See Annex X for details.

the terms and conditions of the assignment (sale-purchase) agreement conforming to the standard. Such attempt should also conform to the qualifying accounting principles.

On the other hand the SPV could also be construed as a bankruptcy proof entity if there are no fraudulent transfers and the transactions comply with the law. However, a caveat should be kept in mind that since there is no precedence of court cases at hand in Bangladesh in this regard, it is quite difficult to gauge or fathom what could be the view, opinion or position of the court of law on specific instances.

### 1.3 Transfer of Receivables

The receivables may be considered as 'immovable property' or 'actionable claim' as delineated in the Bangladesh Transfer of Property Act, 1882.

**Actionable claim:** The Section 3 of the Act defines 'actionable claim' as follows:

'actionable claim' is a claim to any debt, other than a debt secured by mortgage or immovable property or by hypothecation or pledge of movable property, or to any beneficial interest in movable property not in the possession, either actual or constructive, of the claimant, which the Civil Courts recognize as affording grounds for relief, whether such debt or beneficial interest be existent, accruing, conditional or contingent;

It is generally viewed that according to the definition of the Act, claims to lease rentals, hire-purchase receivables, credit card receivables or other receivables can be treated as actionable claims. The Bangladesh legal systems commonly require dealings in intangible properties including the actionable claims to be recorded down to writing, whether registered or not. The transfer of actionable claims calls on complying, in particular, the Sections 130 through 137 of the Bangladesh Transfer of Property Act, 1882.

The most pertinent Section 130 (1) of the Act reads as follows:

'The transfer of an actionable claim whether with or without consideration shall be effected only by the execution of an instrument in writing signed by the transferor or his duly authorized agent, shall be complete and effectual upon the execution of such instrument, and thereupon all the rights and remedies of the transferor, whether by way of damages or otherwise, shall vest in the transferee, whether such notice of the transfer as hereinafter provided be given or not:

Provided that every dealing with the debt or other actionable claim by the debtor or other person from or against whom the transferor would, but for such instrument of transfer as aforesaid, have been entitled to recover or enforce such debt or other actionable claim, shall (save where the debtor or other person is party to the transfer or has received express notice thereof as hereinafter provided) be valid as against such transfer.'

A closer reading of the referred section(s) would reveal that transfer of an actionable claim shall be effected only by the execution of an instrument in writing, signed by the transferor, whether a notice to the debtor is issued or not. However, issuance of such notice is rather advisable.

Notably, though Section 130 of the Act requires the transfer to be effected through execution of an instrument in writing, it does not imply that registration of such transfer is mandatory under the Registration Act 1908.

There are also views that the assignment of a debt secured by hypothecation or pledge of movable property may be executed even without strict compliance with the referred Section 130. It is recommended that executors take legal advice in this regard on a case to case basis, depending on the nature and character of the mortgaged properties, which is likely to be varied.

**Immovable property:** Apparently receivables under loan secured by mortgage of immovable properties shall itself be treated as an immovable property according to a close reading of the Bangladesh Transfer of Property Act 1882. The relevant provision of the Act as quoted under implies that when the loan secured by the mortgage is transferred, there will be a transfer of the mortgage also.

Section 8: Unless a different intention is expressed or necessarily implied, a transfer of property passes forthwith to the transferee all the interest which the transferor is then capable of passing in the property and in the legal incidents thereof.

Such incidents include, ..... where the property is a debt or other actionable claim, the securities thereof (except where they are also for other debts or claims not transferred to the transferee), but not arrears of interest accrued before the transfer;

It is a generally held opinion that if there is an assignment of mortgage debt secured by immovable property, the provisions relating to transfer of immovable properties will be applicable. Since mortgage is an immovable property, it can only be transferred through a registered instrument. Sale of such loans will require a transfer of the Deed of Mortgage at the Land Registrar. A Deed of Transfer may need to be filed with the office of the Registrar. However, the transfer of land or a facility as a result of foreclosure requires an added process of 'Mutation,' a change of ownership. Pursuant to the Transfer of Properties Act, the Mutation process is not complete until the Office of the Registrar has served notice to the original owner. It is recommended that executors take legal advice in this regard also on a case to case basis.

As it appears, like immovable properties, transfer of actionable claims also would require a conveyance and thus the applicable stamp duty attracts to the transfer of receivables as well.

## 2. Purview of Authority

There is a gray area in the securities market regulatory regime pertaining to division of authority between Bangladesh Bank and the Securities and Exchange Commission (SEC) on the issuance of long-term debt instruments. We hold that a simple ruling from the Bangladesh Bank can remove confusions, if any, for the purpose of asset securitization under the auspices of CBSF.

It is the generally held view, with reference to the Securities & Exchange Ordinance 1969, that securities under 12 month tenure characterizing as 'money market instruments' should fall under the jurisdiction of the Bangladesh Bank and those with tenures exceeding 12 months under the SEC regime. However, if public subscription (IPO) is involved, irrespective of the tenure of the securities, consent from SEC shall be mandatory. The SEC



has meanwhile already set a precedent in this regard while ruling on an earlier application on behalf of BRAC, an NGO, for securitization of micro-credit receivables in Bangladesh<sup>8</sup>.

It is also our considerate opinion that in cases where the originator(s) of the securitization attempt is a commercial bank or non-bank financial institution or any other institution licensed by the Bangladesh Bank, it is obvious that such institution(s) would require prior approval/clearance from its licensing authority i.e. the Bangladesh Bank. It is so since transfer or assignment of assets may impact on the statutory capital adequacy and provisioning requirements of those institutions, on which the Bangladesh Bank has legitimate interest.

As another alternative, the Bangladesh Bank may also very well consider bringing the entire activities of asset securitization and issuance of debt instruments by any financial institution licensed by it, other than the public issue part, if any, under its full authority. Analogy can be drawn in this regard with the status of the Investment Corporation of Bangladesh (ICB) and Bangladesh Shilpa Rin Sangstha (BSRS) managed Mutual Funds, which does not have to comply with any of the relevant SEC Rules and is therefore essentially not under the SEC jurisdiction, whereas the privately managed mutual fund does. This however unfortunately resulted in an uneven playing field, though has been accepted since 1997, when the Mutual Fund Regulations were introduced by the SEC, as a *fait accompli*.

The Bangladesh Bank can also, in consultation with the SEC wherever required, formulate a set of 'Prudential Guidelines' and 'Standard Operating Procedure' for asset securitization in Bangladesh.

### 3. Regulator of SPV

Since the SPV is created for the special purpose of isolation of the transferred assets from the originator and holding the collective interest of the investors, it would be prudent to examine and review the determination of regulatory authority, if any, and the extent of influence to oversee and monitor the SPVs by any such authority. Few prospective originators and probable investors have also expressed their interest on the issue.

Usually, the SPVs are not 'regulated', rather 'supervised' or 'looked after' in the regional countries. It is the general norm that some form of prudential requirements are warranted only in cases where public issue of securities are involved or when bank assets are being restructured, often accompanying a bail-out plan. In cases where no public issue of securities are involved there is no attempt to exert authority by any regulatory or controlling agency. This should also be the case for Bangladesh.

**Comment:** According to the current regime prevailing in Bangladesh, no prior consent is required from any regulatory or registering authority, including the Securities and Exchange Commission (SEC), for establishing a SPV. The Trust Deed of a SPV in trust form is also not required to be vetted or approved by any authority, including by the SEC even also in cases where public issue is contemplated, as has been opined by the SEC on a recent application for vetting/approving a draft trust deed establishing a SPV by BRAC, a leading NGO (society)<sup>9</sup> for the purpose of asset securitization in Bangladesh.

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<sup>8</sup> See Annex XI for details.

<sup>9</sup> See Annex XI for copy of SEC letter.

However, considering the prevailing financial environment and system and the substance of the SPV, it could be recommended that it is best for the market, on account of investors' comfort, for the SEC to be the 'overseeing' authority of the SPVs where public issue is involved, since in case of public issue of securities it is by law the exclusive domain of the SEC. On the other hand, as regards to establishment of an SPV and also where private placement is the only mode of distribution, there should not be any regulatory intervention whatsoever.

Meanwhile, the SEC has already created precedence by formally according approval to a private asset management company, AIMS of Bangladesh Limited, to act as the Trustee of a SPV for asset securitization, where retail distribution and public float is the ultimate objective<sup>10</sup>.

For the very specific objectives, SPV may not qualify as a financial institution and as a result it is quite unlikely that the activities of the SPV will fall under the authority of Bangladesh Bank.

**Regional experience:** In Sri Lanka there is no requirement of approval or registration of SPV with any regulatory or supervising authority, other than registering the Trust Deed with the Land Registrar. They also do not register with the taxation authorities (no Tax Identification Number is required), being tax-exempt entities. The prospectus and/or information memorandums are also not approved/consented by the SEC but by the Stock Exchange, only when public issue is involved. In Thailand also the SPVs are not required to be approved or registered with any regulatory authority but are governed under the well-defined Securitization Act<sup>11</sup> and the SPV Act, under which the SEC is the 'over-looking' agency. Curiously, the purpose of the referred Acts promulgated through Royal Decree bypassing the parliament in Thailand is to facilitate and not regulate the securitization regime. Therefore, large securitizations are being done without strict compliance of these Acts. In Pakistan<sup>12</sup>, registration of the SPV with the SEC is a mandatory formality only when any public issue is involved.

## B. Concerns of Prospective Issuers

NBFIs, especially the equipment leasing and housing finance companies, and the commercial and investment banks are the major candidates of securitization in Bangladesh. Another potential group is the micro-credit lenders and credit card issuers. Through informal as well as formal discussion with several financial institutions including all the participating companies of CBSF the following issues, among others, were identified for adequate addressing.

### 1. The Potential Candidates and Their Motivations

It is found that the major potential candidates for securitization are the lease and loan portfolios of NBFIs. The second tier candidates are the syndicated loan portfolios of the commercial banks and the housing finance companies. Leading micro-credit providers also have strong appetite.

<sup>10</sup> See Annex XI for details.

<sup>11</sup> See Annex X for details.

<sup>12</sup> See Annex IX for details.

The major motivation of the NBFIs to securitize their assets is to open up an alternative source of finance at reduced cost. Until now the traditional banking system has been the chief source of their finance, which is gradually drying up as the banks are increasingly becoming reluctant to offer long term loans out of maturity mismatch concerns. Conceivably the growth potential of the NBFIs, especially the small-capitalized companies, has become restricted. As the NBFIs seek loan from several banks, the marginal rate of borrowing increases, which also dent their return prospects. The commercial banks themselves are also increasingly entering the foray of equipment and automobile leasing as competitors of the NBFIs and undercutting the market.

On face of the dire need of sustainable finance at reasonable cost, the NBFIs are contemplating securitization of their assets. The NBFIs are also considering issuing securitized instruments with a view to revive the capital market, which they consider as a future cheap fount of finance. Few also expressed apprehensions on the possibilities of parting with best quality assets through securitization but are constrained since conditioned by the CBSF for continuing credit facilities.

## 2. Asset Transferability

It has been observed that the standard lease agreements of the leasing companies of Bangladesh contain necessary provisions for assignment, transfer, pledge or encumber the interest in the leased equipment. The provision also usually empowers the lessor to assign the right of the lessor's assignee to receive the lease receivables directly from the lessee.

Also as discussed in the forgoing sections, the Transfer of Property Act 1882 would generally and under usual circumstances recognize transfer of the lease rentals under the provisions of actionable claims.

## 3. Status of Existing Agreement

The NBFIs have expressed concern on the status of the lease/loan agreement after transferring their rights to receivables to the SPV. In other words, there remain confusions among the prospective originators about the valid mode of transfer of receivables. Few feared that after transferring the receivables, the existing lease/loan agreement would be void and thus their status as lessor/lender should be void as well. Consequently, the original lessees/borrowers need to execute a new agreement with the SPV, which leads to novation.

**Comments:** It is already discussed earlier that Bangladesh common law provides adequate provision to assign the receivables through conveyance. Assignment is a legal conveyance of rights in a receivable - similar to transfer of any other property. Assignment in common law usually does not require the consent of the debtor, though notification may be required at instances and for the practical purpose of unhindered servicing. On the contrary, novation is consensual and not unilateral.

This, however, should not be an issue where the Originator is appointed as the Servicer, which is the recommended course of action for the initial securitization attempts.

#### 4. Transfer of Lease Assets

Transfer of lease asset draws several other uncertainties. The leasing companies of Bangladesh generally originate financing lease. However, the usual practice of leasing is that the lessor retains a small residual of 1% to 5% of the leased out assets. The leasing agreement contains a provision for transferring the ownership of the leased assets to the lessee. The residual ownership qualifies the transaction as operating lease for accounting purpose, which enables the lessor to take the depreciation allowance and enjoy tax benefit, though insurance and maintenance and in cases of vehicles/vessels the registration and route permit charges, taxes and related costs are imposed on the lessee.

Although the leases are financing/capital leases as per international norms, the lessor treats it as operating lease for accounting purpose in Bangladesh and as a result the lease assets are stated on the book of accounts of the lessor.

According to the **FASB No. 13**, a lease is a capital lease if just one of the following criteria hold:

- a. *The title is transferred to the lessee at the end of lease period.*
- b. *A bargain purchase option exists.*
- c. *The lease period is at least 75% of the asset's life.*
- d. *The present value of the lease payments is at least 90% of the fair value of the asset using the minimum of the lessee's incremental borrowing rate or the rate implicit in the lease.*

*For a capital lease, the leased asset and liability is recognized on the balance sheet of the lessee and is depreciated on the income statement although the legal title remains with the lessor.*

##### 4.1 Procedure of Transfer

For a registered transfer, the transfer of leases can be consummated within a reasonable period, even in a single day by filing a "registration of changes" with the Office of the Registrar in pursuant to Registration Act 1908. The "payment stub," issued when the filing is made, together with a copy of the certified copy of the "Transfer Deed" could be considered sufficient proof of transfer by legal counsel.

##### 4.2 Physical Asset Attribute

Since the lease assets are stated on the balance sheet of the lessor like an operating lease, the transfer of lease assets may require satisfying the physical delivery attributes, as pointed out by few leasing company officials. The question however is pertinent when the underlying assets are also transferred with the transfer of rights on the receivables in an attempt for 'true sale' status. Therefore, it should not be of concern at this level of development.

##### 4.3 Depreciation Treatment

As discussed, the lessee is entitled to charge the depreciation in a financing lease on its income statement as per international standard. However, in Bangladesh the accounting and taxation authority considers the financing leases as operating and allows the lessor to charge the depreciation on its income statement. Moreover, the government in the last national budget (fiscal 2002-3) has provided further incentive of charging initial

depreciation of 25% in addition to usual depreciation on the first year of the lease. This depreciation treatment provides higher cash flow by way of reduced tax during the early years of the lease. Due to the tax advantage, the leasing companies are quite naturally and expectedly not motivated to remove the lease assets from their books for securitization purpose.

Secondly, current tax rule stipulates that the full depreciation deduction goes to the asset holder of record as at fiscal year end. This provision greatly benefits the assignee not the assignor. For example, if a company transfers its assets to the SPV at the middle of a year, the company shall not be entitled to claim the depreciation for the half-year during which the asset was with the company.

In order to overcome the specific difficulty, all the leasing companies have suggested preference to transferring/assigning the receivables only without transferring the underlying leased assets in any securitization proposition. The point of view appears logical at the current state of development of the market.

**Comments:** The transfer of receivables without transferring the underlying assets could be rather confusing. Since the receivables include both interest/rental and principal components, transfer of which virtually implies the transfer of the assets too. However, it is not any unique idea. In fact in many of the developed as well as developing markets it is an accepted and common practice. In all the cases of securitization at Sri Lanka only receivables has been transferred and not the leased asset.

We would rather take the view that discussion should be initiated to adopt the international accounting and taxing standards in Bangladesh in the long run, which is necessary to remove the ambiguity discussed above. The Institute of Chartered Accountants Bangladesh (ICAB), the National Board of Revenue (NBR), Ministry of Finance and Bangladesh Bank should be involved in the discussion process, preferably under the auspices of the World Bank Group, as part of the broader financial sector reform agenda.

However, in the short run, a directive from Bangladesh Bank, in consultation with NBR, relating to depreciation issue may take away the confusion. Since the debt market in Bangladesh is now only shaping up, high return to the investors is essential for its rapid expansion. If depreciation tax advantage is withdrawn, the originators' ability to offer higher returns shall largely be curtailed.

**Regional experience:** The difficulty relating to depreciation is common to other neighboring countries including Sri Lanka and Thailand. The securitization transactions in Sri Lanka do not qualify for 'true sale' status and hence the originators do not get the off-balance sheet treatment for such transaction. SPVs are also not technically totally bankruptcy-remote entities in its strictest sense. In all considerations, the securitization transactions that took place in Sri Lanka are merely secured borrowing on the part of the originators and rationally they take the depreciation advantage. However, as the market of Sri Lanka is maturing gradually, they are pondering on adoption of a more perfect structure for securitization. Consequently, the participants are frequently raising the issue of loss of depreciation for tax purpose. Fitch, an international rating company at Sri Lanka, has offered a solution proposing that the titling trust (SPV) transfers to the originator a beneficial interest in all leases owned by the titling trust. The holder of the beneficial interest obtains the economic value for tax purposes of the assets

in the titling trust, but not ownership for accounting purposes. The solution requires further examination, however.

## 5. Charge on Lease Assets

Customarily the lenders of a leasing company holds charge jointly and severally on the lease assets of the company, which is viewed as an impediment to the assignment of assets to the SPV as the creditors are likely to object on such transfer.

**Comments:** Since it is essentially a bilateral issue, the originators have to negotiate with and convince their existing creditors to accept such transfer. Restricting the originators on use of the proceeds from such transfer may well protect the creditor's interest. However, securing the claim of the investors over the existing creditors of the originator on the transferred assets should be achieved. Obtaining legal opinions on a case to case basis is recommended in this regard. In any case, the CBSF funded portfolios should in all practical and legal purpose be remaining unencumbered and available for securitization.

## 6. Recognition of Assignment of Receivables for Tax Purpose

The possible originators have expressed fears that since there is no precedence of securitization in Bangladesh, the recognition of the transferred receivables by the tax authority as sales are uncertain. If the National Board of Revenue (NBR) does not consider the transfer as sales, the participants shall still remain liable for taxation on the transferred receivables. Such a disadvantaged situation may thwart the securitization attempts.

**Recommendations:** A directive from the NBR has to be received recognizing the assignment of receivables to the SPV as sales to remove the confusion. In neighboring Sri Lanka and Thailand such transfers are recognized as sales for the purpose of taxation.

## 7. Transfer of Security

The status of transferability of loans secured by mortgage is another pertinent concern of NBFIs. The Bangladesh Transfer of Property Act 1882 stipulates that the transfer of loans secured by mortgage of immovable property or by hypothecation or pledge of movable property, requires the transfer of the collateral property as well. The relevant section of the Act states that the transfer of a debt or other actionable claim shall necessitate the transfer of the securities thereof. The issue has been elaborately dealt with at the foregoing sections. However, it should be noted that in case of mortgage of leased assets this should not be a vexing problem since the objective could be achieved at a comparatively reasonable and low cost<sup>13</sup>, generally at around Tk 8,000 only.

## 8. Collection Enforceability

The originator cannot transfer right more than it possesses. Several prospective participants expressed their concern that the transfer of right on the receivables to the SPV may, in practical operation, attenuate the collection ability of the SPV. This point has

<sup>13</sup> Circular dated July 2, 1994 AD corresponding to Ashar 13, 1401 BS of the Ministry of Law Justice & Parliamentary Affairs, Government of the Peoples' Republic of Bangladesh.

been provoked due to lack of proper foreclosure law and practice. The foreclosure of security involves much complicated procedure, as discussed in the earlier sections.

**Comments:** Bangladesh have only taken initiative to develop the structured instruments. The more practical approach, as it is common to all the neighboring countries, would be to appoint the Originator as the sole Servicer of the SPV under a separate and independent servicing agreement. Conceivably it will retain the same collection ability as the investors suppose. This procedure has been adopted in an independent securitization attempt by AIMS of Bangladesh Limited for BRAC now in progress in Bangladesh, even under a 'true sale' environment.

## 9. Credit Rating

Few of the prospective originators have expressed their concern on rating of the securitized instruments, based on cost, quality, reliability and confidentiality perspectives. However, it is our view that rating is only worthy when it reduces the cost of the originator through augmenting the marketability and demand of the securities rated and thereby also lowering the coupon rate. Therefore, the rating requirement shall rather be considered from the investors' point of view. Sooth to say, the general investors of Bangladesh market are not at all aware of the intricacies, mechanism, system and message of rating and as a result of that rating does not carry much relevance for the time being. Additionally, the first several tranches of securitization shall ideally be pursued through private placements, where rating is not expected to be a factor of consequence.

Rating would however be an essential element in a cross-border float or overseas placements. There again it should not be out of context to mention that since Bangladesh does not carry any sovereign rating, the rating of a corporate body or instrument within the territorial jurisdiction of Bangladesh may not be of any significance to an international investor.

Making the requirement of rating obligatory shall significantly increase the cost of issuance, which may not be desirable at this early stage of development, poising as a deterrent. Rating is a continuous process, which will increase the operating expense of the SPV and thereby the cost to the originator. But the rating should be kept optional so that the practice may grow as the market matures and eventually demands.

**Regional experience:** Rating is not mandatory in neighboring countries like Sri Lanka, Thailand, India and Pakistan. In Sri Lanka rating is optional and so far no asset-backed securities have been rated, though they boast the presence of a globally renowned rating agency. In Thailand, rating is only required when securities over Thai Bath 3 billion is offered and is not a private placement and where it is placed with more than 10 investors. This also holds true in case of underwriting requirement in both the jurisdictions.

A directive should therefore preferably be obtained from the SEC to the effect that securitized debt issues would not require any credit rating.

## 10. Litigation Against SPV

The possibility of taking legal action against the SPV may be a significant consideration for the investors as a protective measure. The inaction of the trustees of the existing debentures in the market against the issuers in the event of default has undoubtedly

whipped up the trepidation of the investors. Possibility of taking such action shall depend upon the form of the SPV and how the transaction shall be structured and organized.

From a common legal understanding it could be stated that the investors, collectively and individually, shall be eligible to take legal action against the SPV in case of breach of obligation if it is established in the form of a company, as a company is recognized as a legal entity. On the contrary, trust is a body, other than a legal entity. As a result, it is the trustees whom the investors can sue against their breach of trust, but not the SPV itself.

However, to allay the fears of the investors the trust deed of any SPV Trust can contain a section specifically stating that the SPV Trust could be sued by the investors like a company in case of default. As a case in point in this regard, the SEC requires the Mutual Fund Trusts established under the Trust Act 1882 and registered under the Registration Act 1908 to have such an explicit clause.

From a practical viewpoint, it may not be feasible or economically viable for a single investor to take legal action against the SPV if the securities are offered to the public. A security trustee will be required to hold the collective interest of the investors and as expected will be responsible for taking legal action against the SPV in case of default or mistrust. On the other hand, if the securities are placed privately with a handful of investors, they can always take such action in their own capacity.

The structure of the SPV may also bring forth few issues relating to the matter. In a SPV trust pass-through structure, the securities trustee may not be created and so the PTC (Pass-Through Certificate) holders shall have weak control over the SPV. The experience of private mutual fund can be referred in understanding this particular aspect. As per SEC (Mutual Fund) Rules 2001, mutual funds are trust property under the Bangladesh Trust Act 1882 and are registered under Registration Act 1908. Unit certificates are issued by the Trust and no provision of securities trustee is held. The ultimate action against the trustee comes from the SEC, the regulator. In case of pay-through structure, where the SPV usually issues various debt instruments, conceivably there may be the securities trustee to collectively hold the interest of the investors and can take legal action on behalf of its beneficiaries (investors) against the issuer, which is the SPV.

It is generally perceived that for an SPV in trust form, separate securities trustee may not be required, as long as the trustee of the SPV has no business relations with the SPV trust and absolutely no interest in the funds under management.

Lack of precedence of any determination or judgment on court cases in Bangladesh in this regard may increase the risk perception of the investors. However, the precedence is not uncommon in many other countries including India and Pakistan.

## 11. Approval Requirement from Bangladesh Bank

The concern on transfer of loan assets centers on transferring of good assets leaving all the bad assets on the books of the transferor/originator. Bangladesh Bank, as a regulator, may control such transfer, especially the large loans, to protect the banks and financial institutions from deteriorating their asset quality, few prospective participants genuinely feared. Also the central bank may be uncomfortable on disintermediation of the financial system through securitization as it may impact on the effectiveness of monetary policy.

**Comment:** Ideally, the pool of transferred assets shall represent the existing loan



portfolio of the originator in terms of quality and risk measures. Therefore, the transfer shall not downgrade the credit standing of the originator. Additionally, transfer of bad or non-performing loans, which is a frequent practice in many mature economies including Thailand, may improve their credit quality. Besides, securitization is expected to increase the real financing capacity of the economy through increasing the financial flexibility of the institutions.

Creating alternative source of financing for the financial institutions and establishing an active debt market is understandably receiving top priority of the government as well as the central bank now. At this early stage of development, it is expected that the transfer of assets by the financial institutions for the purpose of securitization should be freed from any strict restriction from Bangladesh Bank. However, it is advisable that the central bank shall provide approval to the transfers, both true and equitable, with a view to check any fraudulent transfer and to keep the records as well as a tab on provisioning and capital adequacy requirements.

## 12. Partial or Fractional Assignment

Few of the prospective participants have questioned the possibility and implications of assigning a fraction of the future receivables to the SPV. English common law requires that the whole of the receivables should be assigned for the assignment to be a legal transfer. This requirement for legal assignment of receivables, according to general understanding, should also be applicable in Bangladesh, as it is the follower of English common law.

For example, from a given pool of receivables to be sold, it is possible to assign the first 24 payments out of total 48 payments that should be received in the next 4 years. But it is not possible to assign 80% of the first 24 receivable payments, since a right to receive is not a severable right. The basic contract law principles should be applicable here. The principle explains that an obligation can be joint and several while a right can only be a joint right and not a severable right. Fractional assignment creates a joint right on the receivables, which is not independently enforceable by either the originator or the SPV. As a result, fractional assignments cannot make the SPV a bankruptcy-remote entity.

**Comment:** It is not advisable to adopt or attempt partial transfer at this development phase of securitization in Bangladesh, as it may give rise to further confusions pertaining to taxation and accounting treatments. It is also a complex process to which the PFIs are not geared at the moment when they are just contemplating the debut issue. However, just as a point of interest, the newly enacted "Securitization & Reconstruction of Financial Assets and Enforcement of Security Interest Ordinance 2002" of India (June 2002) makes fractional transfers legally acceptable at instances, that also awaits to be tried out.

## C. Taxation and Stamp Duty

Taxation issues remain one of the prime concerns in securitization regime. Even in a developed financial system like Singapore securitization has not been so popular understandably due to taxation impediments.

Taxation issues may arise in the following areas in the process of asset securitization:

## 1. Tax Status of the SPV

All the four PFIs of the CBSF have expressed their concern over the issue of tax status of the SPV. The tax on SPV shall essentially increase the cost of securitization and consequently shall force the originators to reduce the coupon of the instruments, which will be inhospitable from the marketing perspective. In order to encourage securitization, the SPV needs to be a tax neutral entity whether it is in the form of a trust or a corporate structure. It is reasonably expected that the SPV shall enjoy a tax-exempt status if formed as a trust or a not-for-profit company. However, there is a need for specific determination by the National Board of Revenue (NBR) on the tax treatment of the SPV as has been the practice in almost all the neighboring countries.

The SPV beneficially holds the transferred assets for the benefit of the investors. The income emanating from such assets becomes the income of the SPV, and the SPV distributes such income among the investors in accordance with the terms of the scheme. Three most common approaches to SPV taxation are:

- a. **SPV as tax transparent entity:** *In case the SPV is created as merely a passive conduit between the investors and the originator, the conduit should be tax neutral/tax transparent. The SPV is viewed as nothing but a collective device for the investors and the investors are viewed as receiving what is legally received by the SPV. In this case, tax is usually imposed on the investors relative to their share of income other than imposing tax on the SPV. A pass-through entity usually receives such treatment.*
- b. **Representative taxation of SPV income:** *SPV is charged to tax on the income, but the tax is deemed to be a tax on behalf of the investors. Consequently, the investors do not pay any taxes. There is no double taxation of income. However, it may result to complexities given the differing tax status, slabs and brackets of prospective investors, more so in absence of any imputation system in Bangladesh.*
- c. **Entity-level taxation of SPV:** *If the conduit amounts to an active framework for re-configuration of the cash-flows transferred by the originator, the conduit may be taxed on entity taxation principles. Any income received by the SPV is deemed to be its income and becomes subjected to taxation. Any income distributed by the SPV is deemed to be the expense of the SPV and the income of the investors, which also becomes taxable at individual capacity resulting into double taxation.*

*A distribution by the SPV will be treated as an expense if it is a payment towards debt, or charge against income, but should not be payment towards equity or a distribution of income.*

*Securitization transaction where the SPV uses a bond structure, such as CLO, would likely to fall under the entity level taxation principle, if no tax exemption has been provided to the SPV.*

**Comment:** It is recommended that the SPV may either be exempted from tax altogether, as is the standard practice in the regional countries, or in the worst case scenario be taxed in a representative capacity. Approach should be made

immediately to the NBR for an early resolution/determination of the issue.

**Regional experience:** In Sri Lanka the tax on SPV is dependent on the structure of that particular securitization transaction. In case the SPV takes on the pass-through structure, no taxation is applied. If the SPV is formed in a pay-through structure, the income of the SPV becomes liable for taxation. Therefore, naturally no pay-through structure has been attempted as yet in Sri Lanka. The SPVs are also not required to be registered with the tax authorities, since they are tax exempt in all purpose.

In Thailand, corporate or mutual fund form is the only accepted form of SPV, in absence of a Trust Act. The corporate form is subject to entity level tax while the mutual fund form is not. However, to overcome the difficulty the cash flows are structured in such a way that the revenue and expense of the corporate SPV matches leading to zero profit at year-end which is recognized and accepted by all authorities, including taxation. In case of any mismatches, the Thai government allows to charge the residue amount for provisioning of future bad debt to facilitate asset securitization. Therefore, both in Sri Lanka and Thailand no SPV has to pay any income tax at all.

## 2. Capital Gain Tax

Sale of assets (lease/loan) to the SPV may create a one-time capital gain for the originator. The provisions of the Income Tax Ordinance 1984 require capital gain tax at a flat rate of 15% regardless of the period of holding of the asset from the date of its acquisition. Capital gain is mandated at Clause 31 of the Ordinance as under :

'The tax shall be payable by an assessee under the head 'Capital Gains' in respect of any profits and gains arising from the transfer of a capital asset and such profits and gains shall be deemed to be the income of the income year in which the transfer took place'

**Comment:** It is likely at this initial phase of securitization that the originators shall structure the transfer of their assets as equitable transfer. The equitable transfer is more of a financing transaction than a 'true sale'. Moreover, capital gain tax may cause the securitization transactions especially lease assets difficult or unattractive. Accordingly waiver of capital gain for the purpose of securitization is highly recommended. A directive from the NBR on the matter shall be beneficial for the originators, for which approach should be made from the CBSF or Bangladesh Bank. It is however recommended that for the time being transfers/assignments to the SPV should be made on 'book value' of the assets, which would normally be the case anyway.

**Regional experience:** In both Sri Lanka and Thailand there is no capital gain tax on transfers to the SPVs. Moreover, assets are normally transferred on 'book value' where there is no possibility of incidence of capital gain.

## 3. Tax in Case of Transfer of Income Only

Transfer of income without transfer of underlying assets may make the originator liable for taxation. According to a common rule in taxes against diversion of income by overriding title, the income could continue to be taxed in the hands of the transferor. Therefore, a

favorable ruling from the NBR is recommended to be sought in this regard to avoid future complications, if any.

#### 4. Double Taxation

In case the SPV is subject to entity taxation, there would be a double taxation of incomes to the extent of residual interest of the originator, i.e. where the income of the SPV is taxed at the entity-level, the earnings of SPV shall be taxed and again the residual amount could be taxed at the Originator's hand when those will be reverted back - which tantamount to double taxation on a single sum of income. Attaining the recommended tax-exempt status for the SPV shall remove the possible impediment.

#### 5. Stamp Duty on Conveyance of Assets

Like in other common law jurisdictions, stamp duty is viewed as the most vexing stumbling block to securitization in Bangladesh. As stated earlier, the transfer of receivables could be regarded as 'actionable claims' under the Bangladesh Transfer of Property Act 1882. The transfer of such actionable claims requires conveyance and hence such transfer should be subject to stamp duty according to the Bangladesh Stamp Act 1899. Currently the duty is 5% on the value of transfer, which is too high to make 'true-sale' asset securitization cost effective or even possible at all.

**Regional experience:** From the regional experience it could be observed that the securitization transactions preceded the legal proceedings. Bangladesh may follow the example of Sri Lanka. In Sri Lanka, receivables, most of which are against automobile leases, are assigned to the SPV (trust) and the lease assets are mortgaged to the SPV. Since such transfer is equitable assignment, the deed of transfer is not registered and thus does not require stamp duty. However, Sri Lanka has recently abolished the stamp duty altogether (May 2002) for asset securitization purpose. In Thailand, stamp duty, VAT and Specific Business Tax (SBT), all of which are applicable on a corporate body, are exempted for transfer of assets to a corporate form SPV, through passage of the securitization law under a Royal Decree<sup>14</sup>. Malaysia also exempted the transfer of assets to the SPV from stamp duty<sup>15</sup>. In India stamp duty is under the purview of the state governments and as a result the duty varies at different states. The states which have notified lower stamp duties are Maharashtra (0.1%, 0.5% for credit cards), Gujarat (0.1%), Karnakta (0.1%), Tamil Nadu (0.1% only for housing receivables) and West Bengal (0.1%). Since duty is applicable at the place of signing and registration, the originators in India generally choose a low stamp duty jurisdiction for securitization. However, in any case the duty is quite negligible.

**Comment:** It is recommended that the prospective originators should follow the model of equitable assignment for the time being, which does not involve any stamp duty. However, it is expected that the government shall exempt the conveyance from stamp duty altogether for the purpose of asset securitization so that the debt market develops, as it has been done in the neighboring countries. Meanwhile, urgent and forceful measures should be initiated under the auspices of the Bangladesh Bank for seeking stamp duty exemption against

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<sup>14</sup> See Annex X for details.

<sup>15</sup> See Annex VIII for details.

transfers/assignment of assets to a SPV. This aspect may very well be treated as a precondition for securitization to be initiated and developed in Bangladesh. The Ministry of Law Justice and Parliamentary Affairs and the Ministry of Finance should be engaged on priority basis to secure the exemption. Since the government is not generating any revenue on this account now, there should not be any question or possibilities of revenue loss whatsoever if the exemption is provided to the SPVs.

## 6. Duty on Transfer of Instruments

The provisions of The Companies Act, 1994 stipulates that the transfer of shares and debentures should be appropriately stamped. Section 38(3) of the Act asserts :

“It shall not be lawful for the company to register a transfer of shares in or debentures of the company unless the proper instrument of transfer is duly stamped”

As per the Item 62 of the Schedule I of the Stamp Act 1899 the transfer of shares in an incorporated company or other body is subject to duty at 1.50% of the value of consideration. The same schedule also prescribes duty on transfer of debentures being marketable securities at 1.50% on the face amount of the debentures. However, the duty is exempted on transfer of publicly listed securities. This exemption is incorporated at the EXEMPTION section of the same Item as :

‘(2) Transfer of shares and debentures of the public limited companies defined in the Companies Act, 1994 (Act. No. 18 of 1994) and whose shares are listed in the stock exchange.’

Since Bangladesh debt market is only developing now, the initial issuance of debt instruments is likely to be made through private placement within selected investors’ group, due to cost and market considerations. The duty on transfer of such privately issued instruments shall severely constrain marketability, which will possibly retard the development process of an efficient and vibrant secondary debt securities market. Secondly, the duty shall induce the investors to claim extra coupon for being penalized on any transfer, which again will discourage the prospective originators to securitize their assets.

The duty on transfer of unquoted securities shall affect the securitization attempts irrespective of their transaction status. To elaborate, stamp duty will be applicable in cases where the transfer of assets to the SPV qualifies as ‘true sale’ and also for equitable transfer of rights. Adding further, the duty is also applicable irrespective of the characteristics of the instruments, i.e., duty shall be imposed equally on PTC (Pass-through Certificate), a unit of ownership interest, and also on various debt instruments like CLO, CBO, CP etc. In short, it would be almost impossible to avoid the duty through favorably structuring the transaction and/or specially characterizing the instruments.

An argument to ponder here is that the relevant Section 38(3) of the Companies Act 1994 refers to shares and debentures of a (implying issued by) ‘company’. Therefore, this particular section may not be applicable when the issuer is a trust, i.e. the SPV is established in a trust form. However, how far this particular position would be acceptable to the tax authorities is not certain.

It is notable that in case the SPV issues Promissory Notes or IOUs and the notes are transferred by endorsement, such transfer shall be exempted from stamp duty as per the Exemptions to the Item 62 of Schedule I of the Stamp Act 1899.

**Recommendation:** For the sake of developing an efficient debt market the stamp duty on transfer of privately placed debt instruments should be withdrawn altogether through an unambiguous notification. It is strongly recommend that the Bangladesh Bank, World Bank, CBSF, PFIs, local investment and merchant banks as well as other interested parties should collectively take up the matter with the government. The Ministry of Finance, NBR and specifically the Ministry of Law Justice and Parliamentary Affairs should be approached for exemption of the duty. Since developing an efficient debt securities market appears to be a priority agenda of the government, we hold that the government shall rightly perceive the problem and immediately waive the stamp duty on transfer of unlisted debt securities instrument issued by the SPVs.

**Regional experience:** There is no tax or duty on transfer of securitized or any other debt instruments in Sri Lanka and Thailand.

In all considerations, the stamp duty on transfer of unlisted securities is a crucial question that should be resolved as a high priority issue.

## 7. Capital Gain Tax on Transfer of Instruments

As per the provisions of the Income Tax Ordinance 1984, any capital gain which arises from transfer of securities, except government securities and stocks and shares of public companies listed with a stock exchange, shall be subject to capital gain tax at a flat rate of 15% regardless of the period of holding of the asset from the date of its acquisition.

Securitized instruments, whether debt or not, shall be considered as 'capital asset', as defined in Section 2(15) of the Income Tax Ordinance 1984 and so shall be subject to gain tax on the event of its transfer unless it is listed with any stock exchange.

*Section 2(10):* "capital asset" means property of any kind held by an assessee, whether or not connected with his business or profession, but does not include...

- (a) stock-in-trade (not being stocks and shares), consumable stores or raw material
- (b) personal effects
- (c) agricultural land in Bangladesh

As deduced earlier, it is quite unlikely that at the initial stage of development the securitized instruments would be publicly floated and listed with the stock exchanges as a result of which their transfer shall require gain tax. Conceivably, the gain tax on transfer of unlisted securitized instruments shall have the same deleterious effect as the stamp duty on transfer carries. Accordingly, the issue of gain tax on transfer of privately placed securitized instruments is also another crucial question that should be resolved with utmost priority.

**Recommendation:** For the sake of developing an efficient debt market the gain tax on transfer of unlisted debt instruments issued by SPVs should be withdrawn altogether. We strongly recommend that the World Bank, CBSF, participating companies, local investment banks and other interested parties shall pull together

to resolve the matter with the government immediately, with the active assistance of Bangladesh Bank.

**Regional experience:** There is no capital gain tax on any debt instrument in Sri Lanka and Thailand.

## 8. Stamp Duty on Issuance of Securitized Instruments

If the SPV issues Pass-through Certificate (PTC) or other document evidencing the right or title of the holder to any shares, script or stock, each of the issued certificates shall be affixed with stamp of Tk 20 irrespective of face value, according to Item 19 of the Schedule I of Stamp Act 1899. We would not consider such duty as a major problem for securitization. Initially, as we contemplate, securitized issues should be placed with few selected investors. Therefore, the number of certificates shall be minimal possibly with higher value market-lots and so the cost negligible.

If the SPV issues bond as defined in the Section 2(5) of the Stamp Act 1899, each of the bond certificates shall also be affixed with stamp of Tk 20 each according to the Item 15 of the Schedule I of the said Act. As per Item 27 of the Schedule I of the Act the debentures, whether mortgage debenture or not, are also subject to stamp at 2% of the value of the consideration. However, an exemption has been allowed under the same Schedule which is as under:

'A debenture is issued by an incorporated company or other body corporate in terms of a registered mortgage-deed, duly stamped in respect of the full amount of debentures to be issued thereunder whereby the company or body borrowing makes over, in whole or in part their property to trustees for the benefit of the debenture-holders; provided that the debentures so issued are expressed to be issued in terms of the said mortgage-deed.'

Inference could be drawn from the referred clauses that if the SPV issues debentures through trustees, there shall be no requirement of such stamp duty. This is one another reason favoring trust form of SPV.

**Comment:** There remains a question whether additional trust (security trust) will be needed even if the SPV is established as a trust. We would be tempted to take the position that security trust will not be necessary in case of equitable transfer of assets to the SPV. Since equitable transfer of assets by the originator to the SPV does not make the SPV an independent entity, in essence, the originator will be the original issuer and the SPV shall hold the interest of the investors. Nevertheless, a directive from the Bangladesh Bank, in the form of a prudential guideline may resolve the issue for good.

Although the Stamp Act 1899 does not provide any provision for other extra-generic debt instruments like CLO, CBO etc. we hold that the order relating to debenture shall be applicable for those instruments as well, for their similarity of characteristics.

**Regional experience:** The laws of Sri Lanka do not require affixing stamp on any sort of securities certificate.

## 9. Withholding Tax

The question of withholding tax may arise in the following two areas:

**When SPV collects from the obligators:** Securitization transaction does not upset the original practice of payment that exists between the originators and their debtors. Fortunately, there is no practice of withholding tax that is being followed in the transactions of the prospective originators like leasing and housing finance companies, banks and development finance institutions.

**When SPV distributes payments to the investors:** In this situation the withholding tax may invoke more argument from different parties. However, it may be argued that the tax shall not arise if the SPV is constituted as a pass-through structure. In a pass-through structure, the payments made by the SPV to the investors are deemed to be carrying interest, i.e., SPV acts merely as a conduit and directly passes the payments to the investors without any reconfiguration of the cash-flows. On the contrary, in a pay-through and bond structure, the SPV, not merely redistributes the cash-flows but rather reconfigures cash-flows and makes interest payment, and as a result may suffer withholding tax.

**Comment:** In the event of equitable transfer of assets, the withholding tax shall not arise while making payment to the investors irrespective of the SPV structure. Equitable transfer essentially results in borrowing from the part of the originator. Therefore, the payments to the investors shall be deemed as payment of interest. However, to be on the safe side, it is highly recommended that the Ministry of Finance and the NBR be approached for a definitive direction in this regard.

**Regional experience:** There is no withholding tax against debt instruments and payment of interest thereof either in Sri Lanka or Thailand.

A short list of fiscal incentives/measures in the form of proposed amendments to different laws, rules and regulations to facilitate asset securitization is provided at the Annex for pursuing by the interest parties and authorities<sup>16</sup>. Issues that require ruling or determinations only appear on the respective sections where those are discussed.

## D. Accounting

It is naturally desirable that the participating financial institutions shall follow an uniform accounting practice for securitization transactions to continue comparability among the financial statements of different companies and also to avoid taxation ambiguity, as well as setting the standards. In order to apply the 'true sale' concept in accounting the transactions shall result in removing the transferred assets from the balance sheet of the originator to the SPV, in a best practice environment.

It is gathered from an earlier World Bank sponsored study<sup>17</sup> that reputable local auditors affiliated with a major international accounting/auditing firm confirmed that sale of lease assets through the CLO program will receive true sale status if there is no recourse to the originator. The auditors have also affirmed that the reinvestment by the originator in the

<sup>16</sup> See Annex V for details.

<sup>17</sup> 'Issuance of CLO Securities in Bangladesh'; Peter C. Wong CFA, Worldwide Capital Corporation, December 1998



subordinated CLO component or equity residual will be considered as separate transaction (investment), independent of the sale of assets.

**Comment:** As maintained earlier, striving to achieve a perfect 'true sale' in all field of law may not be practical in the securitization transactions especially at the current state of development. However, it is not expected that the less-than-perfect true sale shall hinder the securitization attempts. Expectedly, as more securitization deals will be completed, the transactions and the accounting practices shall progress towards more perfection. Almost all the developed and developing economies including neighboring countries like Sri Lanka, India, Thailand, Malaysia and Pakistan have experienced such gradual evolution and progression.

The current Bangladesh GAAP does not include any accounting guidelines for the transfer of assets under the securitization scheme. It is highly recommended that the ICAB adopt either FASB 125 (Accounting for Transfer and Servicing of Financial Assets and Extinguishments of Liabilities)<sup>18</sup> or IAS 39 (Accounting for Financial Instruments)<sup>19</sup> as the common standard. Approach should be made by the CBSF in this regard to ICAB on a priority basis.

**Regional experience:** There has been no perfect true sale in Sri Lanka in its strictest sense. There the leased assets remain and are carried over on the book of the lessor. The securitizations at Thailand also may not pass a stringent test on this count. Some form of recourse, bank guarantee and over-collateralization is the accepted norm.

Some indicative accounting treatments have been discussed at the Annex to the report<sup>20</sup>.

## E. Market

### 1. Pricing and Benchmarking

The pricing of debt securities could be contingent on the following purported benchmarks, in absence of a structured long-term yield curve:

- a) **Yield of treasury issues:** Mostly treasury bills are issued through weekly auction. Since the issues are not traded in an active debt market, the prices do not necessarily represent market yields. Moreover, the auctioning procedure is not as standard as to maintain an unbiased pricing mechanism. Nevertheless, in an underdeveloped financial market the rates of on-the-run and off-the-run treasury issues can serve as a good proxy for benching yield curve especially for short to medium-term instruments.
- b) **Coupon of agency bonds:** *In absence of active market of medium to long-term treasury bonds, various government agency bonds (i.e. National Saving Schemes) can be used to derive an acceptable yield curve for medium to long maturity issues. Since the bonds are not traded in any secondary market, their stated coupons can be substituted as market yields for a particular maturity class.*

<sup>18</sup> See Annex VI for details.

<sup>19</sup> See Annex VII for details.

<sup>20</sup> Please refer to Annex IV

- c) **Coupon of bonds issued by NCBs:** *So far Agrane Bank, a Nationalized Commercial Bank (NCB), has issued two long-term industrial bonds (5 and 7 year maturity). Although the bonds are sold over the counter only, their coupon may be a good proxy for long-term base rates.*
- d) **Repo rates:** *Recently Bangladesh Bank has started to provide repurchase facilities to the treasury issue primary dealers, most of which are banks. We could reasonably expect that the Repo market should gain a gradual momentum shortly. Apart from the Bank Rate the Repo Rates can also provide the originators with an acceptable base of pricing their instruments.*
- e) **Prime rate of commercial loan agreements:** *An interest index constructed on prime rates of commercial loan agreements may also be an indicative benchmark for securitized issues.*
- f) **Long-term deposit/FDR Rates:** *Considering the competition for deposit funds coming from the commercial banks as well as savers' preferences, the prevailing long-term deposit (fixed deposit) rates should also be considered in pricing of similar term securities.*

## 2. The Appropriate Pricing Strategy

The appropriate pricing strategy shall depend upon the nature of the pool of assets. For example, the coupon on a debt instrument backed by a pool of commercial loan assets may use prime rates as its base. The investment advisor shall determine the appropriate spread for the issue considering the cash flow pattern and default history of the pool, the standing of the originator as well as the investors' required return. It would therefore vary on a case to case basis and should be attempted as and when specific assets have been identified for securitization by the respective PFIs.

## 3. The Probable Cost of Issuing ABS

In absence of a separate securitization law governing all aspects it appears, and the SEC has indeed ruled, that securitized debt instruments should be issued following the existing relevant laws and conventional practices of issuing shares and debentures. The SEC has advised that for public float of debt securities, including securitized instruments, the SEC (Public Issue Rules) 1998 has to be followed<sup>21</sup>. The stock exchanges also opined, on a formal approach, that their normal listing rules shall apply for listing of any debt issue, including securitized instruments.

The following table demonstrates the probable costs of securitization in Bangladesh under public issue and private placement options. It has been construed assuming issuance of 5-year maturity Asset Backed Securities (ABS) with a face value of Tk 5000 backed by a pool of assets worth Tk 200 million.

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<sup>21</sup> See Annex XI for details.

Table-1

Cost Item	Rates and Tenure			Total
	Amount (Tkm)	Accruing Period (Yr)	Per Cent	
<b>Expenses for Private Placement (Common Expenses):</b>				
Investment Advisor/Issue Manager <sup>1</sup> (Structuring & Marketing)	2.00	One-Off	1.00%	1.00%
Trusteeship and facility management Fee <sup>2</sup>	10.00	5	1.00%	5.00%
Stamp on Conveyance <sup>3</sup>	10.00	One-Off	5.00%	5.00%
Servicing Fee <sup>4</sup>	1.50	5	0.15%	0.75%
Legal Fee and Charges	0.10	One-Off	0.05%	0.05%
Certificate Printing & Holograms	0.28	One-Off	0.14%	0.14%
Stamp on Certificate	0.80	One-Off	0.40%	0.40%
SEC fee for capital issue	0.20	One-Off	0.10%	0.10%
<b>Total (With Only Private Placement)</b>				<b>12.44%</b>
<b>Total Per Annum</b>				<b>2.49%</b>
<b>Additional Expenses for Public Issue:</b>				
Underwriting Commission <sup>5</sup>	5.00	One-Off	2.50%	2.50%
Allotment letters, Refund Warrants, Envelops etc.	0.04	One-Off	0.02%	0.02%
Prospectus Publication (2 papers)	0.40	One-Off	0.20%	0.20%
Rating Fee <sup>6</sup>	-	-	-	-
Brokers Commission	2.00	One-Off	1.00%	1.00%
Bankers' Commission	0.50	One-Off	0.25%	0.25%
Data Processing	0.10	One-Off	0.05%	0.05%
Lottery Conduction	0.08	One-Off	0.04%	0.04%
Initial Listing Fee (2 exchanges)	4.00	One-Off	2.00%	2.00%
Annual Listing Fee (2 exchanges)	0.55	5	0.06%	0.28%
SEC fee for public issue	0.66	One-Off	0.30%	0.30%
<b>Total</b>				<b>6.63%</b>
<b>Total Additional Per Annum (For Public Issue)</b>				<b>1.33%</b>
<b>Total for Life of Issue (Public)</b>				<b>19.07%</b>
<b>Total Per Annum (With Public Issue)</b>				<b>3.81%</b>

(Source: AIMS Information & Marketing Services)

#### EXPLANATORY & ADDITIONAL NOTES :

<sup>1</sup> The structuring fee has been calculated at a bare minimum assuming that CBSF shall provide technical support in this regard at low or subsidized cost, including that for hiring local or foreign consultants/advisors, if needed in this regard. The cost is expected to be higher in case the issue size is small. It is assumed that the Trustee & Manager of the SPV shall be technically competent and therefore involved in the issue structuring process and also be engaged in marketing of the instruments, thereby aiding in reducing the cost of issue. If that is not the case, the cost could go up by at least another 0.5-1%.

<sup>2</sup> Since as per provisions of the Trust Act the trustee is essentially the functional manager of a financial trust, the management cost would be lower in case the SPV is in the form of a trust and the trustee is qualified to be a financial asset manager.

It is also assumed that trusteeship fee will be charged on principal amount and the principal shall not be repaid during the 5-year period. Trusteeship fee could be lower if the instrument is a simple bond rather than a securitized issue.

<sup>3</sup> Assumed that the issued amount and the amount of transferred assets are same, i.e. there is no overcollateralization. However, this cost may not arise in case of equitable assignment.

<sup>4</sup> Since it is proposed that the Originators shall be the respective Servicers, at least for the initial tranches of issues, the PFIs may opt for waiving the servicing charges due to themselves, in order to reduce the issue cost.

<sup>5</sup> Since underwriting cost is a major component, it is recommended that for securitized instruments the 'best effort underwriting' is adopted instead of the requirement of a 'firm underwriting' as now practiced. The matter may be taken up with the SEC in right earnest, before any public issue is attempted.

<sup>6</sup> As credit rating is not recommended to be made mandatory, the possible fees and recurring periodic cost of evaluation during the whole life of the instruments has been ignored.

Cost of credit enhancement (like for procuring any Bank Guarantee) has not been accounted for in the cost estimation. If availed, it could range between 1%-3%.

Liquidity facility fees, if any, that may be due to the CBSF has not been accounted for.

**Regional experience:** In Sri Lanka or in Thailand no securitized instrument were floated for the public. Since all were placed privately therefore no public issue cost was involved. However, the institutional investors that took up the issue are free to on-sale to retailers, since the instruments are tradable and transferable. Credit rating is not mandatory in either of the countries therefore no issue has been rated at Sri Lanka. In Thailand Lehman Brothers obtained rating, on their own accord, for one of their very large issue being distributed globally.

In all the neighboring countries the government or the SEC either imposes absolutely no or, under circumstances, a very nominal fixed token fee for filing documents for capital issue and there is also no stamp duty on conveyance. However, the issue structuring cost paid to the investment advisors are quite substantial and form the major cost component, followed by legal advisors' fees.

In Sri Lanka the first securitization was attempted by the Lanka Orix Leasing Company (LOLC), the largest leasing company of the country in which the World Bank affiliate International Finance Corporation (IFC) is a shareholder. The IFC provided technical assistance in structuring the issue<sup>22</sup> where a sinking-fund and fixed coupon mechanism was adopted. However, with a substantial structuring fee, the deal eventually turned out to be uneconomic, as opined by the company. They have since abandoned the sinking-fund concept for securitized issues and also now the coupons usually carry a floating rate, benchmarking on the T-bills. Issue structuring is now mostly done by local experts and legal advice provided by local firms. This has substantially reduced the issue and management cost in Sri Lanka.

It may kindly be noted that the costs appearing on the above table are only indicative and representative and are therefore, subject to variation. The percentage wise cost would be lower or higher depending on the respective size of the issue, since usually there would be

<sup>22</sup> In 1996. Incidentally, the issue was structured by an IFC official of Bangladeshi origin.

a minimum charge on account of issue structuring and marketing, notwithstanding the factor of economies of scale.

#### 4. Possible Ways of Reducing Cost

Higher cost appears to be the prime hindrance to issuance of securitized instruments. The major cost appears in the form of stamp duty on transfer of assets to the SPV. Although the government has reduced stamp duty to 5 percent from 10 percent in the Finance Act 2002, the rate is still exorbitantly high for securitization to be successful. The question of stamp duty arises as the Stamp Act considers the transfer of receivables as conveyance like any transfer of real estate. Unless the government waives or exempts stamp duty on transfer/assignments to a SPV, the cost of issuing securitized instruments cannot be reduced.

The cost of stamp duty can only be avoided by not registering the transfer/assignment of assets/receivables and opting for equitable mortgage.

The reduction in costs, other than the stamp duty, can be achieved at least in two ways, however. The methods are as follows:

- a. ***Avoiding public issue:*** as evidenced (see Table-1 above), opting for private placement rather than offering to public at the initial stages would certainly and significantly reduce the cost of ABS issuance. Issuing ABS through private placement shall help avert many public issue related costs and complications including underwriting and listing expenses as well as through avoiding credit rating expenses.
- b. ***Adopting a multi-seller conduit structure:*** The main thrust of cost reduction under the method shall come from the economies of scale in transaction cost. Under the conduit structure, several sellers (originators) transfer their assets to a single pre-existing SPV. The SPV finances its purchases through issuing various debt instruments. Since the SPV already exists, the originators are not needed to establish any SPV for raising funds through securitization. Moreover, the size of the pool becomes larger as multiple originators sell their assets. Due to non-linear variability of transaction cost, the operation expenses become smaller as the size of the pool grows. Assets from several originators improve the diversity of the portfolio of the SPV and in so doing the SPV becomes able to reduce risk and coupon of its issued instruments.

Considering the strength and homogeneity of the probable originators, available parties, investors' preference and expenses, the multi-seller conduit structure is highly recommended for adoption. For acclimating a conduit SPV structure, the following options may be considered:

- a) *Under the recommended structure ideally and preferably, from a point of convenience and commitment, the CBSF could have established a conduit SPV in the form of a Trust through executing a trust deed with an asset manager or the CBSF could have acted as the trustee of an SPV trust established by the PFIs. However, since the CBSF is obligated to offer liquidity facility for the issues, it is by default disqualified under best practice principles and on account of conflicting interests and the proposition being beyond its mandate. The trustee of an SPV should have no financial dealing/facility with the SPV, other than management and operation and to some extent promotion/marketing activities.*
- b) *Therefore, alternately and in the most likely scenario the PFIs could jointly execute the trust deed as Author(s) or Settler(s) with an asset manager as Trustee & Manager to establish a conduit SPV Trust.*
- c) *The SPV Trust shall buy assets from the PFIs of the CBSF and the SPV shall issue ABS, which will be backed by the pool of the purchased assets.*
- d) *As per arrangement, the CBSF shall provide liquidity facility and marketing support through holding any unsold ABS. The CBSF can also offer Repo facilities to the institutional investors of the ABS to create an active secondary market of the instruments.*
- e) *Furthermore, the CBSF may consider providing liquidity facility to the SPV for ensuring timely payments to the investors in cases of contingency and temporary cash crunch, however only if extending such facility is within the scope of its' mandate.*
- f) *Some other NBFIs, which are yet to graduate as PFIs for the CBSF can also be offered only these facilities by the CBSF, in case they step forward for asset securitization, in order to encourage and develop the market. The reach and impact of the CBSF viz a viz FIDP would also be broadened in this way.*

## **5. Enhancements to Improve Marketability**

In order to improve the marketability of the securities, few enhancements over the common and existing instruments is advisable for incorporation. Except for few quoted plain vanilla and convertible debentures, there is no other debt instrument in the capital market of Bangladesh available to the general investors. Unfortunately, the performance of the listed and transferable debentures has not been quite pleasant. The servicing of the debts beset with a history of frequent default or delayed payments. Consequently, the debentures lack liquidity in the market. The security trustees of most of these issues were the state-owned Investment Corporation of Bangladesh (ICB) which failed to take any legal or other conceivable action against the issuers in order to safeguard the interest of the investors. In some instances the SEC had to intervene to enforce compliance. Reportedly, some large unlisted and private issues also defaulted. In this phenomenal defaulting atmosphere, the prime enhancements should be centered on featuring inflexible legal obligations of the parties and ensuring timely payment of the promised cash-flow. Some possible enhancements are suggested below, the appropriateness of which will depend upon the nature of the particular asset pool.

### **5.1 Liquidity Facility**

Liquidity facility is necessary for ensuring maintenance of scheduled payments in time, but not for absorbing any ultimate loss. Ideally, the facility shall be availed from the CBSF, as the investors shall not question its credit standing. However, it has to be closely examined if offering such facility by CBSF is mandated. Alternately, the facility may be availed from

any reputed commercial bank, preferably multinational. In any case, such facility also has to be cost effective.

**Comment:** Liquidity facility for maintaining timely servicing commitments in temporary phase of adverse eventualities is not uncommon in Bangladesh also. One private mutual fund, established by the Grameen Bank under management of AIMS of Bangladesh Limited, with minimum dividend commitment has employed this particular immunization technique.

## 5.2 Guarantee

The marketability of any issue of ABS by the CBSF supported SPV shall greatly improve if it is backed by guarantee from CBSF or Bangladesh Bank or any reputed commercial bank. The guarantee would not only improve the marketability of the ABS but may also reduce cost by way of lower coupon. But on the other hand it will also attract additional fees and charges. Usually the cost of procuring Bank Guarantee ranges between 1%-3% per annum on the amount guaranteed. The charges, however, could be negotiated on a case to case basis.

**Comment:** As it is intended that the initially issued ABS shall be backed by the best quality pooled assets of the PFIs, which have complied with the strict qualitative criteria of the CBSF, the Bangladesh Bank may consider the assets as 'conforming' assets. Government providing guarantee to the 'conforming' assets is common in USA and other developed economies. Procurement of cost effective Bank Guarantees from reputed banks, preferably multinational, may be attempted by the PFIs only if that appears to add value in their securitization endeavor.

**Regional experience:** Bank guarantee is a preferred and common means of credit enhancement in Sri Lanka.

## 5.3 Overcollateralization

As overcollateralization is designed to create a safety buffer, it is expected to improve the marketability of the ABS through improving the confidence of the investors relating to return. Overcollateralization happens to be the oft-used practice in asset securitization across the globe. For the initial issues it could be higher but should decrease gradually as the market matures, like it happened in the regional countries.

**Regional experience:** Overcollateralization is a popular tool to improve creditworthiness and marketability of the instruments in Sri Lanka. Initially overcollateralization was as high as 40% there but it gradually decreased to around 20-25% now. It is also a prevalent practice in Thailand, India and Pakistan and many other developed economies too.

## 5.4 Yield Spread

The rate on the receivables underlying ABS is generally substantially greater than the coupon on the securities themselves. The difference between the two rates can be allocated, in addition to other actual costs, to provision for losses. As a result, the wider the spread will be, the more funds will be available to make payments to the investors. This however, would greatly depend on the prevailing market rates.

## 5.5 Subordination

The marketability of senior tranches could be improved by subordinating claims of the junior/residual tranches, if any. All losses are absorbed by the subordinated tranches until and unless it is completely exhausted. This method is unique in that it does not depend on the credit of a third party. Also subordination as measure of credit enhancement does not involve any additional costs that pertain to other methods.

## 5.6 Recourse to the Originator

Limited recourse without hampering the 'substance over form' nature of securitization may greatly improve the marketability of the ABS. However, this sort of enhancement binds the creditworthiness of the originator. There has been opinions that even in case of a 'true sale' some degree of recourse may be possible in Bangladesh under the provisions of the Contract Act 1872, in the form of the commonly used warranty clause.

Basing on the cash flow pattern of the receivables, any or any combination of the above enhancements may be adopted to improve marketability of the ABS. As a final point it may be stated that the improvement of marketability shall largely depend on the (a) reputation, standing, knowledge level and creditworthiness of the parties involved in the securitization organizing, structuring, marketing and management; and (b) clearly defining on the securitization documentation the legal obligations of the parties and the remedies available to the investors at times of distress.

## 6. Other Marketability Improvements

The following additional measures are suggested to further improve the marketability of the instruments:

### 6.1 Short Maturity ABS:

As the investors' experience with private (non-government) debt securities is rather unpleasant at the best, they may be reluctant to invest in a long-term private security. However, transferability feature and eventual creation of a secondary market may gradually remove the particular concern. Fifteen/eighteen to thirty-six month maturity securities may be introduced at the initial stages.

### 6.2 Early Amortization:

The cash flow schedule of the ABS could be designed in such a fashion that ensures early amortization of principal. Early amortization schedule will provide comfort to the investors through ensuring an extra security for the principals.

### 6.3 Payment Frequency:

Increasing payment frequency (say quarterly if not monthly) as against the current semi-annual payment practice in case of debentures floated in Bangladesh may also improve the marketability of the ABS.

**Comment:** Since all the participating companies are engaged in leasing business and monthly lease payment is the usual practice here, a pass-through structure or an ABS with monthly payment schedule may be contemplated. As the pass-through structure limits the control of the parties over the cash-flow, it should carry a greater marketing potential.



## 6.4 SLR Qualification

Marketability of ABS under the CBSF regime could be enhanced if such issues are granted SLR qualifications for the investing financial institutions, especially commercial banks. As long as the practice of SLR and qualifying restrictions thereto are in place, it would continue to pose as a threat to marketability of private or corporate securities.

## 6.5 Allowing Securitized Instruments as Approved Investment:

Apart from obtaining SLR qualification status with the commercial banks, life insurance companies, which are one of the potential investors could be especially targeted in any marketing endeavor. Since the insurance companies can only invest in securities approved by the Chief Controller of Insurance, we believe that substantial investment in the securitized instruments can be drawn from the companies if the investments could be made permissible.

**Recommendation:** The Ministry of Commerce and the Chief Controller of Insurance should be approached on priority basis by the CBSF to secure a general and blanket 'approved/qualifying investment' status for the proposed ABS issued under the auspices of the facility.

## 7. Product Promotion

In order to create a vibrant asset-backed debt securities market, acclimatizing the investors with the instruments is not only essential but also a foremost task. Adopting appropriate awareness program is critical to achieve the target. As we recommend private placement as the preferred mode of distribution at the several initial tranches of the ABS issues, the immediate awareness building programs should aim primarily at institutional investors like the banks and insurance companies, trustees of employee provident fund of corporate bodies including transnational corporations, mutual fund managers, micro-finance institutions etc. The capital market intermediaries like the stock exchanges, stock dealers & brokers, merchant bankers & portfolio managers could also be included in the scheme, though ultimately the target group should shift to the retail investors as well in the long run.

Appropriate budgetary allocation should accompany any promotional strategy. It is understood that the World Bank affiliate International Finance Corporation (IFC) has a fund available for support to develop debt securities market in the region. Sourcing support from IFC in this regard therefore could be seriously explored.

The following general marketing programs are suggested for adoption in promoting securitized debt instruments in Bangladesh, which however is not exhaustive :

### 7.1 Group Presentation/Workshop/Seminar

Prospective investor groups and market participants can be pre-selected and brought together at sponsored sessions on the theoretical frameworks of securitization. Special focus should be put on superiority aspect of ABS over other debt instruments. Such sessions could be under the auspices and funding of the CBSF and/or be shared by the PFIs, the ultimate beneficiaries. Resources could also be outsourced and event managers appointed for a series of presentations and calendar of events. Teaming up with independent third parties and distributors for awareness building should add credence to the process, as against the PFIs being perceived as interested parties only. Regional experts could also be

invited at such sessions to share their experiences. These kinds of programs should be continuous and rather unrelenting at the initial stages.

## **7.2 Corporate Visit/Presentations**

Relatively enthusiastic participants of the group presentation sessions should deserve added attention in order to clear specific queries and ambiguities, if any, arising out of the process. One to one personal discussion and explanation would also help in building confidence and thereby persuading the investors and intermediaries to get involved. The institutional investors and intermediaries in turn will eventually educate the retail investors and contribute in the depth of the market. Such presentation sessions, preferably for the decision and policy makers at the corporate level, should target the top management and the board of directors as audience. Here again resources could be outsourced, if needed, and a team build-up and trained in the process drawing from the staff and officers of the PFIs. Notwithstanding the fact that individual PFIs would be more akin to promote their own issues, if any, a team approach in general awareness building could be more effective on cost and convenience considerations.

## **7.3 Familiarization for Media Personnel**

Media can play a very crucial role in familiarizing the concept and the instruments on a broader scale and raise public interest and expectations. In order to secure this essential support from the members of the electronic and print media, some special short courses could be undertaken outlining the broad structure, potential benefits for different stakeholders and the economy as a whole in the securitization process. Assistance from different press union and journalist forums could be sought to arrange such programs, with special attention on the economic reporters. Also special feature items could be sponsored and carried on the newspapers and electronic media from time to time.

## **7.4 Dissemination of General Information**

Promoting a securitized financial product is not much different from promoting any other financial or manufactured product or delivery system. With the passage of product life cycle and level of development, appropriate promotional strategies are required to be adopted. However, at the introductory phase an intensive campaign is usually necessary. At this stage, publication and distribution of flyers, booklets and pamphlets as well as demonstration compact disks can be a very effective tool in augmenting awareness building and familiarization endeavors. A dedicated web-site could also be developed for dissemination of technical and marketing information in this regard, free for all level of interested quarters to access.

## **7.5 Training Courses for HR Development**

The banking institutions, largest in the financial services sector, have their own strong training programs carried out through in-house training institutes. The Bangladesh Institute of Bank Management (BIBM) is also active in educating and preparing potential recruits for the banking sector as well as continuing education and training programs throughout the year for different level of bank officers and executives. Engaging these formal-training institutes could bring far-reaching results. The students of business schools could also be potential targets that might have a long-lasting impact in familiarization and awareness building on the concept of asset backed securities and the process of securitization. Likewise, the different insurance companies and the association could also be netted in. In this backdrop, a module of course curriculum can be developed by the securitizing agents, under the auspices of the CBSF or through outsourcing, to be introduced in these training

institutes and business schools. A teacher/trainers' manual emphasizing the technicalities involved in asset securitization could also be produced to help the trainers and faculty members of the finance and business courses.

In addition to the above awareness and training programs for the institutional investors and the media, further programs should also be undertaken to make the regulators, tax authority, auditors, legal experts, investment advisors and other service providers adequately aware of the intricacies involved in the process.

## **F. The Compass and Motor of Securitization in Bangladesh**

There has been an unfounded perception that the securitization transactions cannot be made lawful without having a 'true sale' of assets. Part of the confusion is due to diluting the concept of bankruptcy-remoteness and the conversion of illiquid assets into marketable securities. True sale is necessary to enhance the creditworthiness of the issued instruments, which is made through qualifying the SPV as originator-bankruptcy-remote. True sale is a needed condition for that to be achieved.

The term 'true sale' will have a different definition depending on the field of law for which it is operative. The three principal areas of applicability are accounting, tax, and bankruptcy. A given transfer of receivables may well be a sale for certain purpose but not others. Achieving true sale in all the fields is neither practical nor experienced in other economies, even in some of the developed ones. Nevertheless, attaining true sale status in a securitized transaction denotes the practice at its apogee in terms of legal perfection, which can only be actualized as the capital market and the whole financial system matures.

The pivot of securitization lies on the concept of converting illiquid assets into various marketable securities with different risk-return alignments through structuring the cash flows. Therefore, true sale should not be the point of primary concern although less-than-true sale of assets may produce certain disadvantages for different parties. For example, if the transfer of assets is not legally qualified as true sale, the originator is not likely to get the off-balance sheet treatment. However, in the end, securitization efforts without achieving a perfect 'true sale' status should not necessarily be proved futile.

If true sale is not achieved, it is still crucial to put the claim of the investors upon the transferred assets over other creditors of the originator. This can be done through favorably structuring the securitization transaction. A directive relating to the priority of claims of the investors of a securitized instrument may remove any confusion on the matter. However, it is also recommended that the originators should seek independent legal counsel on their proposed structure of securitization, on a case-to-case basis.

Another gross misconception has been that Bangladesh do not have a legal framework for the debt market, not to speak of asset securitization. The perception is founded on the fact that there have been no dedicated rules and regulations in this regard as it is there for equity issuance in Bangladesh. The viewpoint wrongly presupposes that having a dedicated legal regime is a precondition for initiating or developing a market.

Interestingly, dwelling on the experience of other countries including neighboring India, Sri Lanka and Thailand it is happily observed that the securitization transactions preceded the

legal determination in all those countries like many others. In the countries mentioned above the securitization transactions were being carried out for the last couple of years. Not all of the transactions were structured complying the true sale requirements. Over the passage of time, the securitization market has become relatively matured in those countries and in turn, their practices have also got perfection to an acceptable level. Only recently they have started to seriously ponder on enacting separate Securitization Laws in order to achieve greater perfection and global acceptance. There was no attempt to control or regulate the developments by the government or agencies at the formative stages which could have very well scuttled the initiatives in those countries.

India has just enacted a law governing securitization<sup>23</sup>. Thailand, Pakistan<sup>24</sup> and Malaysia also enacted their respective laws governing securitization in the years 1997, 1999 and 2001 respectively.

It is also consequential that the securitization practices that have evolved in the South and Southeast Asian region are not common in nature. They are widely varied depending on financing system, legal framework and market condition of the particular country. In India, the practice of securitization mostly centered on housing finance receivables, which is the automobile lease in case of Sri Lanka. In Thailand, the major securitizations are done on the pool of non-performing loans, which piled up as a fallout of the Asian financial crisis of 1997. So is largely the case in the Philippines, Malaysia, Indonesia and South Korea. Since the motivations of securitization ranged across the region, the organization and procedure also varied accordingly.

What is common in these countries is that the attempt of securitization is initiated and popularized by the private sector and the formal ruling from the authority came next to facilitate and standardize the practices. At instances, the government rather took effective persuasive measures to encourage asset securitization, especially for the non-performing loans. Bangladesh should follow their foot-steps, learning from their experiences.

In light of the findings of this study, the following policy recommendations are set forth for prospective participants to take on stride for their securitization schemes in Bangladesh :

1. Securitization of assets can be done within the existing laws of Bangladesh, although few clarifications and rulings are necessary from the authorities, especially on tax related issues. Appropriate authorities should be approached for a clear determination and rulings on the relevant aspects as recommended in the report.
2. Immediate efforts should be initiated in right earnest specifically for obtaining exemption of stamp duty on conveyance and income tax on SPV. *(See Annex V for a more detailed proposal on recommended necessary fiscal incentives).*

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<sup>23</sup> "The Securitization & Reconstruction of Financial Assets and Enforcement of Security Interest Ordinance 2002"; RBI, June 21, 2002. It essentially addresses possession of NPL by a company for reconstruction under the Reserve Bank of India regime, as was in the case of Thailand, but does not specifically address the issue of establishment of a SPV. The relevant Pakistani law specifically addresses the issue of establishing a SPV.

<sup>24</sup> See Annex IX and X for details.

3. There should not be any requirement for registration/clearance of the SPV from either the SEC or the Bangladesh Bank. However, financial institutions licensed by the Bangladesh Bank may require clearance from the Bank while transferring assets to the SPV and consent of SEC is mandatory only in cases of public float of securities issued by the SPV.
4. To avoid the mischief of stamp duty on conveyance, equitable mortgage of receivables to the SPV should be attempted for the time being.
5. Equitable transfer of assets to the SPV shall well serve the purpose of securitization if the investors' claim on the transferred asset can be prioritized over other creditors of the originator.
6. Assignment of lease receivables, instead of transfer/assignment of the underlying leased assets should be contemplated for securitization by the participating leasing companies, at this preliminary stage.
7. The SPV shall be established in the form of an independent Trust, as is the usual global practice, including at the regional economies.
8. A conduit form of SPV should be the preferred mode for the initial and experimental tranches where the trust is established jointly by the PFIs (being originators) as Authors, through executing and registering a trust deed with an asset manager as the Trustee & Manager of the SPV. However, PFIs can very well opt for going alone with their own SPVs and issues.
9. The CBSF shall provide liquidity facility against the issues and, if allowed under its mandate, as well as to the SPV in case of temporary needs. Similarly, Repo facilities could be extended to the institutional investors of the securities, in order to create a viable secondary market.
10. Private placement should be the preferred mode of issuing securitized instruments at least in the few initial offers. However, eventually public float and listing should be the ultimate objective.
11. The instruments should be featured as marketable i.e. freely transferable and tradable, in reasonable market lots from the very beginning.
12. In order to keep cost at lower level, rating and underwriting should not be made mandatory for issuing debt instruments. These requirements should remain optional. The SEC should be approached for a blanket waiver, if public issue is contemplated.
13. Requirement of prior consent/approval from the SEC and the fees thereof, if applicable, should be waived on private issuance and placement of debt securities. The SEC should be approached in this regard immediately.
14. The CBSF should consider offering support services to some other NBFIs, which are yet to graduate as PFIs for the CBSF, in case they step forward for asset securitization, in order to encourage and develop the market.
15. An well-orchestrated and intensive market and investors' awareness program should accompany any asset securitization endeavor.

Perusing the comments received from the PFIs on the initial draft of this report, which has been meticulously attended and addressed in this final version, it can be conveniently derived that there are encouraging signs and very positive vibes that an Asset Backed Securities market could not be very far away in Bangladesh<sup>25</sup>.

We would like to conclude the report by asserting that 'where there is a way, there only has to be the will.'

#### **DISCLAIMER**

Except for contextual information that may be contained herein, the matters set forth in this release are forward-looking opinion and statements that are dependent on certain risks and uncertainties, including but not limited to such factors as legal interpretations in a court of law or the exigencies of shifting government economic and fiscal policy conditionalities. This report should be read and used in conjunction with and understanding of the prevailing legal and fiscal framework governing its' scope and jurisdiction.

The Consultant and/or his company are not a registered or qualified legal advisor. The information contained in this report has been carefully compiled based upon sources that are believed to be reliable. The Consultant however, does not guarantee the unequivocal accuracy or acceptance of any information or opinion contained in the report by the court, government or any other agency. The information contained should not be construed as an offer to provide, or a solicitation to engage in, any services referred to herein.

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<sup>25</sup> See Annex XII for copies of the comments and remarks on the draft report received from the PFIs.

## Annex I

### TERMS OF REFERENCE FOR A SHORT-TERM ASSIGNMENT ON THE SECURITIZATION OF THE ASSETS OF FINANCIAL INSTITUTIONS

The Financial Institutions Development Project, administered by Bangladesh Bank (BB), with the assistance of the Credit, Bridge and Standby Facility (CBSF), aims to support participating Financial Institutions (FIs) in their efforts to mobilize funds from the market. One of the tools that are proposed to be used for this purpose is the Collateralized Lease/Loan Obligations (CLOs) of the FIs. A local consultant is proposed to be hired to assist the FIs, currently four in number, with the securitization of their portfolios and to review other aspects of securities issuance, as per this TOR.

The scope of work of the local consultant focuses mainly on the initial spadework so as to be sure that the Bangladesh-specific factors and problems have been adequately researched prior to the start of the securitization process. Specifically, the consultant will focus on the following three sets of issues:

#### ***(i) Regulatory and policy constraints:***

The regulatory framework for Securitization is absent. Therefore, the kind of regulation that the first CLO will face is uncertain at the moment. The consultant will provide an indication of the existing regulations that may affect issuance of CLO.

There is no separate law on Securitization in Bangladesh. As such, the legal framework for Securitization is not fully clear. The study will look at the desirability of enacting a Securitization law.

The stamp duty on assignment of receivables is high in Bangladesh. Assignment of receivables is considered as conveyance, and according to the Stamp Act, an assignment could be subject to a Stamp Duty of 10% of the value of consideration. This is on top of the Stamp Duty on the Trust Deed, which was reduced under this Project from 2.5% to a flat fee of Tk 2,500. The study will recommend an appropriate Stamp Duty on assignment of receivables to make issuance of CLO feasible. The reduction of the conveyance will greatly help in introducing Securitization in Bangladesh.

The tax incidence in case of income transfer without transfer of underlying assets is vague. It appears that the Originator of the issue is still liable for taxation. Capital gains implications on assignment of receivables by the Originator to the Special Purpose Vehicle (SPV) are also unclear. The possibility of entity taxation of SPV will be reviewed and a clear picture of the whole tax issue will be presented in the report.

The accounting for securitized transactions is not clear, specially on: de-recognition of assets from books of the Originator; treatment of pass-through certificates and securitized assets in the books of the SPV; and assignment of future receivables and income recognition in the books of the Originator.

#### ***(ii) Market constraints:***

The pricing of the debt instruments is complicated by the absence of a benchmark rate. Although a limited auction of T-Bills is carried out every week, the market suffers from a lack of proper auctioning procedures, longer-term maturities, and more importantly a secondary market in government securities. The report will suggest an appropriate pricing strategy.

The existing interest rate structure makes it difficult for the FIs to issue debt instruments at a rate that makes it feasible for the FIs to remain competitive while adequately covering costs. The structure is further distorted by the high returns offered under the government-sponsored National Savings Scheme (NSS). Ways to reduce the funding cost to the FIs will be suggested in the report.

The cost of issuing CLOs appear to be high as it includes: merchant banking fees, SEC fees, underwriting fees, stamp duties, credit rating fees, prospectus fees, advertisement fees, on top of the interest rate which would have to be relatively high to attract potential investors. A likely cost schedule will be presented in the report.

As a new instrument, the demand for CLOs will have to be created to ensure that they are easily marketed. The study will look at the most effective options available to increase the demand for this instrument as it competes with the existing investment choices including the NSS.

The marketing of CLOs can pose a problem since potential investors are not familiar with this instrument. The study will recommend various options to familiarize potential investors, such as insurance companies, commercial banks, corporate bodies with liquid funds, high net worth individuals, and micro-finance institutions, about the attractive features of CLOs as an investment choice.

***(iii) Procedural constraints:***

Existing FIs lack practical experience in issuing CLOs. Therefore, they would require experienced consultants to guide and assist them through the initial issuances. The study will recommend measures to assist the FIs through the process of issuing their first CLOs.

The FIs would also require assistance in arranging the issue. The study will look at the availability of arrangers to the issue, and measures to encourage this important aspect of issuance.

**Expected Output**

The study is expected to examine the three inter-related but different issues listed above and make recommendations to assist the FIs in issuing CLOs and bonds. It is expected that the output from this study would include:

An assessment of the overall regulatory framework.

An assessment of market conditions, including identification of most suitable assets to be securitized and their quality, the structuring of bonds, their marketability and demand.

Recommendations to enhance the regulatory framework and overcome other requisites impeding the development of a market for securitized assets.

Provide advice to the FIs on specific accounting and tax issues surrounding the new instruments.

A review of Securitization experience in emerging markets and lessons for Bangladesh.

**Period of Study**

The first draft of the report is expected to be presented by August 1, 2002. The final report will be submitted after receiving comments from the stakeholders.



## Annex II

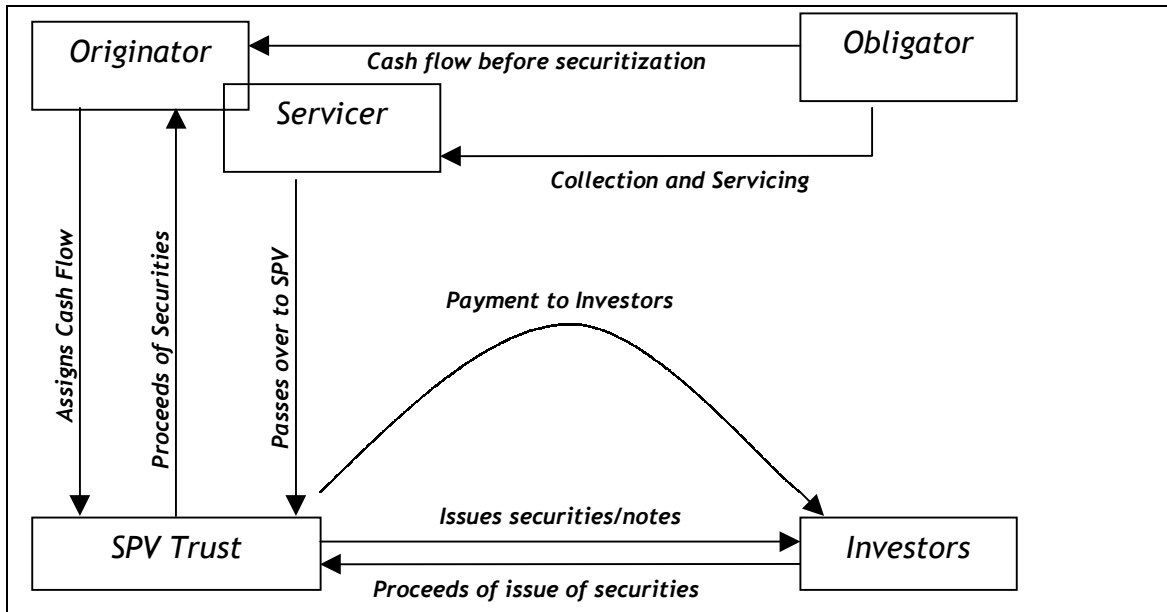
## PROBABLE FORMS OF SPV: COMPARATIVE CONSIDERATIONS

As a Society		As a Company		As a Trust	
<i>Establishment</i>	<i>Critical issues</i>	<i>Establishment</i>	<i>Critical issues</i>	<i>Establishment</i>	<i>Critical issues</i>
<p>Under Societies Registration Act 1860 (Act 21 of 1860)</p> <p>May also come under Voluntary Social Welfare Agencies (Registration &amp; Control) Ordinance 1961 Ordinance No. 46 of 1961).</p> <p>Requirement of registration with the Department of Social Welfare may arise.</p> <p>If having NGO character, required to be registered with the NGO Bureau</p>	<ul style="list-style-type: none"> <li>– Quasi-legal entity</li> <li>– The activities of the entity would be limited within the members of the society. Therefore, issuance of securities to non-members, i.e., general public would not be possible</li> <li>– Slack regulatory control</li> <li>– Low credibility, may be perceived as a NGO</li> <li>– Untested mechanism</li> <li>– No known record of such practice anywhere in the world for asset securitization</li> </ul>	<p>Under the Companies Act 1994 (Act 18 of 1994) and registered with the Registrar of Joint Stock Companies &amp; Firms (RJSC).</p>	<ul style="list-style-type: none"> <li>– Legal entity - however, cannot have limited or predetermined life without going through liquidation process</li> <li>– Higher establishment and registration cost contingent on authorized capital</li> <li>– The entity can be established as a company limited by guarantee under section 29 of the Act</li> <li>– The company can be a non-profit entity under section 28 of the Act</li> <li>– High statutory and periodic reporting requirement as well as filling of returns</li> <li>– Comparatively high operating cost</li> <li>– Can issue securities to the general public</li> <li>– Complex organizational structure</li> <li>– Multi-SPV structure will not be easy to establish as</li> </ul>	<p>Under the Trust Act 1882 (Act 2 of 1882) and registered with the local Sub-Registrars' Office (of the Inspector General of Registration - IGR) under Registration Act 1908 (Act 16 of 1908)</p>	<ul style="list-style-type: none"> <li>– Entity with higher degree of flexibility - can have perpetual, limited or predetermined life as desired</li> <li>– Globally popular form</li> <li>– Very low establishment and registration cost (Tk 2,500 only - fixed irrespective of capital)</li> <li>– The trust can be declared and structured as non-profit entity</li> <li>– No statutory or periodic reporting requirement to the registering authority like for the companies</li> <li>– No return filling requirement to RJSC</li> <li>– Can issue securities to the general public</li> <li>– Plain and simple structure and low operating cost</li> <li>– Easy to formulate multi-SPV structure as the SPV trusts can sponsor another trust, if required</li> <li>– Preferred and suitable form for conduit SPV</li> </ul>

As a Society		As a Company		As a Trust	
<i>Establishment</i>	<i>Critical issues</i>	<i>Establishment</i>	<i>Critical issues</i>	<i>Establishment</i>	<i>Critical issues</i>
			<p>it entails creating multiple subsidiaries</p> <ul style="list-style-type: none"> <li>– Maximum obligation of the sponsors</li> <li>– A securities trustee may be required to be appointed as in the case of debenture issue</li> <li>– Liquidation require court and legal process</li> <li>– Shall attract prior consent and fees requirement from SEC to raise capital under the SEC (Capital Issue of Public Limited Company) Rules 2001</li> <li>– Shall attract duty on transfer of unlisted certificates (under the Companies Act 1994)</li> </ul>		<ul style="list-style-type: none"> <li>– Minimum obligation of the sponsors</li> <li>– The trustee can also act as the manager</li> <li>– Additional securities trustee may not be required/avoided</li> <li>– Simple liquidation procedure</li> <li>– Common practice for debt issuing in Bangladesh - all debentures have been issued under trust form, the SEC has also selected this form for mutual funds in Bangladesh</li> <li>– Greater protection for the beneficiaries interest</li> <li>– May not attract prior consent and fees requirement from SEC to raise capital under the SEC (Capital Issue of Public Limited Company) Rules 2001</li> <li>– Stamp duty on certificates may not be required to be affixed if issued by a trust</li> <li>– Duty on transfer of unlisted certificates (under the Companies Act 1994) may not be applicable if issued by a trust</li> </ul>

Annex III

SIMPLE SECURITIZATION STRUCTURE



## Annex IV SOME ACCOUNTING TREATMENTS IN ASSET SECURITIZATION

### Accounting entries for the Originator:

The structure of securitization shall dictate the accounting treatments of the originator.

1. In a simple structure where the receivables are sold outright or with limited recourse generally expected to be recorded as sales if the risk and rewards have been substantially transferred to the buyer. The entry shall effectively remove the assets from the balance sheet of the originator.

Also the originator shall be permitted to provide an adequate reserve for bad debt for the recourse amount, which must be estimated basing on the probability of non-payment from the obligators.

2. If the recourse provision is generally well above the expected loss ratio on the receivables, the seller retains the entire expected loss occurrences. As a result the originator shall not receive off balance sheet treatment. These transactions shall therefore effectively be treated as collateralized borrowings.

The full amount of the allowance for doubtful accounts related to the receivables sold will have to be retained as the originator has substantially the same credit risk as if the receivables had not been sold.

3. In case the originator equitably transfers the assets in which the originator does not adequately surrender control over the assets transferred, i.e., the originator may legally continue to benefit from the transferred assets, may be reported as secured borrowings with a pledge of collateral. The originator shall retain the full allowance for doubtful accounts.

Insufficient surrender of control may also arise in transfers with continuing involvement of the originator with the SPV. The involvement of the originator may continue through holding servicing, recourse, agreements to repurchase, option written or held, pledges of collateral etc.

### Accounting entries for the Investor:

1. Investment in securitized assets shall be treated like any other investments in marketable securities.

The investment by the originator in the subordinated securitized assets or equity/residual bond may be treated as separate transaction and will involve the similar accounting entries.

2. Interest earnings from the investments shall be recognized as revenue in the income statement.
3. The investment in securitized assets shall be stated on balance sheet either at cost or at fair market value depending on classification of investment. In absence of vibrant debt market, the investment in securitized assets is likely to be categorized in the held-to-maturity portfolio and accordingly will be stated at cost.

If the securitized assets can be prepaid or settled in an amount less than the carrying amount of the investment, its classification as held-to-maturity is likely to be restricted.

**Annex V**  
**SOME PROPOSED FISCAL INCENTIVES (TAX/DUTY EXEMPTION) FOR**  
**DEVELOPMENT OF A DEBT SECURITIES MARKET THROUGH ASSET SECURITIZATION**

**1. INCOME TAX (ON SPV) :**

Amend Para 30 of Part-A of Sixth Schedule of the Income Tax Ordinance 1984 by way of addition of the following section :

*“Any income, including interest, capital gain, dividend and other fees and commission form operating, management and investment activities of a Special Purpose Vehicle (SPV) registered either in the form of a trust or a non-profit company for the sole purpose of asset and/or mortgage securitization, and such income shall also be exempt from any deduction of tax at source.”*

**2. STAMP DUTY (ON CONVEYANCE) :**

Amend Clause 62 (Exemptions) of Schedule I of the Stamp Act 1899 by way of addition of the following section :

(e) *“Sale, transfer, assignment or conveyance of assets, including future receivables, to any Special Purpose Vehicle (SPV) registered either in the form of a trust or a non-profit company for the sole purpose of asset and/or mortgage securitization.”*

**3. STAMP DUTY (TRANSFER OF SECURITY) :**

Amend Clause 62 (Exemptions) of Schedule I of the Stamp Act 1899 by way of addition of the following section :

(f) *“Transfer of any asset or mortgage backed security certificates issued by a Special Purpose Vehicle (SPV) registered either in the form of a trust or a non-profit company for the sole purpose of asset and/or mortgage securitization.”*

**4. TAX AT SOURCE ON INTEREST INCOME (OF THE INVESTORS) :**

As per existing law, income as interest earned attracts deduction of tax at source. In order to promote establishment of a viable debt securities market in the country, the government may favorably consider providing tax **exemption** on interest income for the holder of debt securities issued by a Special Purpose Vehicle (SPV) registered either in the form of a trust or a non-profit company for the sole purpose of asset and/or mortgage securitization.

**5. OTHER INCENTIVES :**

- Tax authorities (NBR) should recognize transfer of receivables to the SPVs by the transferor (Originator) as ‘sales’.
- Transfer of assets to the SPVs shall not attract any ‘gain tax’ for the transferor.
- Income should not continue to be taxed at the hands of the transferor where transfer of ‘income’ has been made to the SPV without transferring the underlying leased asset.
- There shall not be any capital gain tax from sale/transfer of privately placed securities instruments issued by the SPV, as is with the case of listed securities.

## Annex VI



FINANCIAL ACCOUNTING STANDARDS BOARD

Serving the investing public through transparent information resulting from high-quality financial reporting standards, developed in an independent, private-sector, open due process.

## Summary of Statement No. 125

**Accounting for Transfers and Servicing of Financial Assets  
and Extinguishments of Liabilities (Issued 6/96)**

## Summary

This Statement provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. Those standards are based on consistent application of a *financial-components approach* that focuses on control. Under that approach, after a transfer of financial assets, an entity recognizes the financial and servicing assets it controls and the liabilities it has incurred, derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished. This Statement provides consistent standards for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings.

A transfer of financial assets in which the transferor surrenders control over those assets is accounted for as a sale to the extent that consideration other than beneficial interests in the transferred assets is received in exchange. The transferor has surrendered control over transferred assets if and only if all of the following conditions are met:

- a. The transferred assets have been isolated from the transferor-put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership.
- b. Either (1) each transferee obtains the right-free of conditions that constrain it from taking advantage of that right-to pledge or exchange the transferred assets or (2) the transferee is a qualifying special-purpose entity and the holders of beneficial interests in that entity have the right-free of conditions that constrain them from taking advantage of that right-to pledge or exchange those interests.
- c. The transferor does not maintain effective control over the transferred assets through (1) an agreement that both entitles and obligates the transferor to repurchase or redeem them before their maturity or (2) an agreement that entitles the transferor to repurchase or redeem transferred assets that are not readily obtainable.

This Statement requires that liabilities and derivatives incurred or obtained by transferors as part of a transfer of financial assets be initially measured at fair value, if practicable. It also requires that servicing assets and other retained interests in the transferred assets be measured by allocating the previous carrying amount between the assets sold, if any, and retained interests, if any, based on their relative fair values at the date of the transfer.

This Statement requires that servicing assets and liabilities be subsequently measured by (a) amortization in proportion to and over the period of estimated net servicing income or loss and (b) assessment for asset impairment or increased obligation based on their fair values.

This Statement requires that debtors reclassify financial assets pledged as collateral and that secured parties recognize those assets and their obligation to return them in certain circumstances in which the secured party has taken control of those assets.

This Statement requires that a liability be derecognized if and only if either (a) the debtor pays the creditor and is relieved of its obligation for the liability or (b) the debtor is legally released from being the primary obligor under the liability either judicially or by the creditor.

Therefore, a liability is not considered extinguished by an in-substance defeasance.

This Statement provides implementation guidance for assessing isolation of transferred assets and for accounting for transfers of partial interests, servicing of financial assets, securitizations, transfers of sales-type and direct financing lease receivables, securities lending transactions, repurchase agreements including "dollar rolls," "wash sales," loan syndications and participations, risk participations in banker's acceptances, factoring arrangements, transfers of receivables with recourse, and extinguishments of liabilities.

This Statement supersedes FASB Statements No. 76, *Extinguishment of Debt*, and No. 77, *Reporting by Transferors for Transfers of Receivables with Recourse*. This Statement amends FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, to clarify that a debt security may not be classified as held-to-maturity if it can be prepaid or otherwise settled in such a way that the holder of the security would not recover substantially all of its recorded investment. This Statement amends and extends to all servicing assets and liabilities the accounting standards for mortgage servicing rights now in FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities*, and supersedes FASB Statement No. 122, *Accounting for Mortgage Servicing Rights*. This Statement also supersedes Technical Bulletins No. 84-4, *In-Substance Defeasance of Debt*, No. 85-2, *Accounting for Collateralized Mortgage Obligations (CMOs)*, and No. 87-3, *Accounting for Mortgage Servicing Fees and Rights*.

This Statement is effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after December 31, 1996, and is to be applied prospectively. Earlier or retroactive application is not permitted.

## Annex VII



## IAS 39

### Financial Instruments: Recognition and Measurement

**IAS 39, Financial Instruments: Recognition and Measurement**, became effective for annual financial statements covering financial years beginning on or after 1 January 2001. Retrospective application is not permitted.

In October 2000, the IASC Board approved five limited revisions to IAS 39 and other related International Accounting Standards (IAS 27, IAS 28, IAS 31, and IAS 32) to improve specific paragraphs and help ensure that the Standards are applied consistently. These changes become effective when an enterprise applies IAS 39 for the first time. The revisions:

- require consistent accounting for purchases and sales of financial assets for each category of financial assets using either trade date accounting or settlement date accounting;
- eliminated a requirement in IAS 39 as originally approved for a lender to recognise collateral received from a borrower in its balance sheet;
- provide more explicit requirements for impairment recognition;
- require consistent accounting in the consolidated financial statements for temporary investments in equity securities in accordance with IAS 39 and other International Accounting Standards; and
- eliminated redundant disclosure requirements for hedges in IAS 32.

#### **Summary of IAS 39**

- Under IAS 39, all financial assets and financial liabilities are recognised on the balance sheet, including all derivatives. They are initially measured at cost, which is the fair value of whatever was paid or received to acquire the financial asset or liability.
- An enterprise should recognise normal purchases and sales of financial assets in the market place either at trade date or settlement date. Certain value changes between trade and settlement dates are recognised for purchases if settlement date accounting is used.
- Transaction costs should be included in the initial measurement of all financial instruments.
- Subsequent to initial recognition, all financial assets are remeasured to fair value, except for the following, which should be carried at amortised cost:
  - (a) loans and receivables originated by the enterprise and not held for trading;
  - (b) other fixed maturity investments with fixed or determinable payments, such as debt securities and mandatorily redeemable preferred shares, that the enterprise intends and is able to hold to maturity; and
  - (c) financial assets whose fair value cannot be reliably measured (generally limited to some equity securities with no quoted market price and forwards and options on unquoted equity securities).
- An enterprise should measure loans and receivables that it has originated and that are



not held for trading at amortised cost, less reductions for impairment or uncollectibility. The enterprise need not demonstrate an intent to hold originated loans and receivables to maturity.

- An intended or actual sale of a held-to-maturity security due to a non-recurring and not reasonably anticipated circumstance beyond the enterprise's control does not call into question the enterprise's ability to hold its remaining portfolio to maturity.
- If an enterprise is prohibited from classifying financial assets as held-to-maturity because it has sold more than an insignificant amount of assets that it had previously said it intended to hold to maturity, that prohibition expires at the end of the second financial year following the premature sales.
- After acquisition most financial liabilities are measured at original recorded amount less principal repayments and amortisation. Only derivatives and liabilities held for trading (such as securities borrowed by a short seller) are remeasured to fair value.
- For those financial assets and liabilities that are remeasured to fair value, an enterprise will have a single, enterprise-wide option either to:
  - (a) recognise the entire adjustment in net profit or loss for the period; or
  - (b) recognise in net profit or loss for the period only those changes in fair value relating to financial assets and liabilities held for trading, with the non-trading value changes reported in equity until the financial asset is sold, at which time the realised gain or loss is reported in net profit or loss. For this purpose, derivatives are always deemed held for trading unless they are designated as hedging instruments.
- IAS 39 requires that an impairment loss be recognised for a financial asset whose recoverable amount is less than carrying amount. Guidance is provided for calculating impairment.
- IAS 39 establishes conditions for determining when control over a financial asset or liability has been transferred to another party. For financial assets a transfer normally would be recognised if (a) the transferee has the right to sell or pledge the asset and (b) the transferor does not have the right to reacquire the transferred assets. With respect to derecognition of liabilities, the debtor must be legally released from primary responsibility for the liability (or part thereof) either judicially or by the creditor. If part of a financial asset or liability is sold or extinguished, the carrying amount is split based on relative fair values.
- Hedging, for accounting purposes, means designating a derivative or (only for hedges of foreign currency risks) a non-derivative financial instrument as an offset in net profit or loss, in whole or in part, to the change in fair value or cash flows of a hedged item. Hedge accounting is permitted under IAS 39 in certain circumstances, provided that the hedging relationship is clearly defined, measurable, and actually effective.
- Hedge accounting is permitted only if an enterprise designates a specific hedging instrument as a hedge of a change in value or cash flow of a specific hedged item, rather than as a hedge of an overall net balance sheet position. However, the approximate income statement effect of hedge accounting for an overall net position can be achieved, in some cases, by designating part of one of the underlying items as the hedged position.
- For hedges of forecasted transactions that result in the recognition of an asset or liability, the gain or loss on the hedging instrument will adjust the basis (carrying amount) of the acquired asset or liability.
- IAS 39 supplements the disclosure requirements of IAS 32 for financial instruments.

- The new Standard is effective for annual accounting periods beginning on or after 1 January 2001. Earlier application is permitted as of the beginning of a financial year that ends after issuance of IAS 39.
- On initial adoption of IAS 39, adjustments to bring derivatives and other financial assets and liabilities onto the balance sheet and adjustments to remeasure certain financial assets and liabilities from cost to fair value will be made by adjusting retained earnings directly.

## Annex VIII

### MALAYSIA: STAMP DUTY EXEMPTION NOTIFICATIONS

The following is the full text of Stamp duty exemption notification in Malaysia. The exemption was extended and made permanent by the Budget 2001. A similar exemption, with similar conditions, has been granted in respect of Real Property Gains tax as well.

#### STAMP DUTY 1949

#### STAMP DUTY ( EXEMPTION ) ( NO.6 ) ORDER 2000

In exercise of the powers conferred by subsection 80 (1) of the Stamp Act 1949 [act 378 ] ,the minister makes the following order :

#### Citation and commencement

1. (1) this order may be cited as the **Stamp Duty (exemption ) (no. 6) order 2000**
- (2) this order shall be deemed to have come into operation on 30 October 1999.

#### Interpretation

2. For purposes of this order-

"Assets" means claims or securities or properties;

" Credit" enhancement in relation to an asset includes -

(a) The process of insuring risk associated with purchasing or funding of assets by means of securitisation;

(b) Any other similar process related to purchasing or funding of assets by means of securitisation;

"securitisation " means any arrangement approved by the Securities Commission for the funding or proposed funding of assets that have been or are to be provided by the holder or holders of those assets, by issuing bonds to investors and by which payments to investors in respect of the instruments or entitlements relating to such issuing of bonds are principally derived ,directly or indirectly , from such assets ;

"Special" purpose vehicle means any company incorporated in Malaysia that has been approved by the Securities Commission for the purpose of Securitisation

#### Exemption

3. The instruments specified in the schedule executed on or after 30 October 1999 but not later than 31 December 2000 for the purpose of Securitisation are exempted from stamp duty

#### SCHEDULE

- (1) any instrument that operates to transfer, convey, assign, vest, effect or complete a disposition of any legal or equitable right or interest in or title to, assets or charges or mortgages r other documents in relation thereto ( referred in this schedule as "those rights" ), to or in favour of a special purpose vehicle
- (2) Any instrument that operates to effect charges, assignments trust deeds or any letters of guarantee or any other documents for the credit enhancement of the assets
- (3) Any instrument that operates to transfer, convey assign, effect or complete disposition of any of those rights in connection with the repurchase of those rights from the special purpose vehicle to or in favour of the person or persons from whose those rights were acquired for the purpose of securitisation

Made 26 January 2000

[perb. R(8.20 ) 116 /1-138 (2000) (SK 6 ) ; PN (PU2 )\_ 159/xxii ]

on behalf and in the name of the Minister of Finance

Annex IX

**Securities and Exchange Commission of Pakistan**

**STATUTORY NOTIFICATION (S.R.O)  
Government of Pakistan  
SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN**

**NOTIFICATION**

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**PUBLISHED BY AUTHORITY**

*Islamabad the, December 14, 1999*

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**NOTIFICATION**

S.R.O. 1338(I)/99.- In exercise of the powers conferred by section 506 of the Companies Ordinance, 1984 (XLVII of 1984), read with clause (b) of section 43 of the Securities and Exchange Commission of Pakistan Act, 1997 (XLVII of 1997), the Securities and Exchange Policy Board hereby makes the following rules, the same having been published previously as required by the proviso to sub-section (1) of the said section 506, namely:-

**THE COMPANIES (ASSET BACKED SECURITIZATION) RULES, 1999**

**1. Short title and commencement.--**

- i. These rules may be called the Companies (Asset Backed Securitization) Rules, 1999.
- ii. They shall come into force at once.

**2. Definitions.--**

- i. In these rules, unless there is anything repugnant in the subject or context.-
  - a. "Commission" means the Securities and Exchange Commission of Pakistan.
  - b. "connected person" in relation to a company means,-
    - i. any person or company beneficially owning, directly or indirectly, ten per cent or more of the share capital of that company or able to exercise directly, or indirectly, ten per cent or more of the voting rights in that company; or
    - ii. any person or company controlled by a person who meets one or both of the descriptions given in sub-clause (i); or
    - iii. any member of the group of which that company forms part; or
    - iv. any director or officer of that company or of any of its connected persons specified in sub-clauses (i), (ii), or (iii);
  - c. "constitutive documents" means the principal documents governing the

formation of a Special Purpose Vehicle;

- d. "future receivables" includes all such receivables against which income may accrue or arise at a future date;
  - e. "investor" means a person holding any asset backed securities issued by a Special Purpose Vehicle;
  - f. "offering document" means documents containing information on a security calculated to invite offers for the purchase of such security;
  - g. "Ordinance" means the Companies Ordinance, 1984 (XLVII of 1984)
  - h. "Originator" means a person who transfers to a Special Purpose Vehicle any assets in the form of present or future receivables as a consequence of Securitization;
  - i. "Securitization" means a process whereby any Special Purpose Vehicle raises funds by issue of Term Finance Certificates or any other instruments with the approval of the Commission, for such purpose and uses such funds by making payment to the Originator and through such process acquires the title, property or right in the receivables or other assets in the form of actionable claims;
  - j. "Special Purpose Vehicle" means a special purpose vehicle registered by the Commission for the purpose of Securitization;
- ii. All other terms and expressions used but not defined in these rules shall have the same meanings as are assigned to them in the Ordinance.

**3. Prohibition to commence business without registration.--**

No person shall commence business as a Special Purpose Vehicle unless it is registered with the Commission under these rules.

**4. Eligibility for registration.--** A person proposing to commence business as a Special Purpose Vehicle shall be eligible for registration under these rules if,-

- i. it is registered as a public limited company under the Ordinance having a paid up capital of not less than one hundred thousand rupees; or
  - a. it is a trust duly formed under the Trusts Act, 1882 (II of 1882); or
  - b. it is a body corporate formed under any law for the time being in force and owned or controlled, whether directly or through a company or corporation, by the Federal Government or a Provincial Government;
- ii. no director, officer or employee of such person has been adjudged as insolvent or has suspended payment or has compounded with his creditors or has been convicted of fraud or breach of trust or of an offence involving moral turpitude; and
- iii. the promoters, directors and trustees of such person are, in the opinion of the Commission, persons of means and integrity and have special knowledge and experience of matters to be dealt with by a Special Purpose Vehicle.

**5. Registration.--**

- i. A person eligible for registration as Special Purpose Vehicle may make an application to the Commission for registration under these rules in such form and with such documents, as the Commission may notify.

- ii. The Commission, if it is satisfied after making such inquiry and after obtaining such information as may be considered necessary, may grant a certificate of registration to such person on such conditions as may be deemed necessary.

**6. Cancellation of registration.--**

- i. Where the Commission is of the opinion that--
  - a. a Special Purpose Vehicle has contravened or failed to comply with any provisions of the Ordinance, or has otherwise neglected or failed to comply with any requirement of these rules or has failed or neglected to carry out its duties in accordance with law; or
  - b. if a Special Purpose Vehicle fails to make a public offering within such time frame and in such manner as may be specified by the Commission while granting the certificate of registration, and the Commission is satisfied that it would be in the public interest so to do, the Commission may on its own motion, or on the application of the investors holding not less than ten percent of the securities issued by such Special Purpose Vehicle, by order in writing, cancel the registration of the Special Purpose Vehicle: Provided that no such order shall be made without giving the Special Purpose Vehicle an opportunity of being heard.
- ii. If a Special Purpose Vehicle fails to make a public offering within such time frame as may be specified by the Commission while granting the certificate of registration, the Commission may, after affording a reasonable opportunity of be heard by the such Special Purpose Vehicle, cancel its registration.
- iii. If the registration of a Special Purpose Vehicle is cancelled under sub-rule (i), or, as the case may be, under sub-rule (ii), the Commission shall appoint an administrator to manage the business of the Special Purpose Vehicle.

**7. Conditions of Operation.--** No Special Purpose Vehicle shall, --

- i. merge with, acquire or take over any other company or business, unless it has obtained the prior approval of the Commission in writing to the scheme of such merger, acquisition or take-over;
- ii. pledge any of the assets held or beneficially owned by such Special Purpose Vehicle except for the benefit of the investors;
- iii. make a loan or advance money to any person except in connection with its normal business;
- iv. participate in a joint account with others in any transaction;
- v. apply any part of its assets to real estate except property for its own use;
- vi. make any investment with the purpose of having the effect of vesting the management, or control, in the Special Purpose Vehicle; and
- vii. give guarantee, indemnity or security for any liability of a third party;

**8. Obligations of Special Purpose Vehicle.--** A Special Purpose Vehicle shall --

- i. be obliged to manage its assets in the interest of the investors in good faith and to the best of its ability and without gaining any undue advantage for itself or any of its related parties, connected persons or its officers;
- ii. be responsible for the acts and omissions of all persons to whom it may delegate any of its functions as manager as if they were its own acts and

- omissions;
- iii. keep at its registered office, proper books of accounts and records to enable a complete and accurate view to be formed of its assets, liabilities, income and expenditure;
  - iv. prepare and transmit its annual report, together with a copy of the balance sheet and profit and loss account, prepared in compliance with the requirements set out in the Ordinance and the Schedules thereto, and the auditor's report within three months of closing of the accounting period to the investors;
  - v. within two months of the close of the first half of its year of account, prepare and transmit to the investors and the Commission a profit and loss account for, and balance sheet as at the end of that half year, whether audited or otherwise;
  - vi. keep a register of investors at its registered office;
  - vii. appoint an auditor or auditors who shall be a chartered accountant within the meaning of the Chartered Accountants Ordinance, 1961 (X of 1961), in accordance with the relevant provisions of the Ordinance; provided that the auditors so appointed shall be a person other than the auditor of the originator.
  - viii. furnish a copy of the annual report together with copies of its balance sheet, profit and loss account and the auditor's report to the Commission within three months of the close of the accounting period together with a statement containing the following information, namely;
    - a. total number of investors; and
    - b. particulars of its directors, trustees or executives as the case may be.

**9. Advertisement and invitations.--**

- i. Advertisements and other invitations to the public to invest in a scheme, including public announcements, shall be submitted to the Commission for approval prior to their issue.
- ii. The approval so granted may be varied or withdrawn by the Commission after giving an opportunity of being heard to the Special Purpose Vehicle.

**10. Special Purpose Vehicle and the Originator to be independent.--** The Originator shall not be a connected person to the Special Purpose Vehicle.

**11. Guidelines.--** The Commission may, from time to time, issue guidelines for carrying on the business of Securitization.

No.3(3)SECP/SM/99

(HIZBULLAH SIDDIQUI)  
Deputy Chief

Annex X



THE OFFICE OF THE SECURITIES AND EXCHANGE COMMISSION, THAILAND

(English Translation)

**Royal Enactment on Special Purpose Juristic Persons for Securitisation**

B.E. 2540 (1997)

-----  
BHUMIBOL ADULYADEJ, REX.,  
Given on the 27 th day of June B.E. 2540  
Being the 52nd Year of the Present Reign

---

His Majesty King Bhumibhol Adulyadej has graciously issued a royal command to announce that,

Whereas it is expedient to enact a law on special purpose juristic persons for securitisation,

H.M. the King, by virtue of Section 175 of the Constitution of the Kingdom of Thailand amended by the Constitution of the Kingdom of Thailand Amendment (No.5) B.E. 2538 (1995), is therefore graciously pleased to proclaim a Royal Enactment as follows:

**Section 1**

This Royal Enactment is called "Royal Enactment on Special Purpose Juristic Persons for Securitisation B.E. 2540"

**Section 2**

This Royal Enactment shall come in to force from the day following the date of its publication in the Government Gazette.

**Section 3**

In this Royal Enactment,

"securitisation" means a receipt of transfer of assets and an issuance of securities for sale to investors with the requirement that returns to the holders of the securities will depend on a flow of receipts generated from the assets which are transferred.

"assets" means rights of claim or any other rights which generate a flow of receipts in the future, whether or not such receipts are certain, for example, residential loan agreements or rights under concessions for the construction of toll ways.

"a special purpose juristic person" means a juristic person established for the purpose of securitisation under this Royal Enactment.



“mutual fund” means a mutual fund under the law governing securities and exchange.

“project” means a securitisation project.

“SEC” means the Securities and Exchange Commission under the law governing securities and exchange.

“Office of the SEC” means the Office of the Securities and Exchange Commission under the law governing securities and exchange.

“competent officer” means a person appointed by the Minister to act in accordance with this Royal Enactment.

“Minister” means the Minister in charge of the execution of this Royal Enactment.

#### Section 4

The Ministry of Finance shall be responsible for the execution of this Royal Enactment.

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### Chapter 1 General

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#### Section 5

The SEC shall have the following powers and duties under this Royal Enactment.

- (1) to formulate policies concerning securitisation;
- (2) to supervise the special purpose juristic persons to ensure their compliance with this Royal Enactment;
- (3) to prescribe types of assets and securities which may be approved for securitisation;
- (4) to issue notifications to implement this Royal Enactment;
- (5) to determine fees for handling certain matters in accordance with this Royal Enactment;
- (6) to appoint sub-committees or advisors to perform any matters as assigned by the SEC;
- (7) to issue rules relating to the meetings and the performance of duties of the sub-committees;
- (8) to do any other acts to achieve the purposes of this Royal Enactment.

Notifications issued by the SEC in accordance with the first paragraph shall come into force upon publication in the Government Gazette.

#### Section 6

The sub-committees and advisors under item (6) in the first Paragraph of Section 5 shall receive the remuneration as specified by the SEC which shall be paid from the funds of the Office of the SEC.

#### Section 7

The Office of the SEC shall have powers and duties as specified herein and shall be entitled to receive various fees in accordance with this Royal Enactment.

## Section 8

In determining fees under item (5) in the first paragraph of Section 5, expenses and charges incurred in the actual handling of the matters shall be taken into consideration without the principal intention being to generate revenue. The fees shall become the property of the Office of the SEC.

## Chapter 2 Special Purpose Juristic Person

## Section 9

A special purpose juristic person may be established in the form of a limited company, a public limited company, a mutual fund or any other type of juristic person as may be prescribed by the SEC.

## Section 10

Person eligible to submit a project to the Office of the SEC for consideration are:

- (1) commercial banks;
- (2) finance companies;
- (3) credit foncier companies;
- (4) securities companies;
- (5) other juristic persons as prescribed by the SEC.

A proposed project must be submitted together with an application for the offer for sale of newly issued securities or an application for the establishment of a mutual fund under the law governing securities and exchange, and the category of person who will act as the special purpose juristic person and relevant details must also be specified in accordance with rules, conditions and procedures prescribed by the SEC.

If the proposed project is for the establishment of a special purpose juristic person in the form of a mutual fund, a securities company which will be the mutual fund manager must also be proposed.

## Section 11

After the Office of the SEC has approved a project:

- (1) if the special purpose juristic person is a limited company or a public limited company, the Office of the SEC shall register such company under the project as a special purpose juristic person and such special purpose juristic person shall be deemed to have been approved to offer for sale newly issued securities and shall be entitled to proceed with the offering of the securities for sale in accordance with the law governing securities and exchange;
- (2) if the special purpose juristic person is a mutual fund, the securities company specified in the project shall appoint a mutual fund supervisor and shall be entitled to proceed with the offering for sale of investment units to the public and to register the mutual fund in accordance with the law governing securities and exchange. At the time of the registration of the mutual fund, the Office of the SEC shall simultaneously register it as a special purpose juristic person.

In the process of securitisation, the SEC shall have the power to issue any notification

prescribing different courses of action from those prescribed in the law governing securities and exchange.

## Section 12

The special purpose juristic person shall carry out various activities as specified in the approved project and shall be entitled to offer for sale only newly issued securities which are issued pursuant to a proposed project.

Powers stipulated in the first paragraph include:

- (1) to receive the transfer of assets;
- (2) to issue securities for sale to investors;
- (3) to enter into agreements with any persons for the purpose of implementing the approved project;
- (4) to create debts or obligations as specified in the project;
- (5) to invest or seek benefits from the transferred assets in accordance with the approval of the SEC.

## Section 13

The special purpose juristic person shall not engage in any activities other than those specified in the approved project unless a relaxation is granted by the SEC.

## Section 14

If the operations of the special purpose juristic person under this Royal Enactment have the characterisation of those of finance or credit foncier businesses, the special purpose juristic person shall be entitled to engage in those operations without a licence under the law governing such operations.

## Section 15

If the assets which have been transferred are rights of claims whereby the original payee acts as an agent to collect and receive payments of debts incurred, the transfer of the claims shall be lawful without notice being given to the debtor pursuant to Section 306 of the Civil and Commercial Code. However, the rights of the debtor to set up a defence under paragraph two of Section 308 of the Civil and Commercial Code shall not be prejudiced.

The agent who collects and receives payments of debts under the first paragraph shall have a duty to maintain separately an account and a list of the debtors' name in respect of the transferred assets. A debtor shall be entitled to inspect his account and name.

If the agent who collects and receives payments of debts has been changed to be a person other than the original payee, the special purpose juristic person shall give notice of the transfer of the rights of claims to the debtors on the date of the change of the agent who collects and receives payments of debts unless the change of the agent occurs by operation of law governing merger of business of such person.

## Section 16

As regards the transfer of assets under an approved project, if the assets are secured by security other than rights of mortgage, rights of pledge or rights arising from a suretyship, such rights shall pass to the transferee on each transfer through to the transfer to the special purpose juristic person.

## Section 17

The transfer of assets secured by rights of mortgage, rights of pledge or other security under an approved project shall be exempt from any fees which, no matter what law in which they are stipulated, are levied in connection with the transfer of the assets or the transfer of the security for the assets.

### Section 18

The transfer of assets under an approved project which legally carries interest at the rate exceeding fifteen per cent per annum shall not be subject to the provisions of Section 654 of the Civil and Commercial Code. The special purpose juristic person shall be entitled to charge interest on the assets at the rate not higher than the original rate on the basis of interest calculation originally prescribed.

### Section 19

As regards the transfer of assets under an approved project where the seller of the assets is required to receive the re-transfer of assets from a special purpose juristic person, the provisions of Section 15, Section 16 and Section 17 shall apply to the re-transfer of the assets *mutatis mutandis*.

### Section 20

If the special purpose juristic person truly receives the transfer of assets from the seller of the assets, Section 114 of the Bankruptcy Act B.E. 2483 (1940) shall not apply.

The true receipt of transfer from the seller of the assets in accordance with the first paragraph means a transfer of assets under which,

- (1) the consideration is paid for at a fair market price;
- (2) the special purpose juristic person will take the risks and receive returns on the assets; and
- (3) the special purpose juristic person is entitled to the benefits inherent in the transferred assets.

Apart from the characteristics of the true receipt of the transfer of assets as prescribed in the second paragraph, the SEC may prescribe other additional characteristics.

### Section 21

If the securities offered for sale by the special purpose juristic person are debt instruments which are not debt instruments subordinated to ordinary creditors, a holder of the securities of the special purpose juristic person shall have the status of a preferential creditor over the assets which have been transferred to the special purpose juristic person and shall receive performance of obligations from the assets prior to other preferential creditors.

In respect of the preferential right under the first paragraph, a holder of the securities shall have the status of a secured creditor under the law governing bankruptcy.

### Section 22

If the Office of the SEC has found that any special purpose juristic person has securitised the assets into securities in the manner of seeking gains without the genuine purpose of securitisation, the Office of the SEC has the power to revoke the registration of the special purpose juristic person and such person shall pay compensation to the Office of the SEC in the amount equal to the amount of fees which it has been exempted from payment, together with a surcharge at the rate of two per cent per month on the amount payable from the date of revocation of its status as a special purpose juristic person.

**Section 23**

The dissolution of a special purpose juristic person which is a limited company or a public limited company must be consented to by holders of more than half of the total securities which have been sold.

**Section 24**

The special purpose juristic person shall terminate when:

- (1) it neither receives the transfer of assets nor issues securities for sale to investors under the project within six months from the date on which the project was approved;
- (2) it has paid in full the debts owed to investors who have invested in the securities of the special purpose juristic person;
- (3) holders of the securities of the special purpose juristic person who hold more than half of the total securities which have been sold have passed a resolution to dissolve the special purpose juristic person and such resolution has been approved by the Office of the SEC;
- (4) an event specified in the project occurs;
- (5) the Office of the SEC has revoked the registration pursuant to Section 22 and Section 29.

Chapter 3  
Provisional Representative

**Section 25**

If the Office of the SEC is of the opinion that any special purpose juristic person which is a limited company or a public limited company does not have an authorised person to act on its behalf or has an authorised person but such authorised person cannot operate for whatever reason, resulting in the suspension of the activities under the approved project, the Office of the SEC shall have the power to appoint one or several persons as it deems appropriate to be a provisional representative of the special purpose juristic person.

The provisional representative under the first paragraph shall have the sole authority to manage the business of the special purpose juristic person in all respects and do all necessary acts so that the business shall proceed in accordance with the approved project.

If it is appropriate, the Office of the SEC may change the provisional representative.

**Section 26**

On appointing the provisional representative under Section 25, the Office of the SEC shall notify its order by posting it in the open at the office of the special purpose juristic person for a period of not less than fifteen days. The order shall also be published in the Government Gazette and in at least one local daily newspaper with a wide circulation.

**Section 27**

When the Office of the SEC has notified an order for the appointment of a provisional representative of any special purpose juristic person under Section 26,

- (1) directors, employees or any persons of the special purpose juristic person shall take such actions as may be reasonable to protect and preserve the things and interests of the holders of securities of the special purpose juristic person and shall promptly report on the

business and deliver property together with books of account, documents, seals and any other evidence in relation to the business of the special purpose juristic person to the provisional representative within the period prescribed by the Office of the SEC;

(2) any person who is in possession of property or documents belonging to the special purpose juristic person shall inform the provisional representative of its possession within the period prescribed by the Office of the SEC.

### Section 28

If the Office of the SEC has approved the appointment of a new authorised person for the special purpose juristic person, it shall issue an order withdrawing the provisional representative and post it in the open at the office of the special purpose juristic person for a period of not less than fifteen days. The order shall also be published in the Government Gazette and in at least one local daily newspaper with a wide circulation.

### Section 29

If the Office of the SEC considers that any special purpose juristic person is unable to continue its operations, it shall revoke the registration of the special purpose juristic person and shall appoint a liquidator for the special purpose juristic person. The appointment of the liquidator shall be deemed as the appointment of a liquidator under the law governing the establishment of the special purpose juristic person.

The liquidation under the first paragraph shall be carried out in accordance with the provisions of the Civil and Commercial Code governing liquidation of limited companies or under the law governing liquidation of public limited companies, as the case may be, except that any acts in the process of liquidation which are within the power and duty of the general meeting shall be within the power and duty of the Office of the SEC.

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## Chapter 4 Competent Officer

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### Section 30

In the execution of his duties, a competent officer shall have the power to:

(1) enter the premises of a special purpose juristic person, debenture holder representative, mutual fund supervisor or agent who collects and receives payments of debts of the special purpose juristic person or any place where data is collected or processed pursuant to an authorisation of such person or any place where documents, evidence or property of the special purpose juristic person are stored, during the hours between sunrise and sunset or during the working hours of such places, in order to examine the operations, property and liabilities of the special purpose juristic person, including documents, evidence, property or information concerning the special purpose juristic person;

(2) enter any place during the hours between sunrise and sunset or during the working hours of such place, to examine property, accounts, documents or evidence which may be related to the commission of offences under the provisions of this Royal Enactment;

(3) seize or attach documents or evidence related to the commission of offences under the provisions of this Royal Enactment for the purpose of inspection or taking legal action;

(4) order a director, officer, employee or auditor of the special purpose juristic person, debenture holder representative, mutual fund supervisor, agent who collects and receives payments of debts of the special purpose juristic person, any person who collects or

processes data under assignment from any such person or any person who collects documents, evidence or property of the special purpose juristic person, to testify or to deliver copies of or present accounts, documents, seals or other evidence related to the businesses, operations, property and liabilities of the special purpose juristic person;

(5) order any person who will be useful in the performance of the duties of the competent officer to testify or deliver copies of or present accounts, documents or other objects which are related to or necessary for the performance of duties of the competent officer.

### Section 31

In the performance of his duties, the competent officer shall present his identification card to the persons involved.

The identification card of the competent officer shall be in the form prescribed by the Minister as specified in the Government Gazette.

### Section 32

In the performance of his duties in accordance with this Royal Enactment, the competent officer shall be an official under the Criminal Code.

## Chapter 5 Penal Provisions

### Section 33

Any person in proposing a project under Section 10 presents false information or conceals facts which should have been stated shall be subject to a fine not exceeding five hundred thousand baht.

### Section 34

Any special purpose juristic person which contravenes Section 13 shall be subject to a fine not exceeding three hundred thousand baht.

### Section 35

In a case where the commission of offences under Section 33 or Section 34 resulted from the instruction, the act, the failure to give instruction or the omission of an act which is a duty required to be performed by a director, manager or any person responsible for the operation of such juristic person, such person shall be liable to imprisonment for a term not exceeding one year or a fine not exceeding three hundred thousand baht, or both.

### Section 36

Any person who fails to comply with Section 27 shall be liable to imprisonment for a term not exceeding six months or a fine not exceeding sixty thousand baht, or both.

### Section 37

In a case where the person who commits the offence under Section 36 is a juristic person and the commission of an offence by such juristic person resulted from the instruction, the act, the failure to give instruction or the omission of an act which is a duty required to be performed by a director, manager or any person responsible for the operation of such juristic person, such person shall also be liable to the penalties provided for such offences.

### Section 38

Any person who obstructs the competent officer in the course of performing his duties under Section 30 shall be liable to imprisonment for a term not exceeding one year or a fine not exceeding one hundred thousand baht, or both.

### Section 39

Any person who fails to comply with the orders of or fails to give assistance to the competent officer in the course of performing his duties under Section 30 shall be liable to imprisonment for a term not exceeding six months or a fine not exceeding sixty thousand baht, or both.

### Section 40

Any person who makes a false statement to the competent officer, which may cause damage to another person or to the public, shall be liable to imprisonment for a term not exceeding six months or a fine not exceeding sixty thousand baht, or both.

### Section 41

Any person who removes, damages, destroys or renders useless any seal or mark which the competent officer has stamped or affixed on any object in performing his duties under Section 30 as evidence for the seizure, attachment or preservation of such object shall be liable to imprisonment for a term not exceeding three years and a fine not exceeding three hundred thousand baht.

### Section 42

Any person, who damages, destroys, conceals, takes away, or loses or renders useless any property or document which the competent officer has seized, attached, preserved or ordered to be delivered as evidence in accordance with Section 30, regardless of whether the competent officer keeps such property or document by himself or orders such person or another person to deliver or keep it, shall be liable to imprisonment for a term of six months to three years and a fine of sixty thousand baht to three hundred thousand baht.

### Section 43

A fine fixing committee appointed by the Minister shall have the power to fix a fine for offences under Section 33, Section 34, Section 35, Section 36, Section 37, Section 38, Section 39 and Section 40.

The fine fixing committee appointed by the Minister under the first paragraph shall consist of three persons.

Where a fine fixing committee has fixed a fine for an offence and the alleged offender has paid the fine as determined by the fine fixing committee within the period of time specified by the fine fixing committee, such case shall be regarded as settled under the provisions of the Criminal Procedure Code.

If the alleged offender refuses to pay the fine or agrees to pay the fine but fails to pay the fine within the specified period, the legal action shall be continued.

### Section 44

If a legal action in respect of the offence the fine of which can be fixed under Section 43 is not filed with a court within five years from the date of commission of the offence, the statutory limitation period shall expire.

Countersigned by:



General Chavalit Youngchaiyudh  
Prime Minister

Remarks: The reasons for issuing this Royal Enactment are that securitisation business is an important financial process which can be used to solve the problem of shortage of both short-term and long-term fund in numerous business sectors. Securitisation business will also create a new type of financial instrument with high stability which will be conducive to the development of the capital market and mobilisation of domestic savings. In addition, Thailand is currently facing the problem of economic slow-down which has resulted from sluggish conditions of various business sectors, coupled with a shortage of current capital, in particular, in the property sector. These factors lead to a general and wide impact on the operations and the management of liquidity of financial institutions in general, which would further have an effect on the recovery of the economy of the country. It is therefore expedient to enact the law on special purpose juristic persons for securitisation. Furthermore, the current sluggish economic conditions might have far-reaching effects on the economy which could in the long run undermine the economic stability of the country. And since the preservation of the economic stability of the country is an urgent and necessary matter, there is therefore a need to issue this Royal Enactment.

*(published in the Government Gazette, Decree Issue, Vol.114, Part 29 Gor, 28 June 1997)*

Annex XI

**BANGLADESH: COPY OF CONSENT LETTER FROM SEC ON APPLICATION FOR ASSET  
SECURITIZATION OF BRAC BY AIMS OF BANGLADESH LIMITED**



**সিকিউরিটিজ ও এক্সচেঞ্জ কমিশন**  
**SECURITIES AND EXCHANGE COMMISSION**  
JIBAN BIMA TOWER (15 & 16 FLOOR), 10 DILKUSHA, C/A, DHAKA-1000  
PABX : 956 8101, 956 8102, 956 1525, FAX : (88)-02- 956 3721  
E-mail : secbd@bdmail.net Website : <http://www.secbd.org>

SEC/Reg./G-61/Part-VI/2002-10

22 January 2002

Mr. Yawer Sayeed  
Managing Director  
AIMS of Bangladesh Ltd.  
Chandrashila Suvastu Tower (5<sup>th</sup> floor)  
69/1, Panthopath (East)  
Dhaka.

Dear Sir:

Sub: **BRAC Securitized Bond.**

Please refer to your letter dated 01.01.2002 and our letter No. SEC/Reg./G-61/Part-VI/2001-716 dated 30.12.2001.

The Commission has decided to consider your proposal to act as a trustee of SPV trust of BRAC Securitized Bond under বিধি ৩২(খ) of সিকিউরিটিজ ও এক্সচেঞ্জ কমিশন (মিউচুয়াল ফান্ড) বিধিমালা, ২০০১।

In this regard you have to apply with no objection certificate of the trustee of AIMS First Guaranteed Mutual Fund.

It was informed you earlier through our referred letter that the Commission currently is not concerned with any trust deed other than the trust deed required to approve a Mutual Fund. However, for public offering of bonds consent of Commission would be required under Securities and Exchange Ordinance, 1969 and procedure for public offer as prescribed under Public Issue Rules should be followed.

Thanking you

Sincerely yours

**M. Saifur Rahman**  
Deputy Director

**Annex XII**  
**COPIES OF COMMENTS & REMARKS RECEIVED FROM THE PFIs ON THE DRAFT REPORT**

# IDLC

No. 408.9/ ৩৪৬৭

September 05, 2002

**Mr. Yawer Sayeed**  
 Managing Director  
 Aims of Bangladesh Limited  
 Chandrashila Suvasta Tower (5<sup>th</sup> Floor)  
 69/1, Panthopat (East)  
 Dhaka-1205

Subject: **Comment on Draft Report on Asset Securitization by  
 The Financial Institutions in Bangladesh**

Dear Mr. Sayeed,

Please refer to the draft report on Asset Securitization prepared by your organization and subsequent discussion held on this issue in the CBSF Workgroup meeting.

In this connection, we would like to inform you that we have reviewed the whole report thoroughly and found the same very comprehensive covering all the major foreseeable issues related to any asset securitization attempt by the financial institutions of the country. The report's contents and recommendations can be essential for future reference in terms of legal, regulatory and fiscal reforms by the concerned authority for the development of capital market oriented asset securitization products.

Based on our review and understanding, we have summarized the issues we consider may be useful to communicate to you before finalizing the report. The followings are the observations:

1. Considering the prevailing legal and taxation issues in Bangladesh, we also believe that at the initial stage "true sale" kind of asset securitization is not possible at this stage and leasing companies would also prefer financing type of securitization in order to continue to reap the benefits of initial depreciation from the assets in the book.
2. Since the matter of establishing the Special Purpose Vehicle (SPV), whether in the trust form or the corporate form is still alive in the discussion, at least from Bangladesh Bank's point of view, it would be encouraging if you could discuss a little bit further regarding the possible advantage and disadvantage of various forms of SPV.
3. As per para 1.3 regarding transfer of receivables backed by immovable property attracts registered instrument. Since registered assignment of receivables requires 5 percent stamp duty, we would request you to elaborate whether these assets will be excluded in our initial endeavour to securitize under the proposed model of equitable mortgage.

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**INDUSTRIAL DEVELOPMENT LEASING COMPANY OF BANGLADESH LIMITED**

Head Office: Hadi Mansion (7th Floor), 2 Dilkusha C/A, GPO Box 3160, Dhaka-1000, Tel: 9560111, Fax: 880-2-9563620, E-mail: mailbox@idlc.com, Web: www.idlc.com  
 Chittagong Branch: Suriya Mansion (1st Floor), 30 Agrabad C/A, Chittagong, Tel: 711034, 713742, Fax: 880-31-715895, E-mail: idlcctg@gononet.com

# IDLC

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4. We would also appreciate if you could attach an annexure consisting of minimum fiscal/legal changes required in order to initiate the designing, structuring and marketing of securitized products. This list, as we understand, may include among other things the tax status of SPV, Stamp duty of 1.5 percent regarding transfer of debt instruments etc.
5. As discussed in the Workgroup meeting, it would provide more clear picture regarding financing mode of securitization if you could elaborate further on the most likely accounting treatments for the parties involved in the transaction like the originator and the SPV.
6. In para 3 of section E tilted the probable cost of issuing CLOs do you consider that in Bangladesh environment cost of bank guarantee would be an added element? If so, you may incorporate this cost element in your probable cost of issuing CLOs. Marketing and promotional cost could be another very visible cost element.

We also believe that changing some of the fiscal issues are the challenges before us and all of us specially the PFIs under the guidance of World Bank and CBSF should work together with concerned authorities like Ministry of Finance, NBR, SEC, Bangladesh Bank, Controller of Insurance and present our case compared to the other neighbouring countries. With some of the recent changes in the financial market like debarring the institutions from investing in Sanchaypatra, reduction of rates of these instruments, introduction of repo mechanism and opening up treasury bill to institutions and individual are visibly solid steps towards achieving our collective goal i.e. development of a vibrant debt market in Bangladesh. We feel privileged in joining this force with all the concerned parties and would like to contribute to the best of our ability in the days to come.

We once again appreciate the good work done by Aims of Bangladesh Limited.

Thank you.

Sincerely yours,



**M. Aminul Islam**  
Managing Director

**cc to** : i. Mr. Michael Rose, Chief Executive Officer, CBSF  
ii. Dr. Shamsuddin Ahmad, Senior Financial Analyst, World Bank  
iii. All PFIs

09-SEP-02 10:02

UNITED LEASING CO LTD.

88 02 9662596

P. 0

To : Mr. Yawer Sayeed, Aims  
From : United Leasing Co Ltd  
Subject : Draft Report On Asset Securitization  
Date : September 8, 2002

With reference to the draft report we have the following observations.

1. We believe the SPV should not be regulated. However it may be registered with the SEC
2. As recommended in the report we believe initially 'true sale' is not possible. We would like to continue enjoying the benefits of depreciation and therefore the securitization should be so structured
3. A conduit SPV would be preferable. Can an existing Asset Management Company perform the task of SPV? Is any special permission required for that?
4. The problems related to securitization are highlighted in different sections. It would be helpful if a summary of the problems could be provided in order of the magnitude of the problem.

The report is very detailed and includes all the problems on securitization. It is a good working paper and can be used as reference paper when communicating with different ministries and government agencies in resolving the fiscal and other problems.

With regards,

M. M. Alam

03/09 '02 14:49

FAX 880 2 9569928

GSP FINANCE CO

**GSP FINANCE COMPANY (BANGLADESH) LIMITED**

(Incorporated in Bangladesh)

**FACSIMILE TRANSMISSION**

To : Aims Bangladesh Ltd.

Copy to : All PFI's , CBSF , Dr. Shamsuddin Ahmed , World Bank

From : GSP Finance Co. Bangladesh Ltd.

Sub: Asset Securitization by the Financial Institutions Bangladesh.

Referring to : E Mail dated 25.08.02 by CBSF

On the subject indicated above , we observe from studying the draft report submitted by you that the same is very comprehensive & you have dealt at length with all the problems relating to securitization & have also given recommendations / suggestions for addressing the problems . The report has been enriched by incorporation of prevailing practices of neighbouring countries like Srilanka, India , Thailand & Malaysia . The report will act as a document for referring it to the Ministry of Finance , Bangladesh Bank , NBR , SEC or any other agencies for necessary remedial measures from them in order to develop capital market of the country of which assets securitization play a major role .

We as a member of PFI group see eye to eye with most of the recommendations put forward by you in the report and give our comments as under.

1. As for establishment of SPV, we feel that SPV should be registered as a Trust under trust act & SEC should act as regulator.
2. As for treatment of depreciation , further discussion should be held between ICAB , NBR ministry of finance , Bangladesh Bank under the auspicious of World Bank group as recommended.
3. Recommendations in respect of charge on lease assets , recognition of assignment of receivables of tax purpose, transfer of security , collection enforceability , credit rating , litigation against SPV and transferring loan assets appear to be acceptable.
4. For assignment , the recommendations for fractional assignment as is prevalent in India may be accepted.
5. As for taxation , stamp duty , gain tax, withholding tax , duty on transfer of instrument the SPV should be exempted of all these duties and taxes.

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<http://www.gspfinanceco.com>

## **GSP FINANCE COMPANY (BANGLADESH) LIMITED**

(Incorporated in Bangladesh)

6. The accounting model prevalent in srilanka, may be accepted for Bangladesh.
7. In order to reduce the cost of issuing CLO's the recommendations of PFI's executing jointly the trust deed as author ( s) settler (s) with an asset managers to establish the conduit SPV Trust appear to be more plausible for Bangladesh.
8. The study in respect of chapter 5, 6, & 7 and recommendations thereof deserve considerations & in some cases need the assistance of Government , Bangladesh Bank and CBSF for solutions.

However, the presentation & discussion of the report in the PFI's work group meeting will give further directions for acceptance of recommendations and future course of action.

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