Distressed Debt Investing in India—the Use of Debt Aggregation Vehicles

By **NIKHIL NARAYANAN**

Although the security enforcement landscape in India has historically posed a number of challenges, the market in India is evolving. Recent efforts on the part of the Reserve Bank of India ("**RBI**") to encourage Indian banks to clean up their balance sheets has created an opportunity for debt funds to acquire substantial debt portfolios in India. This, together with recent regulatory changes intended to encourage greater investment in the debt market and to improve the local security enforcement process, has led to increased inflows of debt capital into India. Much of this investment has centred around the acquisition of "*distressed debt*" portfolios in India and many international investors have chosen to participate through the use of long term debt aggregation vehicles.

There are two potential debt aggregation vehicles in India: asset reconstruction companies and non-banking finance companies. This article discusses the type of debt that asset reconstruction companies can acquire, the extent to which international investors can invest in such vehicles, the normal investment considerations and the benefits that asset reconstruction companies offer international investors. It also compares asset reconstruction companies to non-banking finance companies in the distressed debt context and considers the impact of the recently enacted Insolvency and Bankruptcy Code 2016 on security enforcement by such debt aggregation vehicles.

Background to the use of debt aggregation vehicles in India

"Distressed debt" in the Indian context

Investors seeking to participate in the debt market in India do not need to do so through debt aggregation vehicles. Indeed, most mezzanine debt or mezzanine-style investments are structured as bespoke secured bond investments through instruments known as "*non-convertible debentures*". Whilst this structure provides access to the capital of highly levered companies, it does not provide direct access to portfolios of distressed loans (although these bonds could themselves become distressed if they suffer an event of default). In contrast, debt aggregation vehicles provide for immediate and direct access to portfolios of distressed loans.

In this regard, distressed debt has a particular meaning. It refers to debt which has failed certain RBI default guidelines. In India, debt is usually regarded as being distressed when, in the RBI's parlance, it is an "SMA-2 account", meaning that payment under the loan is more than 61 days overdue. This is the point at which it can be sold to asset reconstruction companies (see discussion below) and the debt is treated as "non-performing" when payment is more than 90 days overdue.

Borrowers of this nature are often in need of significant restructuring. That is also true of distressed investments elsewhere in the world, but in the Indian context, a successful outcome for an investor often requires the cooperation of the controlling shareholder as well as the borrower's management and labour force. Indeed, the RBI sees the role of private capital as being able to absorb this debt from the banks and to work with the borrowers rather than to undertake "*asset stripping*". This does not mean that security is unenforceable or that the RBI will obstruct creditor action to protect its rights, but that the RBI will expect investors to have a plan in place to re-schedule the debts and enforce security (amongst others). Therefore, investors seeking to invest distressed debt in India are lending into this construct.

> **Two potential debt aggregation vehicles in India: asset reconstruction companies and non-banking finance companies.**

Benefits of debt aggregation vehicles in this context

Apart from providing access to distressed debt, the main benefit of using debt aggregation vehicles is that certain of them benefit from certain enhanced security enforcement tools in India under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("**SARFAESI**"). SARFAESI allows certain lenders to enforce security or take certain other measures to protect their interests without any judicial intervention. These include the right to change the management and to take over the secured assets to realise their value without judicial intervention. In light of the difficult security enforcement regime in India, these remedies are seen as being desirable by international debt investors. The provision of SARFAESI have been strengthened by amendments in 2016, which extend its benefits to certain bond instruments as well.

Whilst it is certainly helpful for an investor to have these tools in its armoury, historically, lenders have had mixed success in using these provisions in practice. Therefore, if this is the only reason for the use of a debt aggregation vehicle rather than a more bespoke investment structure, then investors should consider this aspect of emerging market enforcement risk carefully, i.e. this is not a silver bullet that addresses all enforcement risk in India. In addition, although this is generally considered to be a welcome measure for creditors, the newly enacted Insolvency and Bankruptcy Code 2016 ("**Bankruptcy Code**") does adversely affect SARFAESI (and indeed, that is the intention). The Bankruptcy Code, as a matter of policy, is intended to replace individual creditor enforcement actions with a collective creditor enforcement process upon the onset of insolvency. It achieves this through a moratorium that restricts SARFAESI rights during the insolvency resolution process (discussed further later in this article). The effect of this moratorium is more pronounced in relation to debt aggregation platforms (in comparison to certain other SARFAESI qualifying lenders). Therefore, SARFAESI rights should not be the sole determining factor in an investor's decision to set up or participate in a debt aggregation platform.

Asset reconstruction companies (ARCs) are the most commonly used debt aggregation vehicle, as far as pure distressed investments are concerned.

In addition, there are certain tax advantages in relation to the use of certain debt aggregation vehicles, as discussed further below.

Asset Reconstruction Companies

What is an ARC?
The most commonly used debt aggregation vehicle, as far as pure distressed investments are concerned, are "*asset reconstruction companies*" ("**ARCs**"). The term ARC does not refer to a special type of legal entity in itself, but to a registration with the RBI under SARFAESI. ARCs act as managers to the security trusts that actually acquire the distressed debt portfolio. The security trusts then issue security receipts in relation to the underlying debt acquired.

Investors will also need to consider their overall investment objectives in this regard. An ARC is required under SARFAESI to only undertake "*asset reconstruction*" activity (unless it has received RBI approval for any other activity). Therefore, if an international investor intends to lend more widely, then there may be other structures that are more appropriate.

International participation in the equity and the management of ARCs
International investors now benefit from greater flexibility than in the past.

Historically, international investors were subject to a number of restrictions both in relation their investment in the equity of the ARC itself as well as a cap on its holding of security receipts. However, recent changes to India's foreign direct investment policy and SARFAESI mean that international investors can now invest in up to 100% of the equity of ARCs (although any investments of above 10% will require the investor to also satisfy the "*fit and proper*" person test and hold all the security receipts in any tranche.[1] Of course, that latter point is affected by the separate RBI requirement for ARCs to hold 15% of the security receipts which is discussed further under the heading "*Issuance of security receipts*" below. The changes mean that there is no longer any regulatory reason for an international investor to seek a local partner. That said, some investors have chosen to retain a local partner to assist with local sourcing of opportunities and management of local regulatory and diligence issues (see discussion under the heading "*Regulatory and operational issues*" below).

International investors are free to appoint directors and structure the governance of the ARC as they wish (provided that these arrangements comply with Indian company law), although the RBI does impose an incremental layer of regulation. Some of this relates to ensuring that the directors are appropriately qualified with the right level of experience. However, any "substantial change of management", which is defined to include the appointment of any director or managing director or CEO of the Asset Management Company, will need the RBI's approval.

Acquisition of distressed debt portfolios by the security trust
The debt is required to be of a certain regulated grade of distress before ARCs can seek to acquire them. The RBI requires Indian banks to classify debts using certain codes. Debts which are overdue over 61 days can be sold to ARCs (these are called "SMA-2 accounts", where the debts are 61-90 days overdue and "non-performing assets" where the debts are more than 90 days overdue). In addition, debts which are part of a consortium loan, 75% of which is "non-performing" (as defined above) can also be sold to ARCs.

With that background, there are two ways for an ARC to acquire distressed debt: (a) by participating in a public auction process (discussed further in the paragraph below); and (b) through bilateral arrangements (these are directly between the holder of the debt and the purchaser and it is not common for these sales to involve a third party). The former is more common and the RBI is seeking to introduce greater transparency to this process.

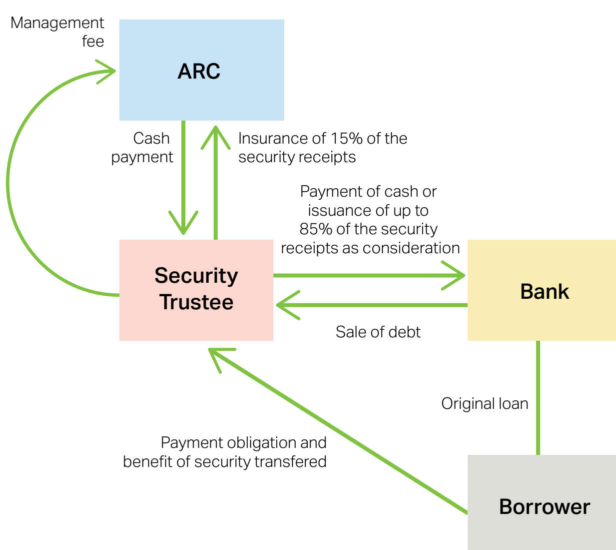
The RBI's main concerns in this regard are to ensure that buyers undertake proper diligence (and its regulations have enabling provisions allowing buyers two weeks to conduct their due diligence) and to ensure transparency. It is also focussed on ensuring that the auctions result in real sales of distressed debt, rather than being a price discovery exercise alone. To this end, in guidelines issued on 1 September 2016 ("**Distressed Debt Sale Guidelines**"), the RBI has set out detailed requirements encouraging the use of electronic auctions, requiring the banks to indicate the discount rate that they are using and to put in place policies to sell debt through the "*Swiss*

Challenge" method (where the failure to sell results in the bank having to put in place higher bad debt provisioning).

Recent amendments to SARFAESI mean that the acquisition of distressed debt by an ARC will not be subject to stamp duty (although stamp duty will apply when one ARC sells any distressed debt to another ARC).

Issuance of security receipts
An ARC will be required to formulate a policy (to be approved by its board) relating to the issues of security receipts by its security trust. The security trustee will then be required to prepare a scheme for the issuance of security receipts and the RBI's Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions 2003 (the "**RBI 2003 Guidelines**") contemplate the preparation of an offering document. The disclosure in this document is quite basic and, to date, there is no regulatory framework for the listing of security receipts.

Illustration of an ARC structure



The security receipts have a number of features that benefit investors. They are required to have a credit rating, which is based on their net asset value ("**NAV**"). The rating is to be on a "*recovery rating scale*" and the RBI has set out a number of rules governing this rating (including the disclosure of any conflicts of interest). Also, there is no minimum maturity period in relation to the security receipts. In addition, following changes introduced in 2016, security receipts benefit from "*pass through*" treatment with regard to the coupon and any redemption premium payable on the security receipts issued by securitisation trusts (there is withholding in India, but treaty benefits will apply).[2]

The RBI requires the ARCs to acquire 15% of the security receipts so that it has direct "*skin in the game*", but otherwise, the security receipts can be issued to "*qualified buyers*".[3] It is common practice for a security trust to acquire distressed loan portfolios from banks and issue them with 85% of the tranche of security receipts (so that the ARC holds its required 15% of security receipts) rather than paying out cash. However, the RBI is seeking to discourage this practice in its recent Distressed Debt Sale Guidelines, by imposing higher provisioning requirements on the banks in such circumstances.[4]

Ability of the ARC to transfer or syndicate its security receipt exposure
From a risk mitigation perspective, any debt investor will want the ability to exit its investment by selling down its exposure at any time (particularly since the credit default swap market in India is currently quite limited). Equally, the ARC may wish to syndicate its exposure at the outset. With regard to investments made by an ARC in security receipts, whilst there is no "lock-in" period, this is possible subject to certain constraints.

Firstly, there is the 15% "*invest and hold*" requirement on the part of the ARCH in relation to each tranche of security receipt. ARCs cannot transfer this stub holding requirement.

Secondly, the sale can only be to other "*qualified buyers*" (this is required to be a term of the security receipt issuance scheme under the RBI 2003 Guidelines). Of course, it may be the case that these qualified buyers constitute much of the addressable market, but before undertaking any sale, this is a point that an ARC will want to check.

Thirdly, the drafting of certain exchange control provisions creates some regulatory ambiguity in relation to the ability of foreign portfolio investors ("**FPIs**") to acquire security receipts in the secondary market (i.e. not directly from the issuer). FPI status is a securities registration allowing international investors the ability to participate in the Indian securities market. Historically, this has been one of the simplest ways for debt investors to hold Indian high-yield securities. The definition of "*qualified buyers*" includes a reference to "*foreign institutional investors*". Since that was the regulatory predecessor of FPIs, that does not cause concern. The issue of concern arises from the fact that the drafting of the relevant provisions of RBI's Transfer or Issue of Securities Regulations 2000 suggests that as far as non-primary acquisitions are concerned, FPIs can only participate if the security receipts are listed. To date, there is no mechanism to list security receipts. Indeed, the Securities and Exchange Board of India ("**SEBI**") regulations that introduced the FPI concept do not refer to listed security receipts. Therefore, this seems to be an inadvertent regulatory oversight that ought to be capable of being explained to the RBI, but it would be prudent for an ARC to seek RBI guidance on this at the outset to avoid facing issues later.

Funding of ARCs

The funding of ARCs requires careful consideration at the outset. Equity funding is the default position, but will an ARC be able to "*leverage*" itself by capitalising itself with debt (i.e. can an ARC leverage its 15% security receipts holding)?

As an initial gating question, any ARC will need to consider to what extent this such leverage will be consistent with RBI's guidelines (which envisage the ARC retaining skin in the game). Beyond that, all Indian companies are subject to a number of restrictive RBI rules on "*external commercial borrowings*" and ARCs would not ordinarily qualify as permitted borrowers under that. That said, there may be other bond instruments (such as "*non-convertible debentures*") which may be capable of being used.

Synthetic exposure

Another question that international investors sometimes consider is their ability to hedge themselves by creating derivative instruments outside India based on the Indian underlying debt (i.e. the debt portfolio acquired). In general, SEBI, India's security regulator, very carefully scrutinises any such arrangements which it refers to "*off-shore derivative instruments*" and its FPI regulations permits the creation of such derivative instruments if the underlying securities are either listed or are "to be listed". Since the security receipts are not listed instruments (and there is no framework to do so), that will impose a restriction in practice.

Commercial arrangements in relation to the ARC

The RBI closely regulates a number of the commercial aspects of the functioning of an ARC.

A Non-Banking Finance Company (NBFC) is a company that provides financial services in the Indian market (which may include lending and, if so permitted, deposit taking too).

The RBI requires the ARC's management fees to be calculated as a percentage of the net asset value based on the lower end of the NAV range indicated by the credit rating agency (rather than being based on the outstanding value of the security receipts). In addition, the fees cannot exceed the acquisition value of the distressed loan portfolio acquired. Management fees are to be recognised on an accrual basis.

The RBI also regulates the treatment of a number of accounting matters. For example, with regard to pre-acquisition expenses (e.g. due diligence), the RBI requires these to be immediately expensed in the profit and loss statement for the period to which such costs relate. There are also detailed provisions with regard to post-acquisition cost expensing. These guidelines also regulate matters such as revenue recognition (including on yield, upside income and management fees) and the accounting treatment of security receipts in the hands of investors. Therefore, any investor seeking to invest in these securities should carefully study these rules to understand the accounting implications as an initial regulatory diligence matter.

Regulatory and operational issues

ARCs are regulated entities and this comes with its own compliance requirements, including a number of periodic filings with the RBI. Well advised lenders will also want to keep a close eye on their portfolio and so this does mean that setting up an ARC will require an effective local presence in practice. Outsourcing arrangements are unlikely to be practical here and it also seems unlikely that the RBI would accept this outside of certain defined boundaries. For this reason, a number of international investors have chosen to partner with Indian counter-parties who are more familiar with the regulatory landscape.

Non-Banking Finance Companies

In addition to ARCs, another form of lending vehicle that is used in the domestic context is the "non-banking finance company" ("**NBFC**"). An NBFC is a company that that provides financial services in the Indian market (which may include lending and, if so permitted, deposit taking too). NBFC are closely regulated by the RBI, which imposes a number of prudential capital norms. They are broken down further into a number of categories, deposit-taking and non-deposit taking and systemically important and non-systemically important. In addition to the RBI guidelines, there an overlay of foreign direct investment regulations that adds an additional layer of regulation for international investors.

Is this a suitable vehicle for distressed debt investment?
NBFCs are commonly used for general financing transactions in India and the number of NBFCs currently in existence is far greater than the number of ARCs. However, despite that, NBFCs have historically not been the default choice of vehicle to undertake distressed debt investments. Part of that reason is that until September 2016, there were certain restrictions on NBFCs that had received international investment. Those restrictions have been removed, so the issue does now merit closer scrutiny.

The main benefit of NBFCs is that they are able to undertake a broad range of finance activities and have access to accounts before they reach the 61-day default stage (which is when ARCs can acquire such debt). This means that they are able to acquire and aggregate debt that has a better chance of recovery. NBFCs can also borrow outside India, subject to certain conditions, unlike ARCs (which are not permitted to borrow under India's "*external commercial borrowings*" exchange controls).

However, there are a number of tax disadvantages to the use of NBFCs. Any instruments they issue will not benefit from tax pass through treatment (unlike security receipts issued by ARCs). Also, any distressed debt that NBFCs acquire will be subject to stamp duty as the exemption recently introduced to SARFAESI in 2016 only applies to acquisitions by ARCs.

From an enforcement perspective, the right to enforce security without the approval of the courts under Section 13 of SARFAESI has recently been extended to certain NBFCs that have a capital of INR 5 billion, roughly $75 million at current exchange rates (and where the secured debt is at least INR 10 million, or about $150,000 at current exchange rates). However, other provisions of SARFAESI, such as the "*deemed assignment*" (by operation of law) of any distressed debts do not apply to NBFCs and they only apply to ARCs. Of course, ARCS can benefit from contractual assignment, so this may not be the most significant disadvantage in practice, but it is a point of difference.

ARCs v NBFCs

A more detailed comparison of ARCs in comparison to NBFCs is set out below.

Consideration	ARC	NBFC
Permitted activities	Limited to asset reconstruction activity, i.e. suitable for the acquisition of distressed loan portfolios but not wider lending.	NBFCs can undertake a broad range of lending activities as permitted by the RBI.
Restrictions affecting foreign investment	None.	Previous restrictions under India's foreign direct investment regulations have now been eased on in September 2016. However, any depending on the nature of activity being undertaken, the regulations of other regulatory bodies (e.g. the RBI) may be relevant.
Need for RBI registration	Yes.	Yes.
RBI approval for change of management	Yes for substantial changes of management (appointment of a director, managing director or CEO). Shareholders holding 10% or more of the shares of an ARC must be "*fit and proper*" persons.	Yes for the following: (a) takeover or change of control (regardless of whether or not it results in a change of management); (b) the transfer of 26% of shares in the company; or (c) a change of 30% of the board (excluding independent directors).
Subject to prudential capital or capital adequacy requirements?	Yes (the 2003 RBI Guidelines).	Yes (there are detailed and separate guidelines on these).
Stamp duty on acquisition of distressed debt portfolio?	No (there is an exception under SARFAESI).	Yes.
Debt capital instruments that it can issue (other than convertible instruments)	Security receipts and non-convertible debentures (there is no explicit restriction in relation to the latter). It is currently unclear as to whether the RBI will accept ARC issuing "masala bonds" and practice is yet to evolve in that regard.	Non-convertible debentures and "masala bonds".
Ability to borrow outside India (outside the instruments referred to in the row above)?	No, ARCs are not permitted to borrow under India's "external commercial borrowing" exchange control rules.	Yes, NBFCs are permitted to borrow under "Track 3" of India's "external commercial borrowing" exchange control rules.
Pass through tax treatment on instruments issued?	Yes on security receipts issued by an ARC.	No.
Benefits from SARFAESI enforcement processes (Section 13)	Yes.	Yes for NBFCs with assets of over INR 5 billion and provided the security interest secures a debt that has a principal of at least INR 10 million.
Benefits of deemed assignment provisions under SARFAESI	Yes.	No.

Impact of the bankruptcy code on both ARCs and NBFCs

Individual v. collective enforcement processes
ARCs and qualifying NBFCs which benefit from SARFAESI will be equally affected by the advent of the recently enacted Bankruptcy Code, which, at the date of publication of this article, is not in force.

SARFAESI constitutes debt recovery legislation, which enables creditors to enforce individual rights. In contrast, the Bankruptcy Code establishes a collective insolvency procedure by imposing a UK style quasi administration regime for insolvency companies. The inter-relation between the two laws will need to establish itself in practice, but there is an obvious tension here.

Moratorium on SARFAESI action
Under the Bankruptcy Code, once the insolvency process commences, a moratorium is imposed upon creditor rights. This restricts not only current and potential legal proceedings, but also rights under SARFAESI. Section 14(1)(c) of the Bankruptcy Code states that the moratorium applies to "any action to foreclose, recover or enforce any security interest" including under SARFAESI. That begs the question as to whether the rights to replace management under SARFAESI would be affected. The language here is not as clear as would have been ideal and there may well be some exploitation of this gap in the future, but the legislative intent is clearly to restrict such type of action as well.

Therefore, if a creditor initiates the bankruptcy process (by applying to the court), the moratorium will take effect and any secured creditors cannot stop this from taking effect and SARFAESI action will need to come to a halt and be replaced by the collective insolvency procedure. Of course, ARCs and NBFCs will be part of the creditor committee which is part of the insolvency process, where decisions need to be undertaken by with a 75% majority (by value and including unsecured creditors). This may give ARCs and NBFCs some leverage to affect the outcome of the insolvency process.

Liquidation
The insolvency process is time bound (180 days extendable by no more than a further 90-day period) and if there is no resolution during that time, the default is for the company to be liquidated. In such circumstances, any secured creditors (including ARCs and NBFCs) can elect to receive proceeds in liquidation (by relinquishing their interest to the liquidation estate) or stand outside this by informing the liquidator and directly enforcing their security interests. Therefore, SARFAESI may play a role in enforcement in this regard.

Will the Bankruptcy Code weaken the attraction of ARCs and NBFCs?
Although, ARCs and NBFCs still hold other advantages for investors (for example, by providing access to distressed debt in India), their attractiveness may be affected by the Bankruptcy Code, once it comes into force and once the institutions and professional bodies that it contemplates come into existence.

In order for ARCs and NBFCs to be able to utilise their SARFAESI rights, they will need to have initiated and completed their SARFAESI sales prior the occurrence of an insolvency trigger (non-payment of debts when they are due and payable). ARCs and NBFCs are only permitted to enforce after the debt has defaulted by certain periods and after then have given the borrower certain further notice periods. In practice the company is almost inevitably likely to be insolvent by the time they are able to exercise their rights, which will dilute the value of their SARFAESI rights.

This dynamic should, in practice, encourage investors to invest in distressed debt through the qualifying permitted debt instruments (which also benefit from SARFAESI), because the event of default in these cases does not need to be tied to the debt being "non-performing" (i.e. having been significantly overdue).

However, it remains to be seen as to how this dynamic plays out in practice, particularly still the institutions and eco-system needed to make the Bankruptcy Code a success will undoubtedly take time to evolve. During this interim period, SARFAESI will continue to be a useful tool.

Alternative Investment Funds

Background
Other than ARCs and NBFCs, some investors have also considered the use of "alternative investment fund" ("AIF") registrations to establish their credit platforms in India. An AIF is a fund pooling vehicle that is incorporated or established in India and is registered with SEBI. AIFs can receive investment from investors both inside and outside India. There are different categories of AIF registrations which are subject to different investment restrictions, but "Category II" AIFs are permitted to make debt investments and hence this provides another route for international investors to access debt capital issued by Indian companies.

Pros and cons
However, AIFs do not benefit from any special enforcement treatment. Also there are restrictions on the ability of Category II AIFs to leverage themselves and so such AIF vehicles do have their limitations. But provided they are properly structured, as the law currently stands, Category I and II AIFs do benefit from tax pass-through treatment and this has been one of their attractions.

Some Closing Thoughts

There is no doubt that debt aggregation vehicles do offer a number of advantages for investors seeking to engage in a long term basis in the distressed debt market in India, particularly in an enforcement scenario. It is also clear that ARCS currently offer a greater range of benefits than NBFCs in this regard.

However, given the time and cost of setting up and ARC and the ongoing regulatory requirements, the bigger question that an international investor will need to ask is what its investment objectives are entering India and whether an ARC will help achieve those objectives, given the investor's preferred modus operandi. These structures will be useful to investors who have the ability to undertake restructurings of the borrower. In the Indian context, that will require the cooperation of the controlling shareholder of the borrower and its management (and in context of corporate India, non-controlled companies are relatively rare).

Also, debt aggregation vehicles mitigate but do not fully eliminate the emerging market risk with regard to enforcement. Whilst in theory SARFAESI (particularly as amended in 2016) offers enhanced security enforcement mechanisms, lenders have historically had mixed success in implementing these provisions successfully and there have been some unhelpful judgments in this regard (for instance, the case of Blue Coast Hotels Limited v. IFCI Limited, dated 23 March 2016, where the court annulled a security enforcement sale under SARFAESI). Therefore, investors will need to bear in mind that "enhanced enforcement rights" do not guarantee a successful outcome. In addition, when the Bankruptcy Code comes into force, it will impose a moratorium on SARFAESI enforcement rights in favour of a collective insolvency process. Therefore, any SARFAESI rights will need to be enforced and security realised ahead of the insolvency trigger under the Bankruptcy Code. This may be difficult to achieve in practice and this may weaken some of the appeal of debt aggregation vehicles. However, it may be some time before the institutions and professions needed for the proper functioning of the Bankruptcy Code are in existence and before the market develops confidence in them. Until then the SARFAESI advantages will remain intact.

With those caveats, for an investor willing to engage with distressed companies and their management in India and willing to take on emerging market risk, ARCs offer a number of positives. ■

1. This is a recently introduced requirement (August 2016) and the RBI has not yet published guidelines on this requirement. Until then, in practice, parties seeking a registration should be guided by the guidance that the RBI has published in the context of other financial institutions. For example, in the context of non-banking finance companies, the RBI in relation to the *"fit and proper"* test for management, the RBI considers the qualifications of management, their technical expertise, track record, integrity and factors of this nature.
2. Any interest and redemption amounts will be taxed as income in the hands of the holder. The applicable tax rate depends on a number of factors. Qualifying NCDs currently benefit from a withholding rate of only 5% until 30 June 2017 (unless extended by law). For other debt instruments, if the debt is structured through a Mauritian holder, it will benefit from a withholding of 7.5% (provided the holder has substance in Mauritius and provided the other requirements of the Indo-Mauritius tax treaty are satisfied). Other jurisdictions such as Luxembourg and Netherlands are sometimes also used to structure debt investment as they also have tax treaty provisions that parties can utilise. However, the default rate on interest on rupee debt in the purely domestic context is 40%.
3. The regulatory definition covers financial institutions (which is itself defined and includes certain defined public institutions, the International Finance Corporation, debenture trustees for secured debt securities, asset reconstruction companies and, following certain recent amendments, non-banking finance companies with assets over INR 5 billion (and where the secured payment exceeds INR 10 million)), insurance companies, banks, state finance corporations, state industrial development corporations and the trustee of an RBI registered asset management company.
4. These enhanced provisioning requirements currently apply when the bank holds 50% of a tranche of security receipts relating to any debt sold to a Security Trust, but from 1 April 2018 the holding of just 10% of the security receipts by the selling bank or financial institution will trigger this enhanced provisioning.

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