

20

Securitisation in Thailand

Stephen Bennett

Hunton & Williams (Thailand) Limited

In Thailand, transactions that could be characterised as securitisations have been implemented under both the general law (but structured as secured loans) and the Emergency Decree on Special Purpose Juristic Persons for Securitisation (the SPV Act).

However, progress has been slow under both laws, with only a handful of completed transactions. Since the enactment of the SPV Act in 1997 approximately eight securitisations have been implemented under it:

- two securitisations of residential hire purchase receivables originated by the National Housing Authority;
- a securitisation of mortgage receivables by the Secondary Mortgage Corporation;
- a securitisation of consumer credit hire purchase receivables by AEON Thana Sinsap PLC in 2003 and 2006;
- a securitisation of lease receivables by Scandinavian Leasing PLC;
- a securitisation of credit card receivables by AEON in 2005; and
- a securitisation of motor vehicle hire purchase receivables originated by Siam Industrial Credit PLC.

In 2005 the Thai government, through DAD SPV Company Limited, initiated a securitisation of lease and fee receivables under a 30-year lease relating to the government's new Chaeng Wattana central office, the first transaction of its type in Thailand. The Chaeng Wattana project included a shelf registration of up to Bt24 billion of debentures over three years, the proceeds of which will finance the development and construction of the central office facilities.

Even fewer securitisations have occurred under the general law in recent years. Lehman Brothers launched GT Stars 1 and GT Stars 2 in May 1999 and July 2002 respectively, each of which was established to undertake limited recourse repackaging of residential mortgage receivables through a special purpose company utilising a secured loan structure.

Recent improvements in the tax regime applicable to securitisations implemented under the SPV Act have resulted in an increase in the number of planned securitisations, owing to significant legal, tax and other disparities between securitisations implemented under the SPV Act and those under the general law.

The small number of completed deals to date is largely attributable to delays by the relevant authorities in removing the negative Thai tax implications arising from securitisations. With the government intending to finance the Chaeng Wattana project through the securitisation of lease and fee receivables and intending to use similar capital markets tools to pay for other future government infrastructure projects, there has been a new impetus to remove these remaining legal and tax barriers, which have inhibited the development of the Thai securitisation market.

In order to eliminate the legal obstacles limiting the development of a robust Thai securitisation market, the Office of the Thai Securities and Exchange Commission (SEC) has proposed amending the SPV Act as well as regulatory interpretations or granting waivers favouring a securitisation-friendly environment. At the time of writing, the proposed amendments to the SPV Act have not yet been implemented. Prior to the launch of the Chaeng Wattana project, the SEC made significant changes to its securitisation regulations, the implementation of which will afford substantial benefits for this project and other, similar securitisations. This chapter considers the significant issues arising from securitisations under the general law and the SPV Act.

Obstacles under the general law

Securitisations under the general law have been structured as secured loans for tax purposes and are fraught with difficulties.

Interest limitation

An SPV is incorporated as an ordinary limited company under the Civil and Commercial Code. In the absence of special legislation such as the SPV Act, a limited company, including an SPV, is prohibited under Thai law from charging interest at more than 15 per cent per year (unlike a bank or financial institution).

Finance company/mortgage lending business

It is arguable that an SPV engaged in the securitisation of mortgage loans is carrying on a finance or mortgage-lending business, which requires a licence from the Ministry of Finance. Although it may be possible to argue that the mere acceptance of a transfer of mortgage loans should not constitute carrying on a finance or mortgage-lending business, approval from the Ministry of Finance may be required if, upon the originator's insolvency, the SPV is to become the registered mortgagee under the relevant securitised mortgages.

Transfer of claims

In a rated transaction, Thai rating agencies have insisted that the documentation provides that the receivables will not be treated as part of the originator's estate upon its bankruptcy, without any further action required on the part of the originator at or around the time of its insolvency.

Under Section 306 of the code the transfer of an obligation for payment to a specific creditor is invalid unless it is made in writing and is valid against the debtor and third parties only if notice has been given to the debtor or if the debtor has consented to the transfer. Therefore, notice must be given to the debtor or consent obtained from it in order for the receivable not to form part of the estate of the originator upon its bankruptcy.

Given the large number of receivables in the completed deals to date, obtaining debtor consent has not been practical. In addition, under Thai law there is doubt as to whether a blanket consent to assignment obtained from the debtor in the underlying mortgage, hire purchase agreement or other document will work for these purposes.

Other points to consider in relation to notices of assignment are as follows:

- If a debtor is not given notice, payment to the originator as creditor will discharge the debtor;
- A debtor may assert any right of set-off that may have accrued before it receives such notice (Section 308 of the code). If a debtor consents to an assignment 'without reservation', the SPV takes it free of all claims (including any claim of set-off) that the debtor may have had against the originator;
- For transfers competing in priority, the first transfer notified to or agreed to by the debtor will be preferred (Section 307 of the code);
- In the case of mortgage receivables, no separate transfer is necessary for the transfer of the rights under the mortgage as they pass to the transferee of the claim (Section 305 of the code); and
- Notice should be by registered mail and there is no need to give notice through a court official.

It has been argued that under Section 746 of the code, an assignment constitutes an 'agreement modifying the mortgage' and must be registered at the Land Department to be valid against a third party. In this respect, the relationship between Section 746 and Section 305 of the code remains unclear. The Land Department appears to take the view that it is necessary to re-register the mortgage, even though Section 305 supports a contrary conclusion. On any such re-registration, a registration fee of 1 per cent would be payable on the amount secured by the mortgage.

In the absence of specific law, it is generally accepted that under Thai general law it is not presently possible to assign future receivables (eg, receivables where there is no existing claim or right to receive the same). However, the SEC has taken recent action to allow certain future flow securitisations.

Commingling

Other than in specific circumstances, Thailand has no equivalent of trust law. Accordingly, if an originator

continues to administer the portfolio of receivables and debtors continue to pay to a general account of the originator which is used by the originator to receive other amounts due to the originator, concerns arise under Thai law as to whether amounts representing the assigned receivables which are commingled with amounts belonging to the originator and are in such general account form part of the estate of the originator in the event of its insolvency.

In such circumstances, it is possible that the SPV may not be entitled to take the funds representing the assigned receivables, but will have to claim as an unsecured creditor in the bankruptcy of the originator, as under Thai law the originator cannot declare a trust over the amount standing to the credit of the account representing collections of the assigned receivables.

One way around this issue is to give notice of the assignment (thus severing the property from the originator's estate) and to direct payments away from the originator's control. Where this is impossible, it is prudent to direct that the assigned receivables are deposited into a specific or designated single purpose account of the originator.

The next issue that arises under Thai law is whether security can be created over this account. It is possible to assign a claim to a bank account under Section 306 of the code by giving notice to the account bank. However, there is some doubt as to whether this will cover a fluctuating account balance. Pledges over bank accounts are also possible under Thai law, but in light of recent Supreme Court decisions there are serious doubts over the enforceability of such pledges. Moves are afoot to bring about legislative change that would enable effective security interests to be created over bank accounts, but any such changes are likely to take some time to implement.

Given these uncertainties, securitisation structures in Thailand incorporate regular sweeps from the originator's account into the SPV's account.

Originator's insolvency

As with most jurisdictions, Thailand has detailed laws for setting aside transactions entered into by an

insolvent person shortly before their insolvency. These are contained principally in Sections 90/40 and 90/41 (which apply in relation to reorganisations) and 113, 114 and 115 (which apply in relation to bankruptcies) of the Bankruptcy Act. For practical purposes, Sections 90/40, 113 and 114, and Sections 90/41 and 115, have the same effect.

Broadly, Sections 90/40 and 113 state that the relevant insolvency official can apply to a court to set aside transactions that are prejudicial to creditors for the purposes of Section 237 of the code. A transaction falls within the scope of Section 237 if it is prejudicial to the creditors of the person entering into the transaction and the person enriched by the transaction knew it was prejudicial.

Based on court decisions, a transaction is considered prejudicial to creditors if it is entered into while the party is insolvent or if the transaction would make it insolvent. Insolvency under Thai law is determined using a balance sheet test - if the originator's assets exceed its liabilities at a time, the originator would not be considered 'insolvent' for bankruptcy purposes in relation to transactions occurring at that time.

In addition to actual knowledge that a transaction was prejudicial, the relevant counterparty will be presumed to know a transaction was prejudicial to creditors of the other party if:

- it was entered into within one year prior to the date of the bankruptcy or reorganisation application; and
- the counterparty received value of less than a reasonable amount.

Even where presumptive knowledge can be shown, it is still necessary to establish that the transferor was insolvent.

Sections 90/41 and 115 provide that in respect of any transfers of property or any acts done by a debtor or permitted to be done during the three months prior to any bankruptcy or reorganisation application (and afterwards), with the intention of giving undue

preference to a creditor, a court is empowered to cancel any such transfer or act on the application of the relevant insolvency official.

Although these sections are unlikely to apply to the initial transfer of receivables to the SPV, as generally at that time the SPV is not a creditor of the originator, they may affect subsequent transfers or acts. Such subsequent acts may include subsequent transfers by the originator of a series (or top-ups) during a revolving period.

Taxation under the general law

Both value added tax (VAT) and specific business tax may be relevant to the transfer of assets to an SPV under the general law.

VAT

Under Thai law VAT is imposed on the sale of goods and the provision of services. The seller collects the VAT by adding it to the purchase price and subsequently accounting for it to the Revenue Department. Where VAT applies, it is imposed at a rate of 7 per cent. For this purpose 'goods' are widely defined as "corporeal or incorporeal objects susceptible of having value and being appropriated, whether for sale, use or for any purpose, and includes everything imported". This definition is broad enough to apply to the transfer of assets or claims to an SPV in the context of a securitisation.

The Thai VAT system operates as a system of inputs and outputs for businesses that are within the system. If the input tax charged to a business registered for VAT exceeds the output tax charged by the business to its customers, the excess can be recovered from the Revenue Department. Unfortunately, it is unlikely that an SPV can be registered for VAT purposes so as to be in the system. Thus, the SPV's output VAT could not be offset with input VAT charged to it (as it would not be authorized to charge VAT on its output) or recovered from the Revenue Department. This represents a real cost or leakage.

To avoid the VAT cost, securitisations under the general law have taken the form of secured loans. A different VAT analysis has been applied by the Revenue

Department to an assignment or transfer where such assignment or transfer is made as security for the repayment of a loan (as was the case in the GT Stars 1 and GT Stars 2 transactions). In such circumstances, VAT is not levied at the time of such transfer, but there are obvious adverse implications for the balance sheet treatment of the transaction, as it will be treated as being on balance sheet for the originator (as borrower), even if the loan is limited recourse to the securitised assets.

Specific business tax

Certain businesses are subject to specific business tax rather than VAT. These businesses include commercial banks, finance companies and businesses with transactions similar to those in commercial banking. Specific business tax is generally charged at the rate of 3 per cent (in some cases associated municipal taxes make the effective rate 3.3 per cent) and is charged on interest, discounts, fees or gross profits from the purchase or sale of, or obtained from, negotiable instruments or documents of indebtedness.

In the case of the sale of receivables that are or have been subject to specific business tax (eg, loans), no specific business tax will be charged on the aggregate consideration paid for the securitised loans.

Registration fees

There are re-registration fees on the transfer of mortgages.

VAT on servicing fees and other fees and costs

Any fee charged to the SPV (eg, fees for loan administration, servicing, risk management transactions, accounting, audit or ratings provision) attracts VAT at the current rate of 7 per cent. As the SPV will not be registered for VAT purposes and thus is unable to offset output VAT collections or otherwise recover input VAT, it will not be able to recover that output VAT in full. It could treat the VAT amount as a fully deductible expense.

Withholding taxes

Interest paid by an SPV is subject to withholding tax at 15 per cent if paid to a Thai individual or 1 per cent if paid

to a Thai corporate entity. Interest paid to non-residents is subject to withholding tax at 15 per cent, which may be reduced to 10 per cent if the recipient is a financial institution and can take advantage of a double tax treaty.

Dividends declared and paid by an SPV are generally subject to a 10 per cent withholding tax. However, dividends paid to a Thai company listed on the Stock Exchange of Thailand or another company which holds 25 per cent or more of the shares of the company paying such dividends (where the recipient company does not have any cross-shareholding in the company paying such dividends) are exempt from withholding tax on dividends.

Benefits of the SPV Act

The SPV Act provides a range of benefits to securitisation transactions approved by the SEC compared to those implemented under the general law. The SPV Act applies to 'securitisations', which are defined as the receipt and transfer of assets and the issuance of securities for sale to investors. Only an outright sale of receivables falls within the ambit of the SPV Act. The SEC's current policy is that a transfer by way of security for repayment of a loan does not fall within the meaning of 'securitisation' under the SPV Act.

Assets that may be securitised under the SPV Act must be rights of claim or other rights that generate a flow of receipts into the future. Underlying assets (eg, vehicles under hire-purchase leases) are not included.

Both SPVs and originators can be private or public companies. An SPV can also be a mutual fund, although the SEC's policy is to refuse approval for a securitisation where the SPV is a mutual fund as mutual funds have particularly favourable tax advantages over private and public companies.

Legal solutions provided by the SPV Act

Under the SPV Act:

- an SPV is not regarded as carrying on a finance or mortgage-lending business, which requires a licence from the Ministry of Finance;

- no re-registration fees are payable on the transfer of mortgages to an SPV;
- if the originator acts as collecting agent, there is no need to give any notice of transfer to the debtors in order to perfect the transfer;
- an SPV may charge interest on the same basis as the originator, meaning that if the originator is a bank or financial institution the SPV will not be subject to the maximum ceiling rate of 15 per cent per year imposed under the code; and
- senior debenture holders have a preferential right to the securitised assets above other creditors of the SPV and, upon liquidation of the SPV, are treated as secured creditors.

The preferential right created under the SPV Act in favour of senior debenture holders does not extend to the back-up servicer, swap counterparties, credit enhancers, liquidity providers or other service providers, which would normally expect to rank ahead of the debt holders in an SPV insolvency. As a result, Thai rating agencies will commonly require that debenture holders waive such preferential rights and approve a cash-flow application provision that ensures that these other creditors are not disincentivised from participating in the transaction. However, the SEC has not yet made it clear whether it requires debentures that include such cash-flow application provisions by-passing the preferential right to be specified and qualified as 'subordinated debentures'.

The provisions of the SPV Act relating to originator insolvency do not satisfactorily address these issues and revisions are expected.

Tax treatment fixes of the Revenue Department

The SPV Act does not address or deal with tax issues. However, subsequent Revenue Department decrees have:

- exempted asset transfers under the SPV Act from VAT and specific business tax and from certain stamp duties; and
- afforded SPVs special tax treatment on bad debts of the SPV for corporate income tax purposes.

Pursuant to Revenue Department Decree 441 (November 11 2005) and Notification of the Governor of the Revenue Department 152 (March 6 2006) an SPV is exempt from corporate income tax for income derived from a securitisation programme approved by the SEC if it complies with the requirements regarding the revenue-flow allocation as specified by the SEC and it undertakes not to pay any dividend to its shareholders.

However, there is still no exemption from VAT on servicing fees for securitisations under the SPV Act.

Recent securities regulation solutions

In October 2005 the SEC implemented major changes in its securitisation regulations relating to debentures to be issued and offered under securitisation programmes. Further changes were made in November 2006 (Notification of the Office of the SEC Kor Yor 31/2549 re: Applying for Approval and Granting of Approval for Offering for Sale Newly Issued Debt Instruments, November 15 2006, effective from January 1 2007). Following the changes criteria similar to those applicable to a traditional debenture offering are now applied to the offering of securitisation-related debentures. However, it is debatable whether these new securitisation regulations will improve the ease of securitisation transactions.

Public offering of securitisation-related debentures

Before October 2005 debentures issued under securitisation programmes could be offered only on a private placement basis. For securitisations of mortgage receivables undertaken by the National Housing Authority, a multi-tier SPV structure was employed to allow general investors to invest in securitised debt instruments. This increased the overall transaction cost unnecessarily and resulted in a far more complicated transaction structure. Since the changes, an SPV can offer debentures secured by securitised receivables to the public. The Chaeng Wattana project was the first straight public offering of securitisation-related debt securities in Thailand.

Future flow securitisation

Before and during the pre-implementation stage of the Chaeng Wattana project, it was uncertain whether the SEC could approve a securitisation of rights to receive lease or fee payments in respect of buildings that had not yet been constructed. The SEC regulations now expressly allow the securitisation of future receivables.

The new developments also allow existing receivables whose payment may be subject to certain conditions to be securitised under the notification. This immediately expands the range of assets to be securitised and may increase the scope (and enhance the sophistication) of Thai securitisation deals in the future.

Specific requirements for offering of debentures to be issued under a securitisation outside the SPV Act

Before October 2005 debentures issued to finance a securitisation under the general law were issued and offered under the legal framework applicable to traditional corporate debentures. The SEC subsequently determined that the general legal framework did not adequately protect investors and therefore stipulated additional requirements in relation to issues under the general law, in both October 2005 and November 2006 pursuant to the notification. These amendments focused on:

- the qualifications of the originator;
- the qualifications of the overall programme, the underlying receivables, the debentures and the investment criteria;
- the qualifications of the offering; and
- new requirements relating to the terms and conditions and servicing of the securitised obligations.

These requirements restrict debenture issues to finance securitisations under the general law and further compound the obstacles to general law securitisations.

Shelf registrations

Without reference to the SEC on a case-by-case basis, debentures can be offered in more than one tranche at the same time or using multiple issuances over time.

Criteria for a transaction to qualify under the SPV Act

To be entitled to the benefits provided by the SPV Act, an SPV must:

- have objectives specifically limited to the securitisation business;
- be bound to apply the proceeds derived from the sale of debentures to purchase the relevant assets sold to it by the originator; and
- have established requirements relating to the application of income on the securitised receivables to debt service and payment of relevant expenses during the programme period.

These requirements are in addition to those set out in the SPV Act and other sections of the notification.

Procedures for offering securitisation-related debentures to foreign investors

Under the notification the SEC set out the following requirements for its approval of an offshore offering of Thai securitisation-related debentures:

- The debentures must be denominated in a foreign currency;
- The debentures must be offered entirely to investors outside Thailand; and
- The debenture holders' representative or trustee must be approved by the SEC.

The Trust for Transactions in Capital Market

The Trust for Transactions in Capital Market Act became effective in 2007 and provides means to support:

- the issuance of securities under the Securities and Exchange Act;
- securitisations under the SPV Act; and

- other transactions beneficial to capital market development.

The act will help to reduce the default and bankruptcy risks of securities issuers and other participants, and is an alternative vehicle for facilitating transactions in the capital market.

Under the act a trust is not a legal entity, but rather a legal association of three parties: a settlor, a trustee and a beneficiary. The settlor transfers to or creates real rights or any other rights in the trustee. The trustee is then legally bound to manage such rights for the benefit of the beneficiary, who is the legal owner of the transferred rights. After trust formation, the settlor no longer has any rights or duties, unless stated otherwise in the trust contract. As the legal owner, the beneficiary has the legal right to claim interest from the trust, while the trustee manages the trust for the benefit of the beneficiary with direct responsibility to the beneficiary. In cases where the trustee resigns, becomes insolvent or is dissolved or removed, the trust itself is not affected, but the trustee must be altered.

Outstanding issues and further possible developments

Existing draft SEC proposals address some, but not all, of the concerns with the existing SPV Act and the coming into force of a new secured transactions law. The draft SEC proposals:

- allow securitisations of future receivables by way of secured loans as well as the securitisation of

existing receivables whether by way of an outright sale or a secured loan;

- include provisions to protect the SPV, including its assets, from an insolvency of the originator;
- remove the preferential creditor status and the secured creditor status of the debenture holders under the SPV Act so that the parties can contractually agree the payment priorities among themselves in the terms and conditions for the debentures;
- allow the SPV to be established in the form of a trust; and
- exempt fees for the transfer of the underlying assets to the SPV.

Conclusion

Although all legal obstacles have still not been eliminated, recent SEC regulations have dealt with some of the significant hurdles. The Chaeng Wattana project was a pilot transaction which established that the SEC supports the growth of securitisation in the Thai capital markets. Some major tax barriers have recently been removed (or at least clarified by rulings of the Revenue Department), which has resulted in the first private sector securitisations in Thailand under the SPV Act, with a significant number of other securitisations planned or in the pipeline. Further expected modifications to relevant laws and regulations should improve the conditions for securitisations in Thailand.