



Date: 5<sup>th</sup> July, 2016

To,  
Joint Secretary (SL),  
Lok Sabha Secretariat,  
Room No. 336, Third Floor,  
Parliament House Annexe,  
New Delhi-110001

**Sub: Representation on the amendments to the SARFAESI Act that may impact leasing industry**

Respected Sir,

Asset Finance Association of India (AFAI), an industry body formed with the objective of promoting leasing, factoring and other asset-backed financing entities is an initiative by the Indian Securitisation Foundation (ISF), a non-profit organization incorporated with the cause of promoting capital market instruments in the country. Some of the eminent players of the leasing industry are members to AFAI and are dedicated to the cause of promoting leasing in India. The details of AFAI, its activities and members are provided for in **Annexure I** to this representation.

The purpose of representation herein below is to bring forward the amendments to the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002<sup>1</sup> ('SARFAESI Act') pursuant to the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Bill, 2016<sup>2</sup> (hereinafter referred to as 'Amendment Bill, 2016') which may have a significant impact on the leasing industry.

**Current position under SARFAESI Act**

In case of hire purchase and lease transaction, the procedure for enforcement of security interest given under the SARFAESI Act will not apply pursuant to clause (e) of section 31 of chapter VI of the SARFAESI Act, which provides that the provisions will not apply to conditional sale or lease or hire purchase wherein no security interest has been created. This exclusion was merely to clarify that the scope of SARFAESI Act does not extend to financial transactions like hire purchase and lease as this transaction does not result in the creation of 'security interest'. Section 31 (e) of the SARFAESI Act has been reproduced below:

*“31. Provisions of this Act not to apply in certain cases*

*The provisions of this Act shall not apply to—*

*XX*

---

<sup>1</sup> <http://www.drat.tn.nic.in/Docu/Securitisation-Act.pdf>

<sup>2</sup> [http://164.100.47.4/BillsTexts/LSBillTexts/Asintroduced/144\\_2016\\_LS\\_Eng.pdf](http://164.100.47.4/BillsTexts/LSBillTexts/Asintroduced/144_2016_LS_Eng.pdf) - site last visited on June 28, 2016.



*(e) any conditional sale, hire-purchase or lease or any other contract in which no security interest has been created;*

*XX.”*

## **Proposed changes in the Amendment Bill, 2016**

Sub-clause (xiv) of clause 4 of the Amendment Bill, 2016 provides for amendment to sub-section (zd) of section 2 of the SARFAESI Act as follows:

*"secured creditor" means any bank or financial institution or any consortium or group of banks or financial institutions and includes—*

*(i) XX*

*(ia) a debenture trustee appointed by any company for debt securities;*

*(ii) XX*

*(iv) any bank or financial institution holding any right, title or interest upon any tangible property given on hire or financial lease or conditional sale or under any other contract, which secures the obligation to pay any unpaid portion of the purchase price of the asset or an obligation incurred or any credit provided to enable the borrower to acquire the tangible property; or*

*(v) any bank or financial institution holding any right, title or interest on any intangible asset or licence or assignment of such intangible asset, which secures the obligation to pay any unpaid portion of the purchase price of the intangible asset or an obligation incurred or any credit provided to enable the borrower to acquire the intangible asset or obtain licence of intangible asset;”*

Pursuant to the amendment in the definition, lessors will be covered under the term ‘secured creditor’. The term ‘financial lease’ was neither defined under the SARFAESI Act nor under direct tax laws, in order to ascertain whether a particular lease is an operating lease or a financial lease, one had to refer to the Accounting Standard-19<sup>3</sup> (or Ind AS 17<sup>4</sup>) which provides for 5 tests, for classification of a lease as a financial or operating lease. Clause (ma) of the Amendment Bill, 2016 provides for insertion of new definition i.e. ‘financial lease’. The insertion shall be as follows:

*“(ma) "financial lease" means a lessor's right in a tangible asset, other than a negotiable instrument or negotiable document, under the lease agreement **where lessee, at the expiry of the term of the lease or on payment of agreed residual value of the asset, becomes the owner of the asset.**” (emphasis ours)*

---

<sup>3</sup> [http://www.mca.gov.in/Ministry/notification/pdf/AS\\_19.pdf](http://www.mca.gov.in/Ministry/notification/pdf/AS_19.pdf) - site last visited on June 28, 2016.

<sup>4</sup> [http://www.mca.gov.in/Ministry/pdf/Ind\\_AS17.pdf](http://www.mca.gov.in/Ministry/pdf/Ind_AS17.pdf) - site last visited on June 28, 2016.



## Our Representation

### *Definition of Financial Lease: Departure from Accounting Standard*

In a finance lease, the risk and rewards pertaining to ownership are passed to the lessee. While the legal title of the asset remains with the lessor, the risks and rewards pertaining to ownership are transferred at the very inception.

It is pertinent to note a few things with regard to lease classification and the timing for such classification as specified below:

- a. The lease classification is based on the AS 19 on leases.
- b. Whether a lease will be a financial lease or an operating lease is to be determined at the inception of the lease and not any time during the subsistence of the lease.
- c. The lease classification does not change during the lease term unless the terms and conditions of lease have undergone a change triggering re-classification.
- d. While the risks and rewards pertaining to the assets are passed to the lessee, the lessor continues to be the legal owner of the asset. Hence, the lessor continues to hold the rights of an owner at all times. In case of financial leases, there is a stripping of legal ownership and beneficial ownership and the legal ownership is retained by the lessor.
- e. In case of a financial lease it is not necessary that the lessee has the option to buy end of the term. Typically, even if there is an option to purchase the asset, it would be available to the lessee only after the lease has come to an end, that is to say, after the expiry of the lease term, the parties can enter into any contract including transfer of legal title of the asset.

The definition of financial lease as mentioned in the Amendment Bill, 2016 has a clear departure from the definition provided for in the accounting standards. The definition in Amendment Bill, 2016 has the following features:

- a) Right of lessor in a tangible asset;
- b) Excluding negotiable instrument or document under the lease agreement;
- c) Where the lessee becomes the owner of the asset -
  - a. At the expiry of the term of the lease; OR
  - b. On payment of agreed RV of the asset;

In a lease transaction, irrespective of the classification as financial or operating lease, there may or may not be an option to purchase the asset at the end of the lease term. However, once the lease is terminated, the lessor has the right to do anything with the asset including selling it to the lessee. Lease as a specie of bailment, does not necessarily require the sale of the asset end of the lease term, it is a lessor's prerogative to deal with the asset as it may desire.

In pretext of the above, there seems apparent deficiencies in the definition of financial leases and we will like to point them out below:

- a. The definition of financial lease under the Amendment Bill, 2016 requires the ownership of the asset to get transferred to the lessee end of the lease term or by virtue of payment of agreed residual value.



- i. In case of financial leases, it is not necessary for a lease to result into a sale of the asset to the lessee.
  - ii. There can be several financial leases, outside of the definition provided under the Amendment Bill, 2016 as well.
  - iii. Even in case of operating leases, there could be a transfer of title of the asset to the lessee end of the lease term. The definition does not say that the transfer needs to be an automatic transfer agreed at the time of the entering into the transaction. In several operating lease transactions as well, it is common practice to provide for an option to purchase the asset end of the lease term.
  - iv. It would be inappropriate to relate the transfer of title of the asset by virtue of an option end of the lease term, as the sale happens after the lease expires and is not a natural progression to the lease.
- b. The determinative tests for financial lease are based on transfer of risks and rewards.

Therefore the definition of financial leases should be aligned with the accounting standards to ensure there are no gaps on the coverage.

### ***Possession and ownership rights of the lessor***

Lease is a specie of bailment. Under bailment one of the rights of the bailor is the reversion of the goods at the end of the bailment period. The reversionary right is well imbibed in case of lease transactions as well and is one of the essential components of a lease.

In case of lease transactions, the right of usage of the asset is stripped from the ownership rights and provided to the lessee. The lessee during the lease has the contractual right to unfettered enjoyment of the asset however the reversionary rights in the asset remains with the lessor. Both in case of financial leases and operating leases, the lessor has the legal title to the asset and therefore shall have all such ancillary rights as any owner of an asset may have including right to acquire/ repossess the asset.

All along for last 8 decades, under common law, the right of repossession of the asset lies in the hands of lessor. In *Sardar Trilok Singh and Ors. v. Satya Deo Tripathi*<sup>5</sup>, the Supreme Court held that, “*Even assuming that the appellants either by themselves or in the company of some others went and seized the truck on 30-7-1973 from the house of the respondent they could and did claim to have done so in exercise of their bonafide right of seizing the truck on the respondent’s failure to pay the third monthly instalment in time.*” In the present case, the appellant was a hire vendor, also the legal owner of the asset.

The legal ownership rights of the lessor have also been discussed in various rulings in the past. The issue was discussed in various rulings *Commissioner of Income-Tax vs. A.M. Constructions*<sup>6</sup>; *Commissioner of Income- Tax vs. Bansal Credits Ltd.*<sup>7</sup>; *Commissioner of*

---

<sup>5</sup> AIR (1979) SC 850 Read more at: <https://indiankanoon.org/doc/1271780/> - site last visited on June 29, 2016.

<sup>6</sup> (1999) 238 ITR 775 (AP)

<sup>7</sup> (2003) 259 ITR 69 (Del)



*Income-Tax vs. M.G.F. (India) Ltd.*<sup>8</sup>; *Commissioner of Income-Tax vs. Annamalai Finance Ltd.*<sup>9</sup>], where the lessor is recognized as the legal owner of the asset.

Under common law the rights of the owner of the assets is well recognized and is clearly distinct from the rights of a secured creditor where the asset is held as a security interest. The ownership rights, therefore cannot be equated to be on the same platform as that of the secured creditor.

The Amendment Bill, 2016 includes banks and financial institutions as lessors into the definition of secured creditor. This would be grossly inappropriate under law as ownership rights are different from rights of security interest and the same cannot be put on the same footing. In case of a default in a lease transaction, the right of the lessor to repossess the asset without any intervention of the courts is valid and tenable as against that of a secured creditor who would require legal intervention to enforce the security interest.

The lessor has the right to take back what he owns, whereas the secured creditor merely possess the right to foreclose the asset for the purpose of recovering the amount lent.

The proposed changes in the Amendment Bill, 2016, by placing the lessor on the same platform as a secured creditor dilutes or rather maligns the rights of the lessor as the owner of the asset. Further, the Amendment Bill, 2016 also makes the enforcement process applicable to the lessor, which means in case of a default in a lease, the lessor will be required to follow the provisions of SARFAESI Act before taking over the asset, same as it would be in case of secured creditors.

### ***Intent of Amendment Bill, 2016: CERSAI registration***

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (Central Registry) Amendment Rules, 2016<sup>10</sup> (hereinafter referred to as “Amendment Rules, 2016”) provides for filing of particulars of various transactions with CERSAI in such form and manner as prescribed under the Amendment Rules, 2016. Banks and financial institutions were required to register an equitable mortgage with CERSAI pursuant to section 23, 24 and 25 of the SARFAESI Act read with rule 4 (2) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (Central Registry) Rules, 2011<sup>11</sup>, however, post Amendment Rules, 2016, such banks and financial institutions are also required to register the particulars of transactions mentioned under sub-rule (2A) to (2D) of rule 4.

The third proviso to sub-rule (1) of rule 5 of the Amendment Rules, 2016 requires the secured creditor to file particulars of all transactions with CERSAI. Post Amendment Bill, 2016, even lessors shall be liable to file such particulars with CERSAI.

---

<sup>8</sup> (2006) 285 ITR 142 (Del.)

<sup>9</sup> (2005) 275 ITR 451 (Mad)

<sup>10</sup> <http://egazette.nic.in/WriteReadData/2016/167743.pdf>

<sup>11</sup> [http://egazette.nic.in/WriteReadData/2011/E\\_175\\_2012\\_031.pdf](http://egazette.nic.in/WriteReadData/2011/E_175_2012_031.pdf)



The objective of inclusion of leases in the Amendment Bill, 2016 was to be able to facilitate registration of leased assets under CERSAI. Registration of the leased assets with CERSAI was introduced in the Amendment Bill, 2016 with the objective of making the public at large aware that the asset is acquired on lease and that the leased asset should be kept outside the lessee's estate.

Registration transaction also facilitates recording of the lease volumes.

### ***Impact of the Amendment Bill, 2016***

As discussed above, the inclusion of lessors to the definition of secured creditors has a wider and far reaching impact than was intended in the first place. The provisions of SARFAESI were extended to allow registration of lease transactions.

The proposed insertions were with the limited objective, not with the objective of extending rights of a secured creditor to the lessor. The proposed amendments, if inserted, will frustrate the rights of an owner under common law. Also, it would dilute the very essence and objective of undertaking a lease transaction from the lessor's perspective. Under the gamut of asset-backed lending, lease has been preferred over loan only because the lessor has the retention of legal title otherwise absent in case of a secured loan. By putting the two kinds of financial products on the same pedestal, the very essence of the lease versus loan distinction will get diluted. It was for this very reason that the extant law creates an exception to applicability of SARFAESI Act to lease transactions and hire purchase transactions.

In light of the above, please do consider on limiting the applicability of SARFAESI Act to lease transactions for the purpose of registration with CERSAI and not to the provisions pertaining to enforcement of security interests.

As AFAI is dedicated to the cause of contributing to the development of the leasing sector in particular, in the event of any further clarification needed, we would be happy to provide the same.

*For Asset Finance Association of India*

*Sd/-*

(Nidhi Bothra)



## **Annexure - I**

The Asset Finance Association of India is an initiative by the Indian Securitisation Foundation to bring together the stakeholders of the asset finance sector in India. The organisation is intended to promote, help, develop, protect, encourage and secure, in India, general interest of various forms of asset backed funding by acting as industry association, to organize industry events, forums, discussions to promote research, generally to take care of the interest of trade, industry and commerce, stakeholders, participants and investors in asset finance and generally to act in the best interest of the Indian asset finance sector. Primarily, the asset finance activities to be catered to by the Association include leasing, factoring, trades in receivables, etc.

The Association aims at bringing industry players on a common platform – to join their thoughts, and to provide a voice to their thoughts. The Association aims at providing a strong platform of advocacy for asset finance industry.

Some of the functions of the organisation include:

- **Advocacy:** making representation to various authorities from time to time on matters concerning the following –
  - a. Leasing
  - b. Factoring
  - c. Receivable Financing
  - d. Other forms of asset backed finance.
- **Industry forums and networking:** holding periodic conventions and educational courses.
- **Development of industry standards:** framing self-regulatory standards on disclosures, reporting, servicing reporting, DOs and DONTs for various forms of asset finance.
- **Information exchange:** on matters of common interest, collateral performance etc.

### **AFAI Executive Committee Members**

#### ***1. Ms. Simi Thapar***

Ms. Simi Thapar is a Head - Equipment Leasing and Financing Solutions - Corporate Finance at Tata Capital. Simi has 25 Years Work Experience in Financial Services across diverse industries and diverse asset and product categories. Ground experience in new business initiative, product development and in devising strategy for organic and inorganic growth of business.

#### ***2. Mr. Gautam Munish***

Mr. Gautam Munish, currently serving Hewlett Packard financial services as regional sales director is a seasoned finance professional with 20 years of diverse work



experience across Asset, Liability and Investment products. He has extensive experience in building and managing business from ground up, with exposure to detailed competitive landscape analysis, compliance and regulatory adherence and evangelizing the merits of a differentiated approach to market.

**3. *Mr. Sunil Badala***

Mr. Sunil Badala is a partner with the financial services tax practice of the Indian Firm of KPMG. He specializes both in domestic corporate tax and international tax and entry and exit strategies for multinationals and large domestic companies investing into/ outside India. He has a total of about 18 years of experience, including 14 years with the India Firm and has extensive experience in International and Domestic taxation, Inbound Entry Strategies for Multinationals and Outbound Structuring Strategies for large domestic companies.

**4. *Mr. Shrirang Tambe***

Mr. Shrirang Tambe founder and CEO of ORIGA Leasing one of the first FinTech asset leasing companies for high growth oriented companies with philosophy of access to finance. His expertise lies in advising and nurturing growth oriented companies across financial and strategic areas.

**5. *Ms. Nidhi Bothra***

Ms. Bothra is a consultant on leasing, asset backed lending, securitisation, structured finance and corporate finance and is Executive Vice President in Vinod Kothari Consultants (P) Ltd. Ms. Bothra has conducted various corporate training workshops on leasing, and has handled several consulting assignments on leasing in different markets. Nidhi has analysed state of leasing industry in several countries and writes the report on the state of leasing industry in India for several years now.

**6. *Mr. Dipankar Sen***

A MBA graduate with specialisation in finance, He has over 20 years of experience in leasing and financial services and today heads the leasing portfolio for Orix in India. His experience has been in both fund based and fee based activities where he has managed the SME, Corporate and PSU segments for their leasing requirements in equipments. Under the leasing portfolio in Orix, he today manages the vehicle leasing business where company offers solutions in both dry and wet leases.