

**Bankruptcy Concerns Pertaining to Asset-Back Securities in Sri Lanka:
An Investigation into Asset-Securitization Practices in Sri Lanka**

Senarath S

Department of Economics, University of Colombo

Shanuka.senarath@griffithuni.edu.au

Asset-back securitization is a secondary market financial technique used by banks and similar financial institutions (originators), which involves creation and pooling of categories of assets of many borrowers and a subsequent sale that should make the asset pool 'detached' from its originator and thus can be claimed as 'bankruptcy-remote'. The *Securitization Act 2009* in Sri Lanka was proposed with the view of promoting asset-securitization as a means of developing capital market in Sri Lanka. The objective of this paper is to identify the formalities and lacuna inherent in this Act and market practices in Sri Lanka, which disputes the 'true sale' requirement of the asset securitization process and imposes the risk of been "clawed back" in case of the originator's bankruptcy. Utilizing a lexonomic (economic-analysis-of-law) approach, this paper analyses the *Securitization Act* and current market practices finds that the risk of securitized assets is claimed by creditors of the originator in case of originator's bankruptcy remains in the system. This analysis finds that the additional asset sales to the trust are not protected via the bankruptcy protections provided by the *Securitization Act*, and thus, inherits the risk of being clawed-back. Given the lack of clear-cut definition of a 'true sale' in the *Securitization Act* or in any other related legislation, there is a significant risk that the courts might define transfer of assets as a 'finance agreement' as opposed to a 'true sale'. Among other recommendations to enhance securitization in Sri Lanka, this paper recommends the Central Bank of Sri Lanka reduce risk-weighted capital requirements for securitized assets based on the ratings of the tranches. This will invariably encourage banks to engage in securitization while rewarding them in terms of lighter capital adequacy requirements for issuing notes.

Key words: *Asset-securitization, Bankruptcy, Clawed-back, True sale*