

The Chairman and Managing Director /
Chief Executive Officers
All Scheduled Commercial Banks
(Excluding RRBs and Local Area Banks)

Dear Sir,

**Second Quarter Review of Monetary Policy
for the Year 2009-10 – Securitisation Transactions- Draft Guidelines**

Please refer to paragraph 161 of the Second Quarter Review of the Monetary Policy for the year 2009-10 announced on October 27, 2009 ([copy of the paragraph enclosed](#)), wherein it was proposed to stipulate minimum retention requirement (MRR) and minimum holding period (MHP) for securitisation transactions.

2. Securitisation involves the pooling of assets and the subsequent sale of the cash flows from these asset pools to investors. The securitization market is primarily intended to redistribute the credit risk away from the originators to a wide spectrum of investors who can bear the risk, thus aiding financial stability and to provide an additional source of funding. The recent crisis in the credit markets has called into question the desirability of certain aspects of securitization activity as well as of many elements of the 'originate to distribute' business model, because of their possible influence on originators' incentives and the potential misalignment of interests of the originators and investors. While the securitization framework in India has been reasonably prudent, certain imprudent practices have reportedly developed like origination of loans with the sole intention of immediate securitization and securitization of tranches of project loans even before the total disbursement is complete, thereby passing on the project implementation risk to investors.

3. With a view to developing an orderly and healthy securitization market, to ensure greater alignment of the interests of the originators and the investors, as also to encourage the development of the securitization activity in the country in a manner consistent with the aforesaid objectives, several proposals for post-crisis reform are being considered internationally. Central to this is the idea that originators should

retain a portion of each securitization originated, as a mechanism to better align incentives and ensure more effective screening of loans. In addition, a minimum period of retention of loans prior to securitization is also considered desirable, to give comfort to the investors regarding the due diligence exercised by the originator.

4. Keeping in view the above objectives and the international work under progress on these accounts, the following guidelines have been formulated regarding the Minimum Holding Period and Minimum Retention Requirement:

4.1 Minimum Holding Period (MHP)

	MHP of the loans
Upto 24 months	<p>(i) (a) In the case of loans with periodic repayment schedules, the MHP would be nine months from</p> <ul style="list-style-type: none"> • date of full disbursement of loans for an activity/purpose; date of acquisition of asset by the borrower (i.e car, residential house, etc.); date of completion of project; as the case may be <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> • date of first instalment of interest/principal/EMI which is due <p style="text-align: center;">whichever is later</p> <p>(b) In case of bullet repayment loans, twelve months from the relevant dates specified in (i) (a) above.</p>
More than 24 months	<p>(a) In the case of loans with periodic repayment schedules, the MHP would be twelve months from</p> <ul style="list-style-type: none"> • date of full disbursement of loans for an activity/purpose; date of acquisition of asset by the borrower (i.e car, residential house, etc.); date of completion of project; as the case may be <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> • date of first instalment of interest/principal/EMI which is due <p style="text-align: center;">whichever is later</p> <p>(b) No securitisation of loans with maturity exceeding 24 months and bullet repayment is envisaged.</p>

4.2 Minimum Retention Requirement (MRR)

Type of loan	MRR		Description of MRR	
Loans with original maturity of 24 months or less	5% of the book value of the loans being securitised	(i)	Where the securitisation involves neither tranching nor any credit enhancement	Investment in the securities issued by the SPV equal to 5% of the book value of the loans being securitised.
		(ii)	Where the securitisation involves tranching	Investment in the equity tranche issued by the SPV equal to 5 % of the book value of the loans being securitised.
		(iii)	Where the securitisation involves no tranching, but involves first loss credit enhancements e.g. off-balance sheet supports, cash collaterals, overcollateralization etc.	Exposure to first loss position through any of the stated credit enhancements equal to 5% of the book value of the loans being securitised.
		(iv)	Where the securitisation involves tranching as well as the first loss credit enhancements (off-balance sheet supports, cash collaterals, overcollateralization etc.)	Exposure to equity tranche or first loss position in other forms as stated equal to 5% of the book value of the loans being securitised.
Loans with original maturity of above 24 months	10% of the book value of the loans being securitised	(v)	Where the securitisation involves neither tranching nor any credit enhancement	Investment in the securities issued by the SPV equal to 10% of the book value of the loans being securitised.
		(vi)	Where the securitisation involves tranching	Investment in equity tranche of minimum 5% of the book value of the loans being securitised and the balance as pari-passu investment in all the remaining tranches of securities issued by the SPV.
		(vii)	Where the securitisation involves no tranching, but involves first loss credit enhancements e.g. off-balance sheet supports, cash collaterals, overcollateralization etc.	<ul style="list-style-type: none"> Exposure to first loss position through any of the stated credit enhancements of minimum 5% of the book value of the loans being securitised and the balance as pari-passu investment in all the securities issued by the SPV.
		(viii)	Where the securitisation	Exposure to equity

			involves tranching as well as the first loss credit enhancements (off-balance sheet supports, cash collaterals, overcollateralization etc.)	tranche or first loss position in other forms as stated equal to minimum 5% of the book value of the loans being securitised and the balance as pari-passu investment in all the remaining tranches (other than equity) of securities.
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5. Limit on total exposure to SPV and/or underlying assets

5.1 At present, total investment by the originator (including its group entities) in the securities issued by the SPV (PTCs) through underwriting or otherwise is limited to 20% of the total PTCs issued. Credit enhancement, liquidity support, and counterparty credit exposures in the case of interest rate swaps/currency swaps with the SPV are outside this limit. However, under the Basel II requirements, there should be a transfer of a significant credit risk associated with the securitised exposures to the third parties for recognition of risk transfer. In view of this, the total exposure of banks to the SPV and/or securitised assets in the following forms should not exceed **20%**, for securitisation transactions undertaken after date of this circular.

- Investments in equity/subordinate/senior tranches of securities issued by the SPV including through underwriting commitments.
- Credit enhancements including cash and other forms of collaterals including over-collateralisation
- Liquidity support

If a bank exceeds the above limit due to devolvement of underwritten securities, the excess amount would be deducted from capital (50% from Tier I and 50% from Tier II).

5.2 Credit Exposure on account of interest rate swaps/currency swaps will be excluded as these would not be within the control of the bank.

6. Hedging of Minimum Risk Retention not permitted

Banks should not hedge the credit risk in the retained exposures counting towards the minimum retention requirements.

7. Securitisation Activities/Exposures not Permitted in India

It is clarified that the banks in India are not permitted to undertake the securitisation activities or assume securitisation exposures as mentioned in paras 7.1 to 7.3 below.

7.1 Re-securitisation of Assets

A re-securitisation exposure is a securitisation exposure in which the risk associated with an underlying pool of exposures is tranching and at least one of the underlying exposures is a securitisation exposure. In addition, an exposure to one or more re-securitisation exposures is a re-securitisation exposure. This definition of re-securitised exposure will capture collateralised debt obligations (CDOs) of asset backed securities, including, for example, a CDO backed by residential mortgage-backed securities (RMBS).

7.2 Synthetic Securitisations

A *synthetic securitisation* is a structure with at least two different stratified risk positions or tranches that reflect different degrees of credit risk where credit risk of an underlying pool of exposures is transferred, in whole or in part, through the use of funded (e.g. credit-linked notes) or unfunded (e.g. credit default swaps) credit derivatives or guarantees that serve to hedge the credit risk of the portfolio. Accordingly, the investors' potential risk is dependent upon the performance of the underlying pool.

7.3 Securitisation with Revolving Structures (with or without early amortisation features)

These involve exposures where the borrower is permitted to vary the drawn amount and repayments within an agreed limit under a line of credit (e.g. credit card receivables and cash credit facilities). Typically, revolving structures will have non-

amortising assets such as credit card receivables, trade receivables, dealer floor-plan loans and some leases would support non-amortising structures, unless these are designed to include early amortization features. Early amortisation means repayment of securities before their normal contractual maturity. At the time of early amortisation there are three potential amortisation mechanics: (i) Controlled amortisation; (ii) Rapid or non-controlled amortisation; and (iii) Controlled followed by a subsequent (after the completion of the controlled period) non-controlled amortisation phase.

8. All other guidelines on securitisation of assets contained to our Master Circular on New capital Adequacy Framework dated February 8, 2010 including that in Annex 7 of the circular remain unchanged.

Yours faithfully,

(B. Mahapatra)
Chief General Manager