Guidelines on declaration of Net Asset Value of Security Receipts issued by Securitisation Company/ Reconstruction Company

Issue of Security Receipts under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act)

1. Sections 7 (1) & (2) of the SARFAESI Act provide for issue of Security Receipts after acquisition of any financial asset under sub-section (1) of section 5 to qualified institutional buyers (QIBs) and raising of funds from the qualified institutional buyers by formulating schemes for acquiring financial assets. The scheme for the purpose of offering Security Receipts under sub-section (1) or raising funds under sub-section (2) of Section 7 of the SARFAESI Act may be in the nature of a trust to be managed by the Securitisation Company or Reconstruction Company (SC/RC).

(i) The trusts shall issue Security Receipts only to QIBs; and hold and administer the financial assets for the benefit of the QIBs;
(ii) The trusteeship of such trusts shall vest with the SC/RC;
(iii) A SC or RC proposing to issue SRs, shall, prior to such an issue, formulate a policy, duly approved by the Board of Directors, providing for issue of Security Receipts under each scheme formulated by the trust ;
(iv) The policy referred to in sub-paragraph (iii) above shall provide that the Security Receipts issued would be transferable /assignable only in favour of other QIBs.
(QIBs is defined under Section 2(1)(u) of the SARFAESI Act).

Special features of SRs

2. The SRs issued by SCs/RCs are predominantly backed by impaired assets. These SRs have the following unique features as compared to other type of securities issued on securitization of normal assets.
a) SRs cannot be strictly characterized as debt instruments since they combine the features of both equity and debt. However, these are recognized as securities under Securities Contracts (Regulation) Act, 1956.
b) The cash flows from the underlying assets cannot be predicted in terms of value and intervals.
c) The investment in SRs is restricted to QIBs only.
d) These instruments when rated would generally be below investment grade. These instruments are generally privately placed and presently not listed.
e) In the event of non-realisation of the financial assets, the SR holders representing 75% of the total value of SRs issued by the SC/RC can call for a meeting of all the SR holders in a particular scheme and every resolution passed in such meeting shall be binding on the SC/RC.

3. Objective of the Guidelines

The objective of these guidelines is to enable Securitisation Company/Reconstruction Company (SC/RC) registered with the Reserve Bank under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) to declare NAV of the Security Receipts (SRs) so that the Qualified Institutional Buyers (QIBs) can value their investment in SRs issued by the SC/RC in accordance with applicable guidelines. For the purpose of arriving at NAV, the SRs should be rated as rating is an important objective tool.

Rating by Credit Rating Agencies

4. Rating should be obtained from SEBI registered Rating Agencies to begin with. The SC/RC should supply the necessary information to rating agencies. Commonality and conflict of interest if any, between the SC/RC and Rating Agency should be disclosed.

Rating/Grading

5 (a) The rating/ grading should be based on `recovery risk' as against `default' which is the basis for rating assignments in normal assets, i.e. how much more can be recovered instead of timely payment. Rating should reflect present value of the anticipated recoverability of future cash flows.

(b) The ratings will be assigned on a new, specifically developed rating scale called "Recovery Rating (RR) scale". Each rating category in the recovery scale will have an associate range of recovery, expressed in percentage terms, which can be used for arriving at NAV of SRs. Symbols should be assigned by rating agencies to the associated range of recovery, which would inter-se not deviate by a specified percentage points, say (+/ -) 10%. The rating would be indicative.

(c) The Recovery Rating should be assessed after factoring in any other relevant obligation and not on the original debt obligation.

(d) The other key factors that should be factored in while assigning Recovery Rating are extent of debt acquired, composition of lenders, collaterals available, security and seniority of debt, individual lender vis-à-vis institutional lender, estimated cash flows, uncertainty in realising expected cash flows in initial period, management, business risk, financial risk, etc.

(e) The Recovery Rating should reflect changes like change in resolution strategy of the SC/RC that take place from time to time.

(f) The Recovery Rating will factor in likely cash flows from the underlying impaired assets till the maturity of the SRs.

(g) The Recovery Rating should comprise of rating of not only the SRs of the scheme as a whole but wherever feasible a desegregation of each component in the scheme, which means the underlying assets of each entity in the scheme forming the basket should also be rated.

(h) The Rating agency should disclose the rationale for rating on request.

Methodology for valuation of SRs for declaration of NAV

5. Each rating category in the recovery scale will have an associate **range** of recovery, expressed in percentage terms, which can be used for computing NAV of SRs. The NAV should be restricted within the recovery range associated with the rating assigned to the SRs. The SC/RC based on its recovery experience should choose a particular percentage within the recovery range indicated by the Rating Agency. The Recovery Rating percentage so picked by the SC/RC multiplied by the face value of the SR will give the NAV. The SC/RC should provide the rationale for selection of the particular percentage of Recovery Rating. For example, if range is between 81% - 90%, SC/RC may pick up 87% based on its judgement. The face value of say Rs 10 multiplied by the recovery percentage i.e. 87% would give the NAV as Rs 8.70.

Frequency of rating

6. The initial rating/grading would be assigned within one year from acquisition of assets by SC/RC or finalization of resolution strategy, whichever is earlier. Thereafter, rating/grading shall be reviewed at half-yearly intervals, i.e. as on June 30 and December 31 every year. However, the review would be on a continuous basis so that any further deterioration in the value of SRs is declared immediately for the information of the investors and necessary adjustment in their valuation of the same. The SC/RC should declare NAV within two months from the date of half-yearly review i.e. by August 31 and February 28 respectively.

Disclosure to investors

7. Disclosure to investors of the quality of assets underlying the SRs as per disclosure norms prescribed by the Bank under “The Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003” is a must. Further, investors can request for information at any point of time from the SC/RC and obtain the same.