Brief Summary: Draft Frameworks on 'Securitisation of Standard Assets' and 'Sale of Loan Exposures'

The Reserve Bank had issued Guidelines on Securitisation of Standard Assets (which included direct assignment transactions) vide circular dated February 1, 2006, which were subsequently updated vide circulars dated May 7, 2012 (which introduced the minimum holding period and minimum retention requirement) and July 1, 2013 (which laid down guidelines regarding reset of credit enhancements). Since then, BCBS has issued guidelines on securitisation that have come into force effective January 1, 2018. Securitisation guidelines should also meet the IFRS requirements.

Separately, the Reserve Bank had, in 2019, constituted a Task Force on the Development of Secondary Market for Corporate Loans ("Task Force") and a Committee on Development of Housing Finance Securitisation Market in India ("Committee"). The Task Force and the Committee have made various recommendations relating to the securitisation market in India, including changes to the regulatory framework. A key recommendation of both the Committee as well as the Task Force was to separate the regulatory guidelines for direct assignment transactions from the securitisation guidelines and treat it as a sale of loan exposure.

The above recommendations were duly examined by the Reserve Bank, taking into account the public response received, and it was decided that, apart from reviewing the securitisation guidelines, it may be a good opportunity to comprehensively revisit the guidelines for sale of loan exposures, both standard as well as stressed exposures, which currently are spread across various circulars. These guidelines on sale of loan exposures have been specific to the asset classification of the loan exposure being transferred and / or the nature of the entity to which such loan exposure is being transferred as well as the mode of transfer of the loan exposures. A review was also necessitated by the need to dovetail the guidelines on sale of loan exposures with the Insolvency and Bankruptcy Code, 2016 ('IBC') and the Prudential Framework for Resolution of Stressed Assets issued vide circular DBR.No.BP.BC.45/21.04.048/2018-19 dated June 7, 2019 ("Prudential Framework"), which have been significant developments towards building a robust resolution paradigm in India in the recent past.

Salient Features

The salient features of the draft securitisation guidelines as compared to the existing guidelines are as follows:

(i) Only transactions that result in multiple tranches of securities being issued reflecting different credit risks will be treated as securitisation transactions, and accordingly covered under these guidelines;

(ii) In line with the Basel III guidelines, two capital measurement approaches have been proposed: Securitisation External Ratings Based Approach (SEC-ERBA) and Securitisation Standardised Approach (SEC-SA).

(iii) Further, a special case of securitisation, called Simple, Transparent and Comparable (STC) securitisations, has been prescribed with clearly defined criteria and preferential capital treatment.
(iv) The definition of securitisation has been modified to allow single asset securitisations. Securitisation of exposures purchased from other lenders has been allowed.
(v) Carve outs have been provided for Residential Mortgage Backed Securities (RMBS) in prescriptions regarding MHP, MRR and reset of credit enhancements.
(vi) A quantitative test for significant transfer of credit risk has been prescribed for derecognition for the purpose of capital requirements, independent of the accounting derecognition

The salient features of the draft framework for sale of loans as compared to the existing guidelines are as follows:

(i) Sale of standard assets may be by assignment, novation or a loan participation contract (either funded participation or risk participation) whereas the sale of stressed assets may be by assignment or novation.
(ii) Direct assignment transactions shall be subsumed as a special case of these guidelines.
(iii) Requirement of MRR for sale of loans has been done away with.
(iv) The price discovery process has been deregulated to be as per the lenders' policy.
(v) Stressed assets may be sold to any entity that is permitted to take on loan exposures by its statutory or regulatory framework.
(vi) Some of the existing conditions for sale of NPAs have been rationalised.

Comments and Discussion Questions

The Reserve Bank invites comments on the draft guidelines, particularly on the following discussion questions that cover key elements of the draft frameworks:

I. Discussion Questions on Draft Framework for Securitisation of Standard Assets

(a) Should the two approaches specified for meeting MRR requirements be prescribed as alternatives, or does one approach have a clear advantage over the other? Please support your positions with quantitative estimates, if any.

(b) For investments in securitisation notes, should there be regulatory prescriptions for valuation by the investors to ensure uniform recognition of the notes across all entities? If so, what could be the valuation methodologies that could be prescribed for uniform adoption by all financial entities?

(c) Should the notes issued in a securitisation be mandated to be listed if the issue size is above a certain threshold? What could be the costs and benefits of such mandatory listing? Do you agree with mandatory listing only in respect of RMBS, as

proposed, or should it cover all classes of securitisation notes? Should the issue size of ₹500 crore as the proposed threshold for mandatory listing be reconsidered?

(d) Should SEC-ERBA and SEC-SA approaches be prescribed as alternatives for banks, or should one of the approaches be prescribed as a preferred approached? Are there scenarios or situations in which one approach should be preferred over the other? Please support your positions with quantitative estimates, if any.

(e) Are the level of disclosures mandated in the Annexures 2 and 3 of the draft sufficient? If not, what could be the additional disclosures that could be mandated for the various parties involved in a securitisation transaction?

Discussion Questions on Draft Comprehensive Framework for Sale of Loan Exposures

(a) Do you agree with the proposal to allow any entity permitted to hold loan exposures as per their statutory or regulatory framework to purchase stressed assets from the lending institutions? What additional safeguards may be considered to address the concerns relating to related party transactions?

(b) Do you see any concerns with regard to the legal modes of loan transfer that have been enabled for transfer of loan exposures from the lending institutions?

(c) Do you see any types of assignment transactions permitted under the current guidelines, which may not be possible under the revised guidelines?

(d) Do you agree with the proposal to deregulate the price discovery process in the case of sale of stressed assets, or should the process be still prescribed by RBI as was the case with the Swiss Challenge method prescribed in the extant regulations?

As mentioned in the press release dated June 8, 2020, the comments on the draft frameworks and the responses to the discussion questions, as above, may be submitted to the Reserve Bank by email not later than June 30, 2020.