

Guidelines to banks/ FIs on sale of Financial Assets to Securitisation Company (SC) / Reconstruction Company (RC) (created under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002) and related issues- Annexure

Scope

These guidelines would be applicable to sale of financial assets enumerated in paragraph 3 below, by banks/ FIs, for asset reconstruction/ securitisation under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

Structure

2. The guidelines to be followed by banks/ FIs while selling their financial assets to SC/RC under the Act ibid and investing in bonds/ debentures/ security receipts offered by the SC/RC are given below. The prudential guidelines have been grouped under the following headings:

- i) Financial assets which can be sold.
- ii) Procedure for sale of banks'/ FIs' financial assets to SC/ RC, including valuation and pricing aspects.
- iii) Prudential norms, in the following areas, for banks/ FIs for sale of their financial assets to SC/ RC and for investing in bonds/ debentures/ security receipts and any other securities offered by the SC/RC as compensation consequent upon sale of financial assets:
 - a) Provisioning / Valuation norms
 - b) Capital adequacy norms
 - c) Exposure norms
- iv) Disclosure requirements

Financial assets which can be sold

3. A financial asset may be sold to the SC/RC by any bank/ FI where the asset is:

- i) A NPA, including a non-performing bond/ debenture, and
- ii) A Standard Asset where :
 - (a) the asset is under consortium/ multiple banking arrangements,
 - (b) at least 75% by value of the asset is classified as non-performing asset in the books of other banks/FIs, and
 - (c) at least 75% (by value) of the banks / FIs who are under the consortium / multiple banking arrangements agree to the sale of the asset to SC/RC.

4. Procedure for sale of banks'/ FIs' financial assets to SC/ RC, including valuation and pricing aspects

(a) The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SRFAESI Act) allows acquisition of financial assets by SC/RC from any bank/ FI on such terms and conditions as may be agreed upon between them. This provides for sale of the financial assets on 'without recourse' basis, i.e., with the entire credit risk associated with the financial assets being transferred to SC/ RC, as well as on 'with recourse' basis, i.e., subject to unrealized part of the asset reverting to the seller bank/ FI. Banks/ FIs are, however, directed to ensure that the effect of the sale of the financial assets should be such that the asset is taken off the books of the bank/ FI and after the sale there should not be any known liability devolving on the banks/ FIs.

(b) Banks/ FIs, which propose to sell to SC/RC their financial assets should ensure that the sale is conducted in a prudent manner in accordance with a policy approved by the Board. The Board shall lay down policies and guidelines covering, *inter alia*,

- (i) Financial assets to be sold;
- (ii) Norms and procedure for sale of such financial assets;
- (iii) Valuation procedure to be followed to ensure that the realisable value of financial assets is reasonably estimated;
- (iv) Delegation of powers of various functionaries for taking decision on the sale of the financial assets; etc.

(c) Banks/ FIs should ensure that subsequent to sale of the financial assets to SC/RC, they do not assume any operational, legal or any other type of risks relating to the financial assets sold.

(d) (i) Each bank / FI will make its own assessment of the value offered by the SC / RC for the financial asset and decide whether to accept or reject the offer.

(ii) In the case of consortium / multiple banking arrangements, if 75% (by value) of the banks / FIs decide to accept the offer, the remaining banks / FIs will be obligated to accept the offer.

(iii) Under no circumstances can a transfer to the SC/ RC be made at a contingent price whereby in the event of shortfall in the realization by the SC/ RC, the banks/ FIs would have to bear a part of the shortfall.

(e) Banks/ FIs may receive cash or bonds or debentures as sale consideration for the financial assets sold to SC/RC.

(f) Bonds/ debentures received by banks/ FIs as sale consideration towards sale of financial assets to SC/RC will be classified as investments in the books of banks/ FIs.

(g) Banks may also invest in security receipts, Pass-through certificates (PTC), or other bonds/ debentures issued by SC/RC. These securities will also be classified as investments in the books of banks/ FIs.

(h) In cases of specific financial assets, where it is considered necessary, banks/ FIs may enter into agreement with SC/RC to share, in an agreed proportion, any surplus realised by SC/RC on the eventual realisation of the concerned asset. In such cases the terms of sale should provide for a report from the SC/RC to the bank/ FI on the value realised from the asset. No credit for the expected profit will be taken by banks/ FIs until the profit materializes on actual sale.

5. Prudential norms for banks/ FIs for the sale transactions

(A) Provisioning/ valuation norms

(a) (i) When a bank / FI sells its financial assets to SC/ RC, on transfer the same will be removed from its books.

(ii) If the sale to SC/ RC is at a price below the net book value (NBV) (i.e., book value less provisions held), the shortfall should be debited to the profit and loss account of that year.

(iii) If the sale is for a value higher than the NBV, the excess provision will not be reversed but will be utilized to meet the shortfall/ loss on account of sale of other financial assets to SC/RC.

(iv) When banks/ FIs invest in the security receipts/ pass-through certificates issued by SC/RC in respect of the financial assets sold by them to the SC/RC, the sale shall be recognised in books of the banks / FIs at the lower of:

- ? the redemption value of the security receipts/ pass-through certificates, and
- ? the NBV of the financial asset.

The above investment should be carried in the books of the bank / FI at the price as determined above until its sale or realization, and on such sale or realization, the loss or gain must be dealt with in the same manner as at (ii) and (iii) above.

(b) The securities (bonds and debentures) offered by SC / RC should satisfy the following conditions:

(i)The securities must not have a term in excess of six years.

(ii)The securities must carry a rate of interest which is not lower than 1.5% above the Bank Rate in force at the time of issue.

- (iii) The securities must be secured by an appropriate charge on the assets transferred.
- (iv) The securities must provide for part or full prepayment in the event the SC / RC sells the asset securing the security before the maturity date of the security.
- (v). The commitment of the SC / RC to redeem the securities must be unconditional and not linked to the realization of the assets.
- (vi) Whenever the security is transferred to any other party, notice of transfer should be issued to the SC/ RC.

(c) Investment in debentures/ bonds/ security receipts/ Pass-through certificates issued by SC/ RC

All instruments received by banks/FIs from SC/RC as sale consideration for financial assets sold to them and also other instruments issued by SC/ RC in which banks/ FIs invest will be in the nature of non SLR securities. Accordingly, the valuation, classification and other norms applicable to investment in non-SLR instruments prescribed by RBI from time to time would be applicable to bank's/ FI's investment in debentures/ bonds/ security receipts/PTCs issued by SC/ RC. However, if any of the above instruments issued by SC/RC is limited to the actual realisation of the financial assets assigned to the instruments in the concerned scheme the bank/ FI shall reckon the Net Asset Value (NAV), obtained from SC/RC from time to time, for valuation of such investments.

(B) Capital Adequacy

For the purpose of capital adequacy, banks/ FIs should assign risk weights as under to the investments in debentures/ bonds/ security receipts/ PTCs issued by SC/ RC and held by banks/ FIs as investment:

- i) Risk weight for credit risk: 100%.
- ii) Risk weight for market risk: 2.5 %

Applicable risk weight = (i) + (ii)

(C) Exposure Norms

Banks'/ FIs' investments in debentures/ bonds/ security receipts/PTCs issued by a SC/RC will constitute exposure on the SC/RC. As only a few SC/RC are being set up now, banks'/ FIs' exposure on SC/RC through their investments in debentures/ bonds/security receipts/PTCs issued by the SC/ RC may go beyond their prudential exposure ceiling. In view

of the extra ordinary nature of event, banks/ FIs will be allowed, in the initial years, to exceed prudential exposure ceiling on a case-to-case basis.

6 Disclosure Requirements

Banks/ FIs, which sell their financial assets to an SC/ RC, shall be required to make the following disclosures in the Notes on Accounts to their Balance sheets:

Details of financial assets sold during the year to SC/RC for Asset Reconstruction

- a) No. of accounts
- b) Aggregate value (net of provisions) of accounts sold to SC / RC
- c) Aggregate consideration
- d) Additional consideration realized in respect of accounts transferred in earlier years
- e) Aggregate gain / loss over net book value.

7 Related Issues

(a) SC/ RC will also take over financial assets which cannot be revived and which, therefore, will have to be disposed of on a realisation basis. Normally the SC/ RC will not take over these assets but act as an agent for recovery for which it will charge a fee.

(b) Where the assets fall in the above category, the assets will not be removed from the books of the bank/ FI but realisations as and when received will be credited to the asset account. Provisioning for the asset will continue to be made by the bank / FI in the normal course.