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4 April 2005

All Commercial Banks (excluding RRBs)
All India Term Lending and Refinancing Institutions
All Non Banking Financial Companies (including RNBCs)

Dear Sir,

Draft Guidelines on Securitisation of Standard Assets

It has been decided to issue guidelines for securitisation of **standard assets** to ensure healthy development of the securitisation market. The guidelines on asset securitisation as **applicable to banks, financial institutions and non-banking financial companies** are furnished in the Annexure.

2. These guidelines are being issued as a draft for feedback from all concerned. The draft will be open for comments for a period of three weeks from the date of this letter. Comments on the draft guidelines may be addressed to the undersigned at the address given below. Comments can also be sent by email to bsivakumar@rbi.org.in and pjthomas@rbi.org.in.

Yours faithfully,

Sd/-

(Anand Sinha)
Chief General Manager-in-Charge

Encls : As above.

Annexure

Draft Guidelines on Securitisation of Standard Assets

1. The regulatory framework provided in the guidelines covers securitisation of standard assets

2. For a transaction to be treated as securitisation, it must follow a two-stage process. In the first stage there should be pooling and transferring of assets to a bankruptcy remote vehicle (SPV) and in the second stage repackaging and selling the security interests representing claims on incoming cash flows from the pool of assets to the third party investors should be effected.

3. For enabling the transferred assets to be removed from the balance sheet of the seller in a securitisation structure, the isolation of assets or 'true sale' from the seller or originator to the SPV is an essential prerequisite. The criteria of true-sale have been prescribed in **Attachment 1 and are illustrative but not exhaustive.** In the event of transferred assets not meeting the true-sale criteria the assets would be deemed to be an on-balance sheet asset of the seller who would be required to comply with all applicable accounting and prudential requirements in respect of those assets.

4. Arms length relationship between the originator / seller and the SPV shall be maintained as defined in Attachment 1.

5. The SPV should meet the criteria prescribed in **Attachment 2 to enable** originators to avail the off balance sheet treatment for the assets transferred by them to the SPV and also to enable the service providers and investors in the PTCs to avail of the regulatory treatment prescribed under these guidelines for their respective exposures in a securitisation structure,. In all cases of securitisation the securities issued by the SPV

should be independently rated by an external credit rating agency and such ratings shall be updated at least every 6 months.

6. The regulatory **norms for capital adequacy, valuation, profit/loss on sale of assets, income recognition and provisioning** for originators and service providers like credit enhancers, liquidity support providers as well as investors as also the **accounting treatment for securitisation transactions and disclosure norms** are given in **Attachment 3.**

7. The originating bank shall furnish a quarterly report to the Audit Sub-Committee of the Board as per format prescribed in **Attachment 4.**

8. The reference to ‘bank’ in the guidelines would include financial institutions and NBFCs.

Attachment 1

The criteria for "True Sale" of assets by the originator

i. Transaction price for transfer of assets from the banks (originator) to the SPV should be market based/arrived at in a transparent manner and at an arm's length basis.

ii. The assets of the banks, after their transfer to SPV, should stand **completely isolated** from themselves i.e., put beyond their own as well as their creditors' reach, even in bankruptcy. The SPVs and holders of beneficial interests in their assets should obtain the unfettered right to pledge or exchange or otherwise dispose of the transferred assets free of any restraining condition, and **shall have no recourse to the originator. The originator shall not enter into an agreement to repurchase (except to the extent and for the purpose indicated at iii below)**.

iii. The banks should **not maintain effective control** over the transferred assets through any agreement that entitles or obligates the banks to repurchase or redeem them before their maturity. Any agreement for repurchase or swapping of assets by the originator would vitiate the true sale criteria. However, an **option to repurchase** fully performing assets at the end of the securitisation scheme where residual value of such assets has, in aggregate, fallen to less than 10% of the original amount sold to the SPV ("clean up calls") could be retained by the banks and would not be construed to constitute 'effective control'.

iv. Mere **provision of certain services** (such as credit enhancement, underwriting, hedging, liquidity support, asset-servicing, etc.) by the banks in a securitisation transaction would not detract from the 'true sale' nature of the transaction, provided such service obligations do not entail any residual credit risk on the assets securitized or any additional liability for them beyond the contractual performance obligations in respect of such services.

v. All **risks and rewards** in respect of the assets **transferred** by banks should have been fully transferred to SPV. In case there is any agreement entitling the originator to any surplus income on the securitised assets the criteria of true sale would be deemed to have been satisfied. Further, assumption of any risk relating to credit enhancement/ liquidity facility as envisaged in these guidelines is permitted.

vi. An **opinion from the solicitors** of the originating banks should be kept on record signifying that all rights in the assets have been transferred to SPV and originator is not liable to investors in any way with regard to these assets. RBI would expect the banks acting as originators / service providers to maintain documentary evidence on record that their legal advisors are satisfied that the terms of the scheme protect them from any liability to the investors in the scheme, other than liability for breach of

express contractual obligations for e.g. credit enhancement/ liquidity facility.

vii. The SPV should have **no formal recourse** to the originating banks for any loss except through the mechanism of credit enhancement, if extended by the banks, for which a written agreement should be entered into at the time of origination of securitisation.

viii. The PTCs issued by the SPV shall not have any put or call options.

ix. The banks should **not make any representation** or provide a warranty in respect of the principal and / or future performance of the PTCs issued by SPV to investors as well as future credit worthiness of the underlying assets.

x. The transfer of assets from originator must **not contravene the terms and conditions of any underlying agreement** governing the assets and all necessary consents (including from third parties, where necessary) should have been obtained to make transfer fully effective.

xi. The originator should not be under any **obligation to repurchase** any asset sold except where the obligation arises from a breach of a representation or warranty, if any, given in respect of the nature of the assets at the time of transfer. A notice to this effect should be given to the SPV and the investors and they should have acknowledged the absence of such obligation on the part of the banks concerned.

xii. The originator should not purchase the PTC issued by the SPV, which are backed by its own assets sold. In case, however, the SPV issues the PTCs in a multi-tranche, senior, mezzanine or subordinate structure, the originator could purchase the **senior-most tranche** of the securities issued by the SPV at market price, **for investment purposes**. Such purchase should, however, not exceed 5% of the original amount of the issue provided the senior-most tranche is at least "investment grade".

xiii. The originator and the SPV may enter into currency / interest rate swap arrangements for **hedging** purposes provided such transactions are entered into at market rates.

xiv. Any re-schedulement, restructuring or re-negotiation of the terms of the agreement, effected after the transfer of assets to the SPV, shall be done only with the express consent of the investors, providers of credit enhancement and other service providers. The altered terms would apply to the SPV and not to the originator.

xv. In case the originator also provides **servicing of assets** after securitisation, under an agreement with the SPV, and the payments / repayments from the borrowers are routed through him, it shall be under no obligation to remit funds to the SPV/investors unless and until these are received from the borrower.

Attachment 2

Criteria for SPV under Securitisation Guidelines

The SPV should meet the following criteria for originators to avail the off balance sheet treatment for the assets transferred by the originators for complying with the prudential guidelines on capital adequacy or for availing of regulatory treatment prescribed under these guidelines for any exposure assumed in a securitisation structure by other banks.

(a) The originating banks transferring the assets to the SPV should not hold substantial interest in the Trustee Company. The term substantial interest for the purpose of these guidelines would mean holding of a beneficial interest in the shares thereof the amount paid up on which exceeds Rs. 5 lakh or 10% of the capital of the Trustee Company, whichever is less. The originator may, however, have one member on the board of the trustee company.

(b) Any transaction between the originator and the SPV should be strictly on arm's length basis.

(c) The trustee company should not resemble in name or indicate any relationship with the originator of the assets in its title or name.

(d) The trustee company should only perform trusteeship functions in relation to the SPV and no other functions or undertake any other business.

(e) SPV should be a non-discretionary trust and the deed of Trust should lay down, in detail, the functions to be performed by the trustee in relation to the assets placed in trust (SPV) and should not provide for any discretion to the trustee as to the manner of disposal and management or application of the trust property i.e. to say SPV should hold on assets passively.

(f) The PTCs issued by the SPV shall compulsorily be rated by a rating agency registered with SEBI and such rating at any time shall not be more than 6 months old. The credit rating should be publicly available.

(g) A copy of the registered trust deed and the accounts and statement of affairs of the SPV should be made available to the RBI, if required to do so.

(h) The SPV should provide disclosures regarding its constitution, ownership, capital structure, size of issue, terms of offer including interest payments/yield on instruments, details of underlying asset pool and its performance history, including details of the individual obligors, information about originator, transaction structure, service arrangement, credit enhancement details, risk factors etc.

(i) The SPV should provide continuing disclosures by way of a Disclosure Memorandum, signed and certified for correctness of information contained therein jointly by the servicer and the Trustee, and addressed to each PTC

holder individually through registered post at periodic intervals (maximum 6 months or more frequent). In case the PTC holders are more than 100 in number then the memorandum may also be published in a national financial daily newspaper. The contents of the memorandum would be as under:

i) Collection summary of previous collection period.
ii) Asset pool behaviour - delinquencies, losses, prepayment etc. with details.
iii) Drawals from credit enhancements.
iv) Distribution summary.
v) Current rating of the PTCs and any migration of rating during the period.
vi) Any other material / information relevant to the performance of the pool.

(i) The SPV should also provide a disclaimer clause stating that the PTCs do not represent deposits liabilities of the originator, servicer, SPV or the trustee, and that they are not insured. The Trustee / originator / servicer / SPV does not guarantee the capital value of PTCs or collectability of receivables pool.

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Attachment 3

Regulatory norms for capital adequacy, valuation, profit/loss on sale of assets, income recognition and provisioning and accounting treatment for securitisation transactions and disclosure norms

1. Capital adequacy for the originator

1.1 In case the assets are transferred to the SPV from the originating banks in full compliance with all the conditions of true sale given in Attachment 1, the transfer would be treated as a 'true sale' and originator will not be required to maintain any capital against the value of assets so transferred from the date of such transfer. The effective date of such transfer should be expressly indicated in the subsisting agreement. However, RBI may, in certain exceptional circumstances, regard the assets removed from the balance sheet of a bank through securitisation, as carrying some residual risk to the originator bank even where the scheme meets the foregoing conditions and may still require regulatory capital thereagainst. Such circumstances might include inadequate segregation of the pool of assets from originator's other assets, co-mingling of cash flows arising therefrom, etc.

1.2 The originating banks could also invest in PTCs backed by the assets originated by it provided the securitised paper carries a minimum investment grade rating. However, the aggregate investment in such securitised paper should not, at any time, exceed 10 per cent of its total investment in non-SLR securities or 5% of the original amount of the issue whichever is lower. In case of multiple-tranche issue of the PTCs, the investment should be confined only to the highest/ senior-most tranche provided it has at least investment grade. Any investment in excess of the above ceiling or in a subordinated / junior tranche (regardless of its rating), shall be deducted from the Tier 1 capital of the investing bank.

2. Capital adequacy for Service Providers

2.1 A bank could provide a variety of services such as, underwriting, credit enhancement and liquidity support for a proprietary or a third-party securitisation transaction. For the capital adequacy of the service providers, these facilities would receive the treatment as detailed below.

2.2 For credit enhancers

2.2.1 A bank may provide credit enhancement for the PTCs issued by the SPV to absorb losses of the SPV or investors in the PTCs or other participants in a securitisation structure in the specified contingencies. The credit enhancement could be structured in a variety of forms, of which the more common are **subordinated loans** to the SPV, **over-collateralisation** or **spread accounts**. The entity providing credit enhancement facilities should ensure that the following conditions are fulfilled:

i. The purpose of the credit enhancement is to mitigate the credit risk inherent in the financial assets and it should be structured in a manner to keep it distinct from other facilities especially the liquidity facility. The nature of the credit enhancement provided to a transaction should be clearly specified in a written agreement at the time of originating the transaction and disclosed in the offer document. There should not be any recourse to the enhancer beyond the fixed contractual obligations so specified. In particular the enhancer should not bear any recurring expenses of the securitisation.

ii. The facility should be provided on an 'arm's length basis' and is subject to enhancer's normal credit approval and review process. The facility should be provided on market terms and conditions.

iii. The facility is limited to a specified amount and duration.

iv. In case where the enhancer is the seller, the credit enhancement facility must be documented in a way that clearly separates it from any other facility provided by the seller.

v. Where any of the above conditions is not satisfied the enhancer is required to hold capital against the full value of all the securities issued by the SPV.

vi. Credit enhancement should be undertaken only at the initiation of the scheme except in the event of a scheme having subsequent tranches of assets being placed in to the SPV.

vii. The credit enhancement in the form of guarantees will be treated as commitment and converted at 100% conversion factor.

viii. The duration of the facility is limited to the earlier of the dates on which:
- the underlying assets are redeemed;
- all claims connected with the securities issued by the SPV are paid out; or
- the bank's obligations are otherwise terminated.

2.2.2 Where any of the conditions as stated above is not satisfied, the bank will be required to hold capital against the full amount of the securitised assets as if they were held on its balance sheet. Where all of these conditions are satisfied, the capital treatment to be applied to credit enhancement facilities is as set out below.

(i) First Loss Facility

(a) A "first loss facility" represents the first level of protection against loss to the investors, SPV or others in a securitisation scheme. The seller of the assets often provides this facility but a third party may also be involved. The providers of first loss facilities bear substantial risks (i.e., some multiple of historic losses or worst case losses estimated by simulation or other techniques) associated with the assets held by the SPV or the PTCs issued there against.

(b) Where first loss credit enhancement is provided then the credit enhancement should be reduced from the capital to the full extent from the books of the provider whether it is originator or third party.

(ii) Second Loss Facility

(a) A "second loss facility" represents credit enhancement that provides a second tier of protection to the investors, SPV or others in a securitisation transaction against potential losses.

(b) Depending on the coverage provided by any first loss facility, a second loss facility might carry a disproportionate share of risk to the scheme. In order to limit this possibility, a credit enhancement facility will be deemed to be a second loss facility **only where**:

- it enjoys protection from a substantial first loss facility; **and**

  (For this purpose, the first-loss facility would be considered substantial where it covers some multiple of historic losses or worst case losses estimated by simulation or other techniques to the satisfaction of RBI)

- it can be drawn on only after the first loss facility has been exhausted.

(c) Where second loss credit enhancement is provided then the credit enhancement should be reduced from the capital to the full extent from the books of the provider whether it is originator or third party.

2.3 Capital adequacy for liquidity support providers

2.3.1 Liquidity facilities may be provided to help smoothen the **timing differences faced by the SPV** between the receipt of cash flows from the underlying assets and the payments to be made to investors in the securities it has issued. The liquidity facility must not provide for bearing any of the recurring expenses of securitisation.

2.3.2 Where a liquidity facility **fails to meet any of the following conditions**, it will be regarded as serving the economic purpose of a credit enhancement facility and, therefore, be **treated in the same manner as a credit enhancement** for capital adequacy purposes:

(a) The facility should be provided on an arm's length basis and be subject to providers' normal credit approval and review processes. The facility must be on market terms and conditions and should be superior to the interest of the investors.

(b) The nature of facility provided to a SPV should be clearly specified in a written agreement at the time of origination of the securitisation transaction and disclosed in any offering document. There must be no recourse to the provider beyond the fixed contractual obligation.

(c) the facility is documented in a fashion which clearly separates it from any other facility provided by the bank;

(d) the documentation for the facility must clearly define the circumstances under which the facility may or may not be drawn on;

(e) The facility should be limited to a specified amount and duration the amount being limited to the amount that is likely to be repaid fully

from liquidation of underlying exposures and any better provided credit enhancement.

(f) The provider must not bear any of the recurring expenses of securitisation.

(g) The facility should not be capable of being drawn for the purpose of credit enhancement.

(h) The facility should be reduced or terminated should a specified event relating to deterioration in the asset quality occur.

(i) Payment of fees or other income for the facility should not be subordinated, subject to deferral or waiver.

(j) Funding should be provided to SPV and not directly to the investors.

(k) Funding under liquidity facility shouldn't be used to cover losses of the SPV. In addition the facility must not cover any losses incurred in the underlying pool of exposures prior to a draw or be structured in a way that a draw down is certain.

(l) Drawings under the facility, if not repaid within 90 days, should be fully provided for.

(m) Any drawdown under the facility **cannot** be used to provide permanent revolving funding;

2.3.3. There must be **substantial credit enhancement** in place. Should the quality of the securitised assets deteriorate to a level where the level of credit enhancement is no longer sufficient, the liquidity facility will be treated as a credit enhancement for capital adequacy purposes.

2.3.4. The commitment to provide liquidity facility, to the extent not drawn would be an off- balance sheet item and attract 100% credit conversion factor as well as 100 % risk weight. The extent to which the commitment becomes a funded facility would attract 100 % risk weight.

2.4 Guidelines for Service Providers

A service provider will normally assume obligations such as collection from obligors, payment to the investors, reporting on the performance of the pool etc., in an asset securitisation scheme. These functions may continue to be performed

by the professional organisations having the desired skills. A regulated entity may act as a servicer for fees for the SPV provided that:

i. There is formal written agreement in place that specifies the services to be provided and standards of performance required from the servicer. There should not be any recourse to the servicer beyond the fixed contractual obligations specified in the agreement;

ii. The services are provided on an arm's length basis, on market terms and conditions;

iii. The Trustee to the PTC and/or investors have the clear right to select an alternative party to provide the facility;

iv. The facility is documented separately from any other facility provided by the bank or FI;

v. Its operational systems (including internal control, information system and employee integrity) and infrastructural facilities are adequate to meet its obligations as a servicer.

The servicer should be under no obligation to remit funds to the SPV or investors until it has received funds generated from the underlying assets. The service provider shall hold in trust, on behalf of the investors, the cash flows arising from the underlying and should avoid co-mingling of these cash flows with their own cash flows. Where the conditions as above are not met the service providers may be deemed as providing liquidity facility to the SPV or investors and treated in the same manner for capital adequacy purpose.

3. Capital adequacy for investors in the PTCs

The capital charge for credit and market risk for banks and FIs investing in PTCs will be governed by the extant RBI guidelines issued from time to time.

4. Valuation of PTCs

The PTCs issued by SPVs would be in the nature of non-SLR securities, therefore the valuation, classification and other norms applicable to non-SLR instruments prescribed by RBI from time to time will be applicable to the investments in PTCs.

5. Exposure norms for investment in the PTCs

The counterparty for the investor in the PTCs would not be the SPV but the

underlying assets in respect of which the cash flows are expected from the obligors / borrowers. The investors should accordingly monitor their exposure to the individual borrowers and the borrower groups as per the credit exposure norms of RBI wherever the obligors in the pool constitute 5% or more of the receivables in the pool or Rs.5 crore, whichever is lower.

6. Income recognition and provisioning norms for investors in the PTCs

As the PTCs are expected to be limited-tenor, interest bearing debt instruments, the income on the PTCs may normally be recognised on accrual basis. However, if the income (or even the redemption amount) on PTCs remains in arrears for more than 90 days, any future income should be recognised only on realisation and any unrealised income recognised on accrual basis should also be reversed. In case of pendency of dues on the PTCs, appropriate provisions for the diminution in value of the PTCs on account of such overdues should also be made, as already envisaged in the extant RBI norms for classification and valuation of investment by the banks.

7. For the originators - treatment at the time of sale

a) On transfer of the assets to the SPV, the book value of the loan asset, net of the provisions held, should be reduced by the amount of consideration received from the SPV. If the resultant is a **positive value**, it should be accounted for by debit to the Profit & Loss account during the same accounting year in which the sale is effected.

b) In case, however, the resultant is a **negative value**, it could be recognised during the same accounting year by credit to the Profit & Loss account.

c) Where the consideration is received partly in cash and partly in kind the treatment specified in paragraph 8 of the Guidance note on Accounting for Securitisation of Assets issued by the ICAI should be followed.

8. Accounting treatment of the securitisation transactions

The accounting treatment of the securitisation transactions in the books of originators, SPV and investors in PTCs will be as per the guidance note issued

by the ICAI with reference to those aspects not specifically covered in these guidelines.

9. Public disclosures in respect of securitisation transactions

The Originators should make the following disclosures, as notes to accounts, presenting a comparative position for two years:

a. Total number and book value of loan assets securitised

b. Sale consideration received for the securitised assets and gain / loss on sale on account of securitisation

c. Form and quantum (outstanding value) of services provided by way of credit enhancement, liquidity support, post-securitisation asset servicing, etc.

Attachment 4

Format of Quarterly Reporting to the Audit Sub Committee of the Board by originating banks of the Securitisation Transactions

1. Name of the originator:

2. Name and nature of SPV & details of relationship with originator and service providers (including constitution and shareholding pattern of SPV):

3. Description and nature of asset transferred:

4. Carrying cost of assets transferred and % of such assets to total assets before transfer:

5. Method of transfer of assets:

6. Amount and nature of consideration received:

7. Objects of the securitisation offer:

8. Classification (as per RBI norms) of assets transferred:

9. Amount and nature of credit enhancement and other facilities provided by the originator (give details each facility provided viz., nature, amount, duration, terms and conditions,):

10. Information regarding third party service providers (e.g. credit enhancement, liquidity support, servicing of assets, etc.) giving the details, facility-wise, viz. name & address of the provider, amount, duration and terms and conditions of the facility.

11. CRAR of transferor: *Before transfer* *After transfer*
    Tier I
    Tier II

12. Type and classes of securities issued by SPV with ratings, if any, of each class of security, assigned by a rating agency:

13. Name and address of holders of 5% or more of securities (if available):

14. Investment by the originator in the securitised paper, issuer wise:

    Name of the issuer | Class of security | No. of securities held | Total amount

15. Details of hedging arrangements (IRS/ FRAs), if any, giving amount /maturity date, name of counter parties, etc.:

16. Brief description (including diagrammatic representation of the structure) of the scheme denoting cash and process flows):

17. Date and method of termination of the scheme including mopping up of remaining assets: