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All NBFCs excluding Primary Dealers (PDs)

Dear Sir,

Revisions to the Guidelines on Securitisation Transactions

Detailed Guidelines on Securitisation of Standard Assets were issued to NBFCs vide Circular DBOD.NO.BP.BC.60/21.04.048/2005-06 dated February 01, 2006.

2. In order to prevent unhealthy practices surrounding securitization viz; origination of loans for the sole purpose of securitization and in order to align the interest of the originator with that of the investors and with a view to redistribute credit risk to a wide spectrum of investors, it was felt necessary that originators should retain a portion of each securitization originated and ensure more effective screening of loans. In addition, a minimum period of retention of loans prior to securitization was also considered desirable, to give comfort to the investors regarding the due diligence exercised by the originator. Keeping in view the above objectives, draft guidelines for banks and NBFCs were formulated and placed in public domain for comments in April 2010 and June 2010 respectively. The Bank vide its circular DBOD.No.BP.BC-103/21.04.177/2011-12 dated May 07, 2012 has issued the final guidelines in this regard to banks. The

Guidelines also cover the regulatory aspects on direct assignment of loans. It has been decided to extend the guidelines to NBFCs also as given in the annex.

3. The guidelines are organised in three Sections. Section A contains the provisions relating to securitisation of assets. A separate circular would be issued in due course on reset of credit enhancements in case of securitisation transactions. Section B contains stipulations regarding transfer of standard assets through direct assignment of cash flows. Section C enumerates the securitisation transactions which are currently not permissible in India.

4. All other guidelines on securitisation of standard assets remain unchanged.

Yours faithfully,

(Uma Subramaniam)
Chief General Manager-in-Charge

Annex

Section A

Guidelines on Securitisation of Standard Assets

1.Requirements to be met by the orginating NBFCs

1.1 Assets Eligible for Securitisation

In a single securitisation transaction, the underlying assets should represent the debt obligations of a homogeneous pool of obligors[1]. Subject to this condition, all on-balance sheet standard assets[2]except the following, will be eligible for securitisation by the originators :

i) Revolving credit facilities (e.g., Credit Card receivables)

ii) Assets purchased from other entities

iii) Securitisation exposures (e.g. Mortgage-backed / asset-backed securities)

iv) Loans with bullet repayment of both principal and interest[3].

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1.2 Minimum Holding Period (MHP)

1.2.1 Originating NBFCs can securitise loans only after these have been held by them for a minimum period in their books. The criteria governing determination of MHP for assets listed below reflect the need to ensure that :

- the project implementation risk is not passed on to the investors, and
- a minimum recovery performance is demonstrated prior to securitisation to ensure better underwriting standards

1.2.2 NBFCs can securitise loans only after a MHP counted from the date of full disbursement of loans for an activity / purpose; acquisition of asset (i.e., car, residential house etc.) by the borrower or the date of completion of a project, as the case may be. MHP would be defined with reference to the number of instalments to be paid prior to securitisation.

[1] The single asset securitisations do not involve any credit tranching and redistribution of risk, and therefore, are not consistent with the economic objectives of securitisation.

[2] In these guidelines the term loans/assets have been used to refer to loans, advances and bonds which are in the nature of advances

[3] Trade receivables with tenor up to 12 months discounted/purchased by NBFCs from their borrowers will be eligible for securitisation. However, only those loans/receivables will be eligible for securitisation where a drawee of the bill has fully repaid the entire amount of last two loans/receivables within 180 days of the due date.

MHP applicable to various loans depending upon the tenor and repayment frequency is given in the following table[4].

Minimum Holding Period				
	Minimum number of instalments to be paid before securitisation			
	Repayment frequency - Weekly	**Repayment frequency - Fortnightly**	**Repayment frequency - Monthly**	**Repayment frequency - Quarterly**
Loans with original maturity up to 2 years	Twelve	Six	Three	Two
Loans with original maturity of more than 2 years and up to 5 years	Eighteen	Nine	Six	Three
Loans with original maturity of more than 5 years	-	-	Twelve	Four

1.2.3 The MHP will be applicable to individual loans in the pool of securitised loans. MHP will not be applicable to loans referred to in foot note 3 of para 1.1.

1.3 Minimum Retention Requirement (MRR)

1.3.1 The MRR is primarily designed to ensure that the originating NBFCs have a continuing stake in the performance of securitised assets so as to ensure that they carry out proper due diligence of loans to be securitised. In the case of long term loans, the MRR may also include a vertical tranche of securitised paper in addition to the equity / subordinate tranche, to ensure that the originating NBFCs have stake in the performance of securitised assets for the entire life of the securitisation process.

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[4] Where the repayment is at more than quarterly intervals, loans can be securitised after repayment of at-least two instalments.

The originating NBFCs should adhere to the MRR detailed in the Table below while securitising loans :

Minimum Retention Requirements at the Time of Securitisation				
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 securitisation involves neither credit tranching nor any first loss credit enhancement by originators	Investment in the securities issued by the Special Purpose Vehicle (SPV) equal to 5% of the book value of the loans being securitised
		ii)	Where securitisation involves no credit tranching, but involves originators providing first loss credit enhancements e.g. off-balance sheet supports, cash collaterals, overcollateralisation etc.	The originator would be providing the required credit enhancement If the first loss credit enhancement required is less than 5%, then the balance should be in the securities issued by the SPV.
		iii)	Where securitisation involves credit tranching but no first loss credit enhancement from originator	5% in equity tranche. If equity tranche is less than 5%, then balance paripassu in remaining tranches.
		iv)	Where securitisation involves credit tranching and first loss credit enhancements by originator (off-balance sheet supports, cash collaterals, overcollateralisation etc.)	If the first loss credit enhancement is less than 5%, then balance in equity tranche. If first loss credit enhancement plus equity tranche is less than 5%, then remaining pari-passu in other tranches.
Loans with original maturity of more than 24 months	10% of the book value of the loans being securitised	i)	Where securitisation involves neither credit tranching nor any first loss credit enhancement	Investment in the securities issued by the SPV equal to 10% of the book value of the loans being securitised.
		ii)	Where securitisation involves no credit tranching, but involves first loss credit enhancements from originators e.g., offbalance sheet supports, cash collaterals, overcollateralisation etc.	The originator would be providing required credit enhancement. If this is less than 10%, then balance in the securities issued by the SPV.
		iii)	Where securitisation involves credit tranching	5% in equity tranche or less if the equity tranche

			but no first loss credit enhancement from originator		is less than 5%. The balance (10% - investment in equity tranche) pari-passu in other tranches issued by the SPV.
		iv)	Where securitisation involves credit tranching as well as the first loss credit enhancements by originators (off-balance sheet supports, cash collaterals, overcollateralisation etc.)	i)	If the first loss credit enhancement is more than 5% but less than 10%, then balance pari-passu in securities including equity tranche issued by the SPV.
				ii)	If the first loss credit enhancement is less than 5%, then in equity tranche so that first loss plus equity tranche is equal to 5%. Balance pari-passu in other tranches (excluding equity tranche) issued by the SPV so that the total retention is 10%.
Bullet repayment loans / receivables referred to in foot note 3 of para 1.1	10% of the book value of the loans being securitised	i)	Where securitisation involves neither credit tranching nor any first loss credit enhancement by originators		Investment in the securities issued by the SPV equal to 10% of the book value of the loans being securitised
		ii)	Where securitisation involves no credit tranching, but involves originators providing first loss credit enhancements e.g. off-balance sheet supports, cash collaterals, overcollateralisation etc.		The originator would be providing the required credit enhancement If the first loss credit enhancement required is less than 10%, then the balance should be in the securities issued by the SPV.
		iii)	Where securitisation involves credit tranching but no first loss credit enhancement from originator		10% in equity tranche. If equity tranche is less than 10%, then balance paripassu in remaining tranches.
		iv)	Where securitisation involves credit tranching and first loss credit enhancements by originator (off-balance sheet supports, cash collaterals, overcollateralisation etc.)		If the first loss credit enhancement is less than 10%, then balance in equity tranche. If balance is greater than equity tranche, then remaining pari-passu in other tranches.

1.3.2 MRR will have to be maintained by the entity which securitises the loans. In other words, it cannot be maintained by other entities which are treated as 'originator' in terms of para 5(vi) of the circular dated February 1, 2006 containing Guidelines on Securitisation of Standard Assets.

1.3.3 The MRR should represent the principal cash flows. Therefore, NBFCs' investment in the Interest Only Strip representing the Excess Interest Spread / Future Margin Income, whether or not subordinated, will not be counted towards the MRR.

1.3.4 The level of or selling the retained interest commitment by originators i.e., MRR should not be reduced either through hedging of credit risk. The MRR as a percentage of unamortised principal should be maintained on an ongoing basis except for reduction of retained exposure due to proportionate repayment or through the absorption of losses. The form of MRR should not change during the life of securitisation.

1.3.5 For complying with the MRR under these guidelines NBFCs should ensure that proper documentation in accordance with law is made.

1.4 Limit on Total Retained Exposures

1.4.1 At present, total investment by the originator in the securities issued by the SPV through underwriting or otherwise is limited to 20% of the total securitised instruments issued. It has been decided that the total exposure of NBFCs to the loans securitised in the following forms should not exceed 20% of the total securitised instruments issued :

- 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, but excluding the credit enhancing interest only strip
- Liquidity support.

1.4.2 If an NBFC exceeds the above limit, the excess amount would be risk weighted at 667%[5].

1.4.3 The 20% limit on exposures will not be deemed to have been breached if it is exceeded due to amortisation of securitisation instruments issued.

[5] The minimum CRAR requirement for NBFCs is 15%. Hence risk weight has been capped at 667% so as to ensure that the capital charge does not exceed the exposure value.

1.5 Booking of Profit Upfront

1.5.1 In terms of para 20.1 of circular DBOD.No.BP.BC.60/21.04.048/2005- 06 dated February 1, 2006, any profit / premium arising on account of securitisation of loans should be amortised over the life of the securities issued or to be issued by the SPV. These instructions were inter alia intended to discourage 'originate-to-distribute' model. Now that these concerns are sought to be addressed to some extent by MRR, MHP and other measures being proposed in these guidelines, it has been decided to allow higher recognition of cash profits during a year based on amortisation of principal and losses incurred as well as specific provision requirements on the securitisation exposures as explained below :

The amount of profit received in cash may be held under an accounting head styled as "Cash Profit on Loan Transfer Transactions Pending Recognition" maintained on individual transaction basis. The amortisation of cash profit arising out of securitisation transaction will be done at the end of every financial year and calculated as under :

Profit to be amortised = $\text{Max}\{L, [(X*(Y/Z))], [(X/n)]\}$

X = amount of unamortised cash profit lying in the account 'Cash Profit on Loan Transfer Transactions Pending Recognition' at the beginning of the year

Y = amount of principal amortised during the year

Z = amount of unamortised principal at the beginning of the year

L = Loss[6] (marked to market losses incurred on the portfolio + specific provisions, if any, made against the exposures to the particular securitisation transaction + direct write-off) excluding loss incurred on credit enhancing interest only strip[7]

n = residual maturity of the securitisation transaction

1.5.2 The above method of amortisation of profit can be applied to outstanding securitisation transactions as well. However, the method can be applied only with respect to the outstanding amortisable profit and un-amortised principal outstanding as on the date of issuance of this circular.

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[6] The losses, including marked-to-market losses, incurred by NBFCs, specific provisions, if any, and direct write-offs to be made on the MRR and any other exposures to the securitisation transaction (other than credit enhancing interest only strip) should be charged to Profit and Loss account. However, the amortisation formula would ensure that these debits to Profit and Loss account are offset to the extent there is balance in *"Cash Profit on Loan Transfer Transactions Pending Recognition* Account". NBFCs should also hold capital against securitisation exposures in terms of extant guidelines of RBI without taking into account balance in "*Cash Profit on Loan Transfer Transactions Pending Recognition* Account".

[7] For accounting of losses in respect of credit enhancing interest only strip, please see para 1.5.3.

1.5.3 At times, the originating NBFCs retain contractual right to receive some of the interest amount due on the transferred assets. This interest receivable by the originating NBFC represents a liability of the SPV and its present value is capitalised by the originating NBFC as an Interest Only Strip (I/O Strip), which is an on-balance sheet asset. Normally, a NBFC would recognise an unrealised gain in its Profit and Loss account on capitalisation of future interest receivable by way of I/O Strip. However, consistent with the instructions contained in circular dated February 1, 2006 referred to above, NBFCs should not recognise the unrealised gains in Profit and Loss account; instead they should hold the unrealised profit under an accounting head styled as "Unrealised Gain on Loan Transfer Transactions". The balance in this account may be treated as a provision against potential losses incurred on the I/O Strip due to its serving as credit enhancement for the securitisation transaction[8]. The profit may be recognised in Profit and Loss Account only when Interest Only Strip is redeemed in cash. As NBFCs would not be booking gain on sale represented by I/O Strip upfront, it need not be deducted from Tier I capital. This method of accounting of Interest Only Strip can be applied to outstanding securitisation transactions as well.

1.6 Disclosures by the Originating NBFCs

1.6.1 Disclosures to be made in Servicer / Investor / Trustee Report

The originating NBFCs should disclose to investors the weighted average holding period of the assets securitised and the level of their MRR in the securitisation. The originating NBFCs should ensure that prospective investors have readily available access to all materially relevant data on the credit quality and performance of the individual underlying exposures, cash flows and collateral supporting a securitisation exposure as well as such information that is necessary to conduct comprehensive and well-informed stress tests on the cash flows and collateral values supporting the underlying exposures. The disclosure by an originator of its fulfillment of the MHP and MRR should be made available publicly and should be appropriately documented; for instance, a reference to the retention commitment in the prospectus for securities issued under that securitisation programme would be considered appropriate. The disclosure should be made at origination of the transaction, and should be confirmed thereafter at a minimum half yearly (end-September and March), and at any point where the requirement is breached.

[8] The I/O Strips may be amortising or non-amortising. In the case of amortising I/O strips, an NBFC would periodically receive in cash, only the amount which is left after absorbing losses, if any, supported by the I/O strip. On receipt, this amount may be credited to Profit and Loss account and the amount equivalent to the amortisation due may be written-off against the "Unrealised Gain on Loan Transfer Transactions" A/c bringing down the book value of the I/O strip in the NBFC's books. In the case of a non-amortising I/O Strip, as and when the NBFC receives intimation of charging-off of losses by the SPV against the I/O strip, it may write-off equivalent amount against "Unrealised Gain on Loan Transfer Transactions" A/c and bring down the book value of the I/O strip in the NBFC's books. The amount received in final redemption value of the I/O Strip received in cash may be taken to Profit and Loss account.

The above periodical disclosures should be made separately for each securitisation transaction, throughout its life, in the servicer report, investor report, trustee report, or any similar document published. The aforesaid disclosures can be made in the format given in Appendix 1.

1.6.2 Disclosures to be made by the Originator in Notes to Annual Accounts

The Notes to Annual Accounts of the originating NBFCs should indicate the outstanding amount of securitised assets as per books of the SPVs sponsored by the NBFC and total amount of exposures retained by the NBFC as on the date of balance sheet to comply with the MRR. These figures should be based on the information duly certified by the SPV's auditors obtained by the originating NBFC from the SPV. These disclosures should be made in the format given in Appendix 2.

1.7 Loan Origination Standards

The originating NBFCs should apply the same sound and well-defined criteria for credit underwriting to exposures to be securitised as they apply to exposures to be held on their book. To this end, the same processes for approving and, where relevant, amending, renewing and monitoring of credits should be applied by the originators.

1.8 Treatment of Securitised Assets not Meeting the Requirements Stipulated above

All instructions contained in this paragraph will be applicable only to the new transactions unless explicitly stated otherwise. If an originating NBFC fails to meet the requirement laid down in the paragraphs 1.1 to 1.7 above, it will have to maintain capital for the securitised assets as if these were not securitised. This capital would be in addition to the capital which the NBFC is required to maintain on its other existing exposures to the securitisation transaction.

2. Requirements to be met by NBFCs other than originators having Securitisation exposure

2.1 Standards for Due Diligence

2.1.1 NBFCs can invest in or assume exposure to a securitisation position only if the originator (other NBFCs / FIs / banks) has explicitly disclosed to the credit institution that it has adhered to MHP and MRR stipulated in these guidelines and will adhere to MRR guidelines on an ongoing basis.

2.1.2 Before investing, and as appropriate thereafter, NBFCs should be able to demonstrate for each of their individual securitisation positions, that they have a comprehensive and thorough understanding of risk profile of their proposed / existing investments in securitised positions. NBFCs will also have to demonstrate that for making such an assessment they have implemented formal policies and procedures appropriate for analysing and recording the following :

a) information disclosed by the originators regarding the MRR in the securitisation, on at least half yearly basis;

b) the risk characteristics of the individual securitisation position including all the structural features of the securitisation that can materially impact the performance of the investing NBFC's securitisation position (i.e., the seniority of the tranche, thickness of the subordinate tranches, its sensitivity to prepayment risk and credit enhancement resets, structure of repayment waterfalls, waterfall related triggers, the position of the tranche in sequential repayment of tranches(time-tranching), liquidity enhancements, availability of credit enhancements in the case of liquidity facilities, deal-specific definition of default, etc.);

c) the risk characteristics of the exposures underlying the securitisation position (i.e., the credit quality, extent of diversification and homogeneity of the pool of loans, sensitivity of the repayment behavior of individual borrowers to factors other than their sources of income, volatility of the market values of the collaterals supporting the loans, cyclicality of the economic activities in which the underlying borrowers are engaged, etc.);

d) the reputation of the originators in terms of observance of credit appraisal and credit monitoring standards, adherence to MRR and MHP standards in earlier securitisations, and fairness in selecting exposures for securitisation;

e) loss experience in earlier securitisations of the originators in the relevant exposure classes underlying the securitisation position, incidence of any frauds committed by the underlying borrowers, truthfulness of the representations and warranties made by the originator;

f) the statements and disclosures made by the originators, or their agents or advisors, about their due diligence on the securitised exposures and, where applicable, on the quality of the collateral supporting the securitised exposures; and

g) where applicable, the methodologies and concepts on which the valuation of collateral supporting the securitised exposures is based and the policies adopted by the originator to ensure the independence of the valuer.

2.1.3 When the securitised instruments are subsequently purchased in the secondary market by an NBFC, it should, at that point in time, ensure that the originator has explicitly disclosed that it will retain a position that meets the MRR.

2.2 Stress Testing

NBFCs should regularly perform their own stress tests appropriate to their securitisation positions. For this purpose, various factors which may be considered include, but are not limited to, rise in default rates in the underlying portfolios in a situation of economic downturn, rise in pre-payment rates due to fall in rate of interest or rise in income levels of the borrowers leading to early redemption of exposures, fall in rating of the credit enhancers resulting in fall in market value of securities (Asset Backed Securities / Mortgage Backed Securities) and drying of liquidity of the securities resulting in higher prudent valuation adjustments.

2.3 Credit Monitoring

NBFCs need to monitor on an ongoing basis and in a timely manner, performance information on the exposures underlying their securitisation positions and take appropriate action, if any, required. Action may include modification to exposure ceilings to certain type of asset class underlying securitisation transaction, modification to ceilings applicable to originators etc. For this purpose, NBFCs should establish formal procedures commensurate with the risk profile of their exposures in securitised positions as stipulated in para 2.1.2. Where relevant, this shall include the exposure type, the percentage of loans more than 30, 60, 90, 120 and 180 days past due, default rates, prepayment rates, loans in foreclosure, collateral type and occupancy and frequency distribution of credit scores or other measures of credit worthiness across underlying exposures, industry and geographical diversification, frequency distribution of loan to value ratios with bandwidths that facilitate adequate sensitivity analysis. NBFCs may inter alia make use of the disclosures made by the originators in the form given in Appendix 1 to monitor the securitisation exposures.

2.4 Treatment of Exposures not Meeting the Requirements Stipulated above

The investing NBFCs will assign a risk weight of 667% to the securitisation exposures where the requirements in the paragraphs 2.1 to 2.3 above are not met. While NBFCs should make serious efforts to comply with the guidelines contained in paragraphs 2.1 to 2.3, the higher risk weight of 667% will be applicable with effect from October 01, 2012. NBFCs should put in place necessary systems and procedures to implement the requirements in paragraphs 2.1 to 2.3 before October 31, 2012.

Section - B

Guidelines on Transactions Involving Transfer of Assets through Direct Assignment of Cash Flows and the Underlying Securities

1. Requirements to be met by the Originating NBFCs

1.1 Assets Eligible for Transfer[9]

1.1.1 Under these guidelines, NBFCs can transfer a single standard asset or a part of such asset or a portfolio of such assets to financial entities through an assignment deed with the exception of the following :

i) Revolving credit facilities (e.g., Credit Card receivables)

ii) Assets purchased from other entities

iii) Assets with bullet repayment of both principal and interest[10]

1.1.2 However, these guidelines do not apply to :

i) Transfer of loan accounts of borrowers by an NBFC to other NBFCs / FIs / banks and vice versa, at the request / instance of borrower;

ii) Trading in bonds;

iii) Sale of entire portfolio of assets consequent upon a decision to exit the line of business completely. Such a decision should have the approval of Board of Directors of the NBFC;

iv) Consortium and syndication arrangements;

v) Any other arrangement / transactions, specifically exempted by the Reserve Bank of India.

1.2 Minimum Holding Period (MHP)

Same as in para 1.2 of Section A.

[9] In these guidelines, transfer would mean transfer of assets through direct sale, assignment and any other form of transfer of assets. The generic term used for transfers would be sale and purchase.

[10] Trade receivables with tenor up to 12 months discounted/purchased by NBFCs from their borrowers will be eligible for direct transfer through assignment. However, only those loans/receivables will be eligible for such transfer where a drawee of the bill has fully repaid the entire amount of last two loans/receivables within 180 days of the due date.

1.3 Minimum Retention Requirement (MRR)

1.3.1 The originating NBFCs should adhere to the MRR detailed in the Table below while transferring assets to other financial entities :

Type of asset		MRR
Assets with original maturity of 24 months or less		Retention of right to receive 5% of the cash flows from the assets transferred on pari-passu basis
i)	Assets with original maturity of above 24 months; and	Retention of right to receive 10% of the cash flows from the assets transferred on pari-passu basis.
ii)	Loans referred to in foot note 10 of para 1.1 of Section B.	

1.3.2 In the case of partial sale of assets, if the portion retained by the seller is more than the MRR required as per para 1.3.1 above, then out of the portion retained by the seller, the portion equivalent to 5% of the portion sold or 10% of the portion sold, as the case may be, would be treated as MRR. However, all exposures retained by the selling NBFC including MRR should rank pari-passu with the sold portion of the asset.

1.3.3 NBFCs should not offer credit enhancements in any form and liquidity facilities in the case of loan transfers through direct assignment of cash flows, as the investors in such cases are generally the institutional investors who should have the necessary expertise to appraise and assume the exposure after carrying out the required due diligence. NBFCs should also not retain any exposures through investment in the Interest Only Strip representing the Excess Interest Spread / Future Margin Income from the loans transferred. However, the originating NBFCs will have to satisfy the MRR requirements stipulated in para 1.3.1 above. NBFCs' retention of partial interest in the loans transferred to comply with the MRR indicated in para 1.3.1 should be supported by a legally valid documentation. At a minimum, a legal opinion regarding the following should also be kept on record by the originator :

a) legal validity of amount of interest retained by the originator;

b) such arrangement not interfering with assignee's rights and rewards associated with the loans to the extent transferred to it; and

c) the originator not retaining any risk and rewards associated with the loans to the extent transferred to the assignee.

1.3.4 MRR will have to be maintained by the entity which sells the loans. In other words, it cannot be maintained by other entities which are treated as 'originator' in terms of para 5(vi) of the circular dated February 1, 2006 containing guidelines on securitisation of standard assets.

1.3.5 The level of commitment by originators i.e., MRR should not be reduced either through hedging of credit risk or selling the retained interest. The MRR as a percentage of unamortised principal should be maintained on an ongoing basis except for reduction of retained exposure due to proportionate repayment or through the absorption of losses. The form of MRR should not change during the life of transaction.

1.3.6 For complying with the MRR under these guidelines, NBFCs should ensure that proper documentation in accordance with law is made.

1.4 Booking of Profit Upfront

1.4.1 The amount of profit in cash on direct sale of loans may be held under an accounting head styled as "Cash Profit on Loan Transfer Transactions Pending Recognition" maintained on individual transaction basis and amortised over the life of the transaction. The amortisation of cash profit arising out of loan assignment transaction will be done at the end of every financial year and calculated as under :

Profit to be amortised = Max {L, [(X*(Y/Z)], [(X/n)]}

X = amount of unamortised cash profit lying in the account 'Cash Profit on Loan Transfer Transactions Pending Recognition' at the beginning of the year

Y = amount of principal amortised during the year

Z = amount of unamortised principal at the beginning of the year

L = Loss (specific provisions to be made on retained exposures for credit losses plus direct write-off plus any other losses, if any)[11] incurred on the portfolio

n = residual maturity of the securitisation transaction

1.4.2 Accounting, Asset Classification and provisioning norms for MRR

The asset classification and provisioning rules in respect of the exposure representing the MRR would be as under :

a) The originating NBFC may maintain a consolidated account of the amount representing MRR if the loans transferred are retail loans. In such

[11] The specific provisions to be made as well as direct write-offs and other losses, if any, on the retained exposures should be charged to Profit and Loss account. In addition NBFCs should hold capital against the exposure retained as part of MRR as required in terms of extant guidelines of RBI without taking into account balance in "Cash Profit on Loan Transfer Transactions Pending Recognition" account. NBFCs will also be required to separately maintain 'standard asset' provisions on MRR as per existing instructions which should not be charged to the "Cash Profit on Loan Transfer Transactions Pending Recognition" A/c.

a case, the consolidated amount receivable in amortisation of the MRR and its periodicity should be clearly established and the overdue status of the MRR should be determined with reference to repayment of such amount. Alternatively, the originating NBFC may continue to maintain borrower-wise accounts for the proportionate amounts retained in respect of those accounts. In such a case, the overdue status of the individual loan accounts should be determined with reference to repayment received in each account.

b) In the case of transfer of a pool of loans other than retail loans, the originator should maintain borrower-wise accounts for the proportionate amounts retained in respect of each loan. In such a case, the overdue status of the individual loan accounts should be determined with reference to repayment received in each account.

c) If the originating NBFC acts as a servicing agent of the assignee bank/NBFC for the loans transferred, it would know the overdue status of loans transferred which should form the basis of classification of the entire MRR / individual loans representing MRR as NPA in the books of the originating NBFC, depending upon the method of accounting followed as explained in para (a) and (b) above.

1.5 Disclosures by the Originating NBFCs

Same as in para 1.6 of Section A.

1.6 Loan Origination Standards

Same as in para 1.7 of Section A.

1.7 Treatment of Assets sold not Meeting the Requirements stipulated above

All instructions contained in this paragraph except in para 1.4.2 will be applicable only to the new transactions undertaken on or after the date of this circular. Instructions in para 1.4.2 will be applicable to both existing and new transactions[12]. If an originating NBFC fails to meet the requirement laid down in paragraphs 1.1 to 1.6 above, it will have to maintain capital for the assets sold as if these were still on the books of the NBFC (originating NBFC).

[12] For existing transactions para 1.4.2 would apply to credit enhancements or any other type of retained exposures.

2. Requirements to be met by the Purchasing NBFCs

2.1 Restrictions on Purchase of loans

NBFCs can purchase loans from other NBFCs / FIs / banks in India only if the seller has explicitly disclosed to the purchasing NBFCs that it will adhere to the MRR indicated in para 1.3 on an ongoing basis. In addition, for domestic transactions, purchasing NBFCs should also ensure that the originating institution has strictly adhered to the MHP criteria prescribed in the guidelines in respect of loans purchased by them.

2.2 Standards for Due Diligence

2.2.1 NBFCs should have the necessary expertise and resources in terms of skilled manpower and systems to carry out the due diligence of the loans / portfolios of loans before purchasing them. In this regard the purchasing NBFCs should adhere to the following guidelines :

a) NBFCs with the approval of their Board of Directors, should formulate policies regarding the process of due diligence which needs to be exercised by the NBFCs' own officers to satisfy about the Know Your Customer requirements and credit quality of the underlying assets. Such policies should inter alia lay down the methodology to evaluate credit quality of underlying loans, the information requirements etc.

b) The due diligence of the purchased loans cannot be outsourced by the NBFC and should be carried out by its own officers with the same rigour as would have been applied while sanctioning new loans by the NBFC.

c) If an NBFC wishes to outsource certain activities like collection of information and documents etc., then NBFCs would continue to retain full responsibility in regard to selection of loans for purchase and compliance with Know Your Customer requirements.

2.2.2 Before purchasing individual loans or portfolio of loans, and as appropriate thereafter, NBFCs should be able to demonstrate that they have a comprehensive and thorough understanding of and have implemented formal policies and procedures commensurate with the risk profile of the loans purchased analysing and recording :

a) information disclosed by the originators regarding the MRR, on an ongoing basis;

b) the risk characteristics of the exposures constituting the portfolio purchased (i.e., the credit quality, extent of diversification and homogeneity of the pool of loans, sensitivity of the repayment behavior of individual borrowers to factors other than their sources of income, volatility of the market values of the collaterals supporting the loans, cyclicality of the economic activities in which the underlying borrowers are engaged, etc.);

c) the reputation of the originators in terms of observance of credit appraisal and credit monitoring standards, adherence to MRR and MHP standards in earlier transfer of portfolios and fairness in selecting exposures for transfer;

d) loss experience in earlier transfer of loans / portfolios by the originators in the relevant exposure classes underlying and incidence of any frauds committed by the underlying borrowers, truthfulness of the representations and warranties made by the originator;

e) the statements and disclosures made by the originators, or their agents or advisors, about their due diligence on the assigned exposures and, where applicable, on the quality of the collateral supporting the loans transferred; and

f) where applicable, the methodologies and concepts on which the valuation of loans transferred is based and the policies adopted by the originator to ensure the independence of the valuer.

2.3 Stress Testing

NBFCs should regularly perform their own stress tests appropriate to the portfolios of loans purchased by them. For this purpose, various factors which may be considered include, but are not limited to, rise in default rates in the underlying portfolios in a situation of economic downturn and rise in pre-payment rates due to fall in rate of interest or rise in income levels of the borrowers leading to early redemption of exposures.

2.4 Credit monitoring

2.4.1 The purchasing NBFCs need to monitor on an ongoing basis and in timely manner performance information on the loans purchased and take appropriate action required, if any. Action may include modification to exposure ceilings to certain type of asset classes, modification to ceilings applicable to originators etc. For this purpose, NBFCs should establish formal procedures appropriate and commensurate with the risk profile of the purchased loans. Such procedures should be as rigorous as that followed by the NBFC for portfolios of similar loans directly originated by it. In particular, such procedures must facilitate timely detection of signs of weaknesses in individual accounts and identification of non-performing borrowers as per RBI guidelines as soon as loans are 180 days past due. The information collected should include the exposure type, the percentage of loans more than 30, 60, 90, 120 and 180 days past due, default rates, prepayment rates, loans in foreclosure, collateral type and occupancy, and frequency distribution of credit scores or other measures of credit worthiness across underlying exposures, industry and geographical diversification, frequency distribution of loan to value ratios with band widths that facilitate adequate sensitivity analysis. Such information, if not collected directly by the NBFC and obtained from the servicing agent, should be certified by the authorized officials of the servicing agent. NBFCs may inter alia make use of the disclosures made by the originators in the form given in Appendix 1 to monitor the exposures.

2.4.2 Depending upon the size of the portfolio, credit monitoring procedures may include verification of the information submitted by the bank/NBFC's concurrent and internal auditors. The servicing agreement should provide for such verifications by the auditors of the purchasing NBFC. All relevant information and audit reports should be available for verification by the Inspecting Officials of RBI during the Annual Financial Inspections of the purchasing NBFCs.

2.5 True Sale Criteria[13]

2.5.1 The 'sale' (this term would hereinafter include direct sale, assignment and any other form of transfer of asset, but does not include bills rediscounted, outright transfer of loan accounts to other financial entities at the instance of the borrower and sale of bonds other than those in the nature of advance) should result in immediate legal separation of the 'selling NBFC'[14] (this term hereinafter would include direct selling NBFC, assigning NBFC and the NBFC transferring assets through any other mode), from the assets[15] which are sold. The assets should stand completely isolated from the selling NBFC, after its transfer to the buyer, i.e., put beyond the selling NBFC's as well as its creditors' reach, even in the event of bankruptcy of the selling / assigning / transferring NBFC.

2.5.2 The selling NBFC should effectively transfer all risks / rewards and rights / obligations pertaining to the asset and shall not hold any beneficial interest in the asset after its sale except those specifically permitted under these guidelines. The buyer should have the unfettered right to pledge, sell, transfer or exchange or otherwise dispose of the assets

[13] For true sale criteria for securitisation transaction, please refer to Guidelines on Securitisation of Standard Assets DBOD.NO.BP.BC.60/21.04.048/2005-06 dated February 01, 2006 as amended from time to time.

[14] In this para, the term 'selling NBFC' will include other financial entities selling loans to NBFCs

[15] In case of sale of a part of an asset, true sale criteria will apply to the part of the asset sold.

free of any restraining condition. The selling NBFC shall not have any economic interest in the assets after its sale and the buyer shall have no recourse to the selling NBFC for any expenses or losses except those specifically permitted under these guidelines.

2.5.3 There shall be no obligation on the selling NBFC to re-purchase or fund the repayment of the asset or any part of it or substitute assets held by the buyer or provide additional assets to the buyer at any time except those arising out of breach of warranties or representations made at the time of sale. The selling NBFC should be able to demonstrate that a notice to this effect has been given to the buyer and that the buyer has acknowledged the absence of such obligation.

2.5.4 The selling NBFC should be able to demonstrate that it has taken all reasonable precautions to ensure that it is not obliged, nor will feel impelled, to support any losses suffered by the buyer.

2.5.5 The sale shall be only on cash basis and the consideration shall be received not later than at the time of transfer of assets. The sale consideration should be market-based and arrived at in a transparent manner on an arm's length basis.

2.5.6 If the seller of loans acts as the servicing agent for the loans, it would not detract from the 'true sale' nature of the transaction, provided such service obligations do not entail any residual credit risk on the sold assets or any additional liability for them beyond the contractual performance obligations in respect of such services.

2.5.7 An opinion from the selling NBFC's Legal Counsel should be kept on record signifying that : (i) all rights, titles, interests and benefits in the assets have been transferred to the buyer; (ii) selling NBFC is not liable to the buyer in any way with regard to these assets other than the servicing obligations as indicated in para 2.5.6 above; and (iii) creditors of the selling NBFC do not have any right in any way with regard to these assets even in case of bankruptcy of the selling NBFC.

2.5.8 Any re-schedulement, restructuring or re-negotiation of the terms of the underlying agreement/s effected after the transfer of assets to the buyer, shall be binding on the buyer and not on the selling NBFC except to the extent of MRR.

2.5.9 The transfer of assets from selling NBFC must not contravene the terms and conditions of any underlying agreement governing the assets and all necessary consents from obligors (including from third parties, where necessary) should have been obtained.

2.5.10 In case the selling NBFC also provides servicing of assets after the sale under a separate servicing agreement for fee, and the payments / repayments from the borrowers are routed through it, it shall be under no obligation to remit funds to the buyer unless and until these are received from the borrowers.

2.6 Representations and Warranties

An originator that sells assets to other financial entities may make representations and warranties concerning those assets. Where the following conditions are met the seller will not be required to hold capital against such representations and warranties.

a) Any representation or warranty is provided only by way of a formal written agreement.

b) The seller undertakes appropriate due diligence before providing or accepting any representation or warranty.

c) The representation or warranty refers to an existing state of facts that is capable of being verified by the seller at the time the assets are sold.

d) The representation or warranty is not open-ended and, in particular, does not relate to the future creditworthiness of the loans / underlying borrowers.

e) The exercise of a representation or warranty, requiring an originator to replace asset (or any parts of them) sold, on grounds covered in the representation or warranty, must be :

   *undertaken within 120 days of the transfer of assets; and

   *conducted on the same terms and conditions as the original sale.

f) A seller that is required to pay damages for breach of representation or warranty can do so provided the agreement to pay damages meets the following conditions :

   *the onus of proof for breach of representation or warranty remains at all times with the party so alleging;

   *the party alleging the breach serves a written Notice of Claim on the seller, specifying the basis for the claim; and

   *damages are limited to losses directly incurred as a result of the breach

g) A seller should notify RBI (Department of Non-Banking Supervision) of all instance where it has agreed to replace assets sold to another financial entity or pay damages arising out of any representation or warranty.

2.7 Re-purchase of Assets

In order to limit the extent of effective control of transferred assets by the seller in the case of direct assignment transactions, NBFCs should not have any re-purchase agreement including through "clean-up calls" on the transferred assets.

2.8 Applicability of Capital Adequacy and other Prudential Norms

2.8.1 The capital adequacy treatment for direct purchase of loans will be as per the rules applicable to loans directly originated by the NBFCs. Investment in tranches of securitized loans will attract capital adequacy and other prudential norms as applicable to securitization transactions. NBFCs may, if they so desire, have the pools of loans rated before purchasing so as to have a third party view of the credit quality of the pool in addition to their own due diligence. However, such rating cannot substitute for the due diligence that the purchasing NBFC is required to perform in terms of para 2.2 of this Section.

2.8.2 In purchase of pools of both retail and non-retail loans, income recognition, asset classification, provisioning and exposure norms for the purchasing NBFC will be applicable based on individual obligors and not based on portfolio. NBFCs should not apply the asset classification, income recognition and provisioning norms at portfolio level, as such treatment is likely to weaken the credit supervision due to its inability to detect and address weaknesses in individual accounts in a timely manner. If the purchasing NBFC is not maintaining the individual obligor-wise accounts for the portfolio of loans purchased, it should have an alternative mechanism to ensure application of prudential norms on individual obligor basis, especially the classification of the amounts corresponding to the obligors which need to be treated as NPAs as per existing prudential norms. One such mechanism could be to seek monthly statements containing account-wise details from the servicing agent to facilitate classification of the portfolio into different asset classification categories. Such details should be certified by the authorized officials of the servicing agent. NBFC's concurrent auditors, internal auditors and statutory auditors should also conduct checks of these portfolios with reference to the basic records maintained by the servicing agent. The servicing agreement should provide for such verifications by the auditors of the purchasing NBFC. All relevant information and audit reports should be available for verification by the Inspecting Officials of RBI during the Annual Financial Inspections of the purchasing NBFCs.

2.8.3 The purchased loans will be carried at acquisition cost unless it is more than the face value, in which case the premium paid should be amortised based on straight line method or effective interest rate method, as considered appropriate by the individual NBFCs. The outstanding / unamortised premium need not be deducted from capital. The discount / premium on the purchased loans can be accounted for on portfolio basis or allocated to individual exposures proportionately.

2.9 Treatment of Exposures not Meeting the Requirements Stipulated Above

The investing NBFCs will assign a risk weight of 667% to the assignment exposures where the requirements in paragraphs 2.1 to 2.8 above are not met. While NBFCs should make serious efforts to comply with the guidelines contained in paragraphs 2.1 to 2.4, the higher risk weight of 667% for non-compliance of these paragraphs will be applicable with effect from October 01, 2012. NBFCs should put in place necessary systems and procedures to implement the requirements in paragraphs 2.1 to 2.4 before October 31, 2012.

Section C

Securitisation Activities / Exposures not permitted

1. At present, NBFCs in India are not permitted to undertake the securitisation activities or assume securitisation exposures as mentioned below.

1.1 Re-securitisation of Assets

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

1.2 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.

1.3 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 nonamortising assets such as credit card receivables, trade receivables, dealer floorplan loans and some leases that would support non-amortising structures, unless these are designed to include early amortisation 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.

2. The appropriateness and suitability of transactions prohibited in the above guidelines would be revisited in due course.

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Appendix - 1

Format for Disclosure Requirements in offer documents, servicer report, investor report, etc[16]

Name / Identification No. Of securitisation transaction[17]

	Nature of disclosure	**Details**			**Amount / percentage / years**
1.	Maturity characteristics of the underlying assets (on the date of disclosure)	i)	Weighted average maturity of the underlying assets (in years)		
		ii)	Maturity-wise distribution of underlying assets		
			a)	Percentage of assets maturing within one year	
			b)	Percentage of assets maturing within one to three year	
			c)	Percentage of assets maturing within three to five years	
			d)	Percentage of assets maturing after five years	
2	Minimum Holding Period (MHP) of securitised assets	i)	MHP required as per RBI guidelines (years / months)		
		ii)	a)	Weighted average holding period of securitised assets at the time of securitisation (years / months)	
			b)	Minimum and maximum holding period of the securitised assets	
3	Minimum Retention Requirement (MRR) on the date of disclosure	i)	MRR as per RBI guidelines as a percentage of book value of assets securitised and outstanding on the date of disclosure		
		ii)	Actual retention as a percentage of book value of assets securitised and outstanding on the date of disclosure		
		iii)	Types of retained exposure constituting MRR in percentage of book value of assets securitised (percentage of book value of assets securitised and outstanding on the date of disclosure)[18]		
			a)	Credit Enhancement (i.e. whether investment in equity / subordinate tranches, first / second loss guarantees, cash collateral, overcollateralisation	
			b)	Investment in senior tranches	

[16] This appendix will also be applicable to direct transfer of loans. For that purpose the words 'securitised assets'/'asset securitised' may be interpreted to mean 'loans directly transferred/assigned'. NBFCs should disclose/report the information in respect of securitisation and direct transfers separately.

[17] These disclosures should be made separately for each securitisation transaction throughout the life of the transaction

[18] This item is not relevant for direct transfer of loans, as there will be no credit enhancement, liquidity support and tranching.

			c)	Liquidity support	
			d)	Any other (pl. specify)	
		iv)	Breaches, if any, and reasons there for		
4	Credit quality of the underlying loans	i)	Distribution of overdue loans		
			a)	Percentage of loans overdue up to 30 days	
			b)	Percentage of loans overdue between 31-60 days	
			c)	Percentage of loans overdue between 61-90 days	
			d)	Percentage of loans overdue between 90 and 120 days	
			e)	Percentage of loans overdue between 120 and 180 days	
			f)	Percentage of loans overdue more than 180 days	
		ii)	Details of tangible security available for the portfolio of underlying loans (vehicles, mortgages, etc.)		
			a)	Security 1(to be named) (% loans covered)	
			b)	Security 2……..	
			c)	Security 'n'	
		iii)	Extent of security cover available for the underlying loans		
			a)	Percentage of loans fully secured included in the pool (%)	
			b)	Percentage of partly secured loans included in the pool (%)	
			c)	Percentage of unsecured loans included in the pool (%)	
		iv)	Rating-wise distribution of underlying loans(if these loans are rated)		
			a)	Internal grade of the NBFC / external grade (highest quality internal grade may be indicated as 1)	
				1/AAA or equivalent	
				2	
				3	
				4.....	
				N	
			b)	Weighted average rating of the pool	
		v)	Default rates of similar portfolios observed in the past		
			a)	Average default rate per annum during last five years	
			b)	Average default rate per annum during last year	
		vi)	Upgradation / Recovery / Loss Rates of similar portfolios		
			a)	Percentage of NPAs upgraded (average of	

				the last five years)	
			b)	Amount written-off as a percentage of NPAs in the beginning of the year (average of last five years)	
			c)	Amount recovered during the year as a percentage of incremental NPAs during the year (average of last five year)	
		vii)	Frequency distribution of LTV ratios, in case of housing loans and commercial real estate loans)		
			a)	Percentage of loans with LTV ratio less than 60%	
			b)	Percentage of loans with LTV ratio between 60-75%	
			c)	Percentage of loans with LTV ratio greater than 75%	
			d)	Weighted average LTV ratio of the underlying loans(%)	
5	Other characteristics of the loan pool	i)	Industry-wise breakup of the loans in case of mixed pools (%)		
			Industry 1		
			Industry 2		
			Industry 3....		
			Industry n		
		ii)	Geographical distribution of loan pools (statewise) (%)		
			State 1		
			State 2		
			State 3		
			State 4		

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Appendix 2

Disclosures to be made in Notes to Accounts by NBFCs

S. No.	Particulars	No. / Amount in Rs. crore
1.	No of SPVs sponsored by the NBFC for securitisation transactions[19]	
2.	Total amount of securitised assets as per books of the SPVs sponsored by the NBFC	
3.	Total amount of exposures retained by the NBFC to comply with MRR as on the date of balance sheet	
	a) Off-balance sheet exposures	
	* First loss	
	* Others	
	b) On-balance sheet exposures	
	* First loss	
	* Others	
4	Amount of exposures to securitisation transactions other than MRR	
	a) Off-balance sheet exposures	
	i) Exposure to own securitisations	
	* First loss	
	* loss	
	ii) Exposure to third party securitisations	
	* First loss	
	* Others	
	b) On-balance sheet exposures	
	i) Exposure to own securitisations	
	* First loss	
	* Others	
	ii) Exposure to third party securitisations	
	* First loss	
	* Others	

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[19] Only the SPVs relating to outstanding securitisation transactions may be reported here