Executive Summary

The introduction of financial sector reforms in India has led to innovations in financial markets and instruments. One of the most prominent developments in the international finance in recent times that is likely to assume even greater importance in future is 'securitisation'. Securitisation is the process of pooling and re-packaging of homogenous illiquid loans into marketable securities. Increased pressure on operating efficiency, on market niches, on competitive advantages, and on capital strength, all provide fuel for rapid changes. Securitisation is one of the solutions to these challenges.

2. Reserve Bank of India, as a facilitator, has attempted to explore the intricacies of securitisation as a process of financial engineering and its applicability to the Indian financial system especially in the mortgage and infrastructure sectors. The in-house Working Group constituted by the Bank had the benefit of presentations of and interaction with market intermediaries, regulators, industry experts and international agencies on various aspects associated with securitisation.

3. The report defines asset securitisation and makes a reference to future flow securitisation. Motivation and benefits in the form of capital relief, improvement in return on equity and return on assets, use as a strategic tool, asset liability management, improved liquidity, upgradation in system, Originator discipline, etc. have been highlighted.

4. Various impediments viz., lack of investors' base, capital market infrastructure, regulatory framework, legal provisions, accounting and taxation issues besides good quality assets, past data and standardisation of documents have been identified. In the process of exploring opportunities in India, the ideal conditions for success of securitisation in USA and other countries are highlighted.

5. Experience of securitisation in a few developed countries (USA, Japan, Australia, etc.) and emerging markets like Thailand, Argentina and Morocco has been discussed in detail. The report also identifies securitisation of impaired assets.

6. The disclosure norms and rating will provide touchstones. The Offer Document should give rating rationale which should seek to comment on the quality of the receivables, payment structures, adequacy of the credit enhancement, risks and concerns for investors and the mitigating factors, etc. Rating agencies have already acquired a fair degree of expertise in India through rating of structured obligations and other issues that are quite similar to securitisation.

7. True sale characteristics of securitisation transactions are required to be reflected in the books of accounts, statements to be furnished to the concerned regulators as also to the tax authorities. Since there are no guidelines for accounting treatment of these transactions, the accounting procedures with appropriate guidelines need to be framed by the Institute of Chartered Accountants of India for the sake of uniformity. A background paper has been prepared in this regard and attached to this report which may serve as a guide in the interregnum. The background paper includes a few illustrations for the guidance of the financial entities.

8. The role of various regulators (RBI, SEBI, etc.) and other agencies / entities has also been discussed.

9. The recommendations have been categorised into short-term, medium-term and long-term with definite timeframe in each category. The major recommendations on legal issues (short-term) are incorporated in Chapter 9. These include:

i) Defining securitisation in the Transfer of Property Act to lend uniformity of approach and restrict the benefits provided by law/regulation for genuine securitisation transactions.

ii) Rationalisation of stamp duty to make it uniform at 0.1 per cent for all securitisation transactions. Attempts may be made to bring the subject under the purview of Indian Stamps Act 1889 from the State Stamp Acts.

iii) Reduction of registration charges by amending Section 17(2) of the Registration Act.

iv) Inclusion of securitised instruments in Securities Contract Regulation Act.

v) SEBI may consider removal of prohibition on investment in mortgage backed securities by Mutual Fund Schemes.

vi) Tax neutrality of Special Purpose Vehicle. Recommendations for tax reforms also include the spread of upfront income received by Originator over the tenure of the loan securitised, extension of benefits under Section 88 of Income Tax Act for repayment of housing loans after the loans have been securitised etc.

10. Other recommendations are summarised below:

i) The most significant impact of securitisation arises from the placement of different risks and rights of an asset with the most efficient owner. The training institutes of the financial institutions should attempt to spread awareness of the benefits and scope of securitisation increasingly among financial community.

ii) Spell out the risk weights and NPA norms on securitised paper. Insurance Companies and Provident Funds need to be encouraged to invest in the securitised paper. Besides, suitable regulatory framework may have to be evolved to encourage Foreign Institutional Investors.

iii) Listing requirements for various securities to be issued may be stipulated which may include minimum issue size, eligible stock exchanges etc.

iv) Include the securitised paper in demat trading.

v) While identifying the key characteristics of special Purpose Vehicle (SPV) to keep the structure “remote” from the bankruptcy of the Originator, the Group recommends flexibility in the structure of SPV. SEBI may formulate detailed guidelines in this regard.

vi) Accounting treatment should enable the ‘off balance sheet’ effect for securitised assets. Such treatment for future flow securitisation, credit enhancer etc. has been clarified. A Research Committee of the Institute of Chartered Accountants of India is already working on minute details of accounting treatment.

vii) Adequate disclosure norms are recommended for an ‘informed” decision by the investor. A model Offer document has been attempted by the Group to give information on description of assets, historical performance, end use of funds, transaction structure, and statement of risk factors. The Group also recommends continuous disclosures.

viii) The report has suggested prudential guidelines for banks, developmental financial institutions, non-banking finance companies, etc. including broad creteria for true sale. Model prudential guidelines have been prepared which incorporate issues such as off balance sheet treatment, credit enhancement, servicing, etc.

ix) *Medium term* measures include increased flow of information thorough credit bureaus, standardisation of documents, improvement in the quality of assets, upgradation of computer skills and exploration of the possibilities of securitising non-performing assets.

x) In the *long term*, certain insurance/guarantee institutions may have to develop to give comfort to investors especially in infrastructure and mortgage sectors. There is a need for developing a host of financial intermediaries with specialised skills to provide the building blocks for market growth. GOI may consider bringing out an *umbrella legislation* covering all aspects of securitisation.

xi) An *Implementation Committee* may be set up within RBI for following up on different measures suggested by the Group and to act as product champion for securitisation in the country.

11. The Group feels that the FIs in future will be judged more by the informal strength and capital base rather than the external support from the Central Bank or Government. Market penetration of FIs in the area of loan origination in future will be determined more by the volume of loans originated during a period than by the amount of loans owned at a particular point of time.