

## Chapter 1 Introduction & Methodology

### 1.1 Introduction

The Governor, during discussions held in March, 1999 with the Chief Executive Officers of some of the Development Financial Institutions (DFIs) on *infrastructure financing*, had suggested that institutional initiatives should be triggered to lay the road map for development and growth of Asset Securitisation in the Indian Financial System. He had accordingly directed constitution of an in-house Working Group (WG), to examine the issues pertaining to development of the market for asset securitisation in its entirety.

### 1.2 Background

The need of asset securitisation is being felt in three major areas in the Indian context - Mortgage Backed Securities (MBS), Infrastructure Sector and other Asset Backed Securities (ABS). National Housing Bank (NHB) is currently steering a pilot project on mortgage securitisation. RBI has been holding periodic informal interactions/meetings with FIs and select banks to discuss the key issues relating to development of infrastructure. While reviewing progress in the power sector, it was observed that FIs / banks had made considerable progress in the financing of projects in this sector and that they were already close to their prudential exposure limits. It was, therefore, felt necessary to develop securitisation and other allied modalities so that FIs could offload their initial exposure and make room for financing new projects. With the introduction of financial sector reforms in the early nineties, banks and FIs, particularly the NBFCs are entering into the retail business in a big way generating large volumes of homogeneous classes of assets (auto loans, credit cards etc.) leading to the attempts for ABS by a few players in the Indian financial sector. During the process, it was observed that there were a number of legal, regulatory, psychological and other issues, which needed to be sorted out to facilitate the growth of securitisation. It was observed that since legislative amendments to various Acts is a time consuming process, it may be beneficial to identify the issues of short-term nature which could be tackled on a priority basis, and, issues of long term nature could be separately dealt with. It was, therefore, suggested in June 1999 that an in-house WG may be set up to examine the issues involved and recommend as to how asset securitisation could be introduced in the Indian financial system.

### 1.3 Working Group – Members, Special Invitees & Terms of Reference

#### 1.3.1 Constitution

The in-house Working Group consisted of the following senior officers of Reserve Bank of India as members:

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| 1 | Shri V.S.N. Murty,<br>Chief General Manager-in-Charge,<br>Reserve Bank of India,<br>Department of Non-Banking Supervision (DNBS),<br>Central Office, World Trade Centre-I,<br>Mumbai 400 005. | Chairman |
| 2 | Shri S. R. Hegde,<br>Addl. Legal Adviser,<br>Reserve Bank of India Central Office (CO),<br>Fort, Mumbai 400 001.  | Member   |
| 3 | Shri A.S. Rao,  | Member   |

Deputy General Manager, Reserve Bank of India CO,  
Internal Debt Management Cell, Fort, Mumbai 400 005.

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| 4 | Shri Rajesh Verma,<br>Deputy General Manager, Reserve Bank of India,<br>Department of Banking Operations and Development, CO, World<br>Trade Centre-I, Mumbai 400 005. | Member               |
| 5 | Shri S.D. Sapkal,<br>Deputy General Manager, Reserve Bank of India,<br>Industrial and Export Credit Department,<br>CO, Fort, Mumbai 400 001.                           | Member               |
| 6 | Shri K. K. Vohra,<br>Deputy General Manager, Reserve Bank of India,<br>DNBS, CO, World Trade Centre-I,<br>Mumbai 400 005.  | Member-<br>Secretary |

The following Special Invitees were requested to participate in all the major meetings of the Group:

Shri Pratip Kar, Executive Director, Securities & Exchange Board of India, Mittal Court, 'B' Wing, 1 <sup>st</sup> floor, 224, Nariman Point, Mumbai 400 021.	Special Invitee
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Shri K.S. Vikamsey, Member Council, Institute of Chartered Accountants of India, M/s. Khimji Kunverji & Co., Suit 52, Bombay Mutual Bldg., Sir P.M. Road, Fort, Mumbai 400 001.	Special Invitee
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Shri R. V. Verma, General Manager, National Housing Bank, Core-5A, 3 <sup>rd</sup> floor, India Habitat Centre, Lodhi Road, New Delhi 110 003.	Special Invitee
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Shri Birendra Kumar, Managing Director, SBI Capital Markets Ltd., 202, Maker Towers 'E', Cuffe Parade, Mumbai 400 005.	Special Invitee
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Shri Ananda Mukerji, General Manager, ICICI Ltd., C-23, G Block, Bandra-Kurla Complex,	Special Invitee
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Mumbai 400 051.

Besides, representatives from ICRA and CRISIL attended the deliberations of the Group. There were a few other officers from RBI as well as other organisations referred to above who contributed actively in the organisation and deliberations of the meetings and finalisation of the report.

#### 1.3.2 Terms of reference

The Working Group was assigned the following terms of reference:

- (i) to examine the regulatory framework for securitisation of assets such as structure and scope of SPV, capital adequacy standards, investor base, operational details, exposure of banks as investor etc.
- (ii) to recommend proper and transparent accounting and disclosure standards;
- (iii) to examine applicability of NBFC directions;
- (iv) to suggest comprehensive guidelines;
- (v) to suggest amendments to various statutes for promoting securitisation of debts in India; and
- (vi) any other aspects relevant to asset securitisation.

### 1.4 Methodology

The WG held nine meetings during the period from July 3 to December 13, 1999 in Mumbai. The WG had the benefit of oral presentations (Annexure – I) made by SBI Capital Markets Ltd., National Housing Bank, the three rating agencies - ICRA, DCR and CRISIL, Citi Bank, Infrastructure Leasing and Finance Services Ltd., ICICI, ANZ Investment Bank, Consultant to Asian Development Bank (Shri S. P. Ghosh) etc. The Chairman of the Group also had the opportunity to interact personally with the officials from International Finance Corporation (IFC), the Chief Executive Officer of the ANZ Investment Bank and a few other international agencies. The Chairman's secretariat interacted with international academicians, global industry specialists, international rating agencies, international investment banks, Bank for International Settlement etc.

#### 1.4.1 Literature research

Some of the previously written publications, articles from financial journals, past research, etc. were analysed. The report incorporates extracts from the thesis titled 'Securitisation of Assets of Financial Institutions' written by the Member-Secretary during his studies abroad (1997-98). Besides, the literature received from various financial institutions, Rating Agencies, ADB, IFC, was also made use for compilation of the report.

#### 1.4.2 Meetings

Besides the formal meetings attended by the Members and Special Invitees, there were numerous meetings organised by various sub-groups. Members and Special Invitees continued to interact with Specialised Agencies. The Special Invitee from ICAI had a few rounds of discussion with Research Committee of ICAI constituted for the purpose.

#### 1.4.3 Other resources

The Group received a clarification from L.I.C. that Securitisation Instruments are part of discretionary investments under Section 27(A)(2) of Insurance Act, 1938. The reply also contained a few suggestions. As a result of active follow up of the oral presentations, a few valuable suggestions were received from Shri S.P. Ghosh, Consultant, ADB, ANZ

Investment Bank, Citi Bank, NHB, ICICI, CRISIL etc. ICICI, NHB and SBI Capital Markets contributed actively in the drafting of various chapters.

#### 1.4.4 Sub-Groups

The Group had the benefit of detailed deliberations by the sub-Groups on the following subjects:

- Legal Framework
- Special Purpose Vehicle
- Disclosure Norms
- Prudential Norms
- Accounting Treatment
- Taxation Issues

### 1.5 Structure of the Report

The contents of various chapters that follow are closely related. The report starts with meaning of securitisation in Chapter 2, which also includes a reference to future flow securitisation. Securitisation can be successful if legal, regulatory and psychological barriers are minimised / eliminated and all the concerned agencies understand the benefits. For this purpose, the motivation and benefits of securitisation are discussed in detail in Chapter 3. Scope of securitisation including some attempts in India during the last few years are highlighted in Chapter 4. While the main impediments in the form of legal provisions are discussed exclusively in detail in Chapter 9, the other impediments are identified in Chapter 5. Securitisation took its birth in USA and has spread in many developed and developing countries. It is important that Indian financial community draws some lessons from experiences of these countries and adopts the same in India according to the local conditions. Chapter 6 deals with international experience. The whole structure of securitisation revolves around Special Purpose Corporation or Special Purpose Vehicle (SPV). It is necessary to understand the pros and cons of various forms of SPV. An exclusive chapter (Chapter 7) has been devoted for the purpose. The chapter also deals with applicability of Non-Banking Financial Company (NBFC) directions. Role of various other agencies including the regulators is discussed in brief in Chapter 8. Legal issues including recommendations are highlighted in Chapter 9. The chapter discusses in detail the major impediments in the form of stamp duties and tax related matters. The concluding chapter (Chapter 10) highlights other recommendations – short, medium and long-term and the suggested time frame. This Chapter refers to accounting treatment for securitisation transactions, disclosure norms and prudential guidelines. It recommends enactment of umbrella legislation and also incorporates suggestion for an Implementation Committee to expedite follow up of various suggestions. References to various paras in other chapters are made in the concluding Chapter to give the background and rationale of the recommendations. The word FI (financial institutions) referred in the subsequent chapters includes banks, financial institutions and the non-banking finance companies.