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RESERVE BANK OF INDIA
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Draft Framework for Securitisation of Standard Assets

Introduction

Securitisation involves transactions where credit risk in assets are redistributed by repackaging them into tradeable securities with different risk profiles which may give investors of various classes access to exposures which they otherwise will be unable to access directly. While complicated and opaque securitisation structures could be undesirable from the point of view of financial stability, prudentially structured securitisation transactions can be an important facilitator in a well-functioning financial market in that it improves risk distribution and liquidity of lenders in originating fresh loan exposures.

Given the above, in exercise of the powers conferred by the Banking Regulation Act, 1949 and the Reserve Bank of India Act, 1934, the Reserve Bank, being satisfied that it is necessary and expedient in the public interest so to do, hereby, issues the directions hereinafter specified.

Short title and commencement

1. These directions shall be called the Reserve Bank of India (Securitisation of Standard Assets) Directions, 2020.

2. These directions shall come into force with immediate effect.

Chapter I: Scope and Definitions

A. Applicability and Purpose

3. The provisions of these directions shall apply to the following entities (collectively referred to as lenders in these directions):
   (a) Scheduled Commercial Banks (excluding Regional Rural Banks);
   (b) All India Term Financial Institutions (NABARD, NHB, EXIM Bank, and SIDBI);
   (c) Small Finance Banks; and,

(d) All Non Banking Finance Companies (NBFCs) including Housing Finance Companies (HFCs).

4. These directions, except Chapter VI and VII, will be applicable to securitisation transactions undertaken subsequent to the issue of these directions. The provisions of Chapter VI and VII shall come into immediate effect, even for the existing securitisation exposures.

B. Definitions

5. For the purpose of these directions, the following definitions apply:

(a) "*bankruptcy remote*" means the unlikelihood of an entity being subjected to voluntary or involuntary bankruptcy proceedings, including by the originator or the creditors to the originator;

(b) "*clause*" means a clause of these directions;

(c) "*clean-up call*" means an option that permits the securitisation exposures to be called before all of the underlying exposures or securitisation exposures have been repaid, and in the context of a traditional securitisation, typically is an option available to the originator to buy back the remaining assets underlying a securitisation structure when the outstanding value of the underlying assets falls below a pre-defined threshold, thereby extinguishing the remaining securitisation exposures of all parties;

(d) "*credit enhancement*" means a contractual arrangement in which an entity assumes a securitisation exposure and, in substance, provides some degree of added protection to other parties to the transaction so as to improve the safety of their securitisation exposures;

(e) "*credit-enhancing interest-only strip (I/O)*" means an on-balance sheet asset of the originator that represents a valuation of cash flows related to future margin income, and is subordinated;

(f) "*early amortisation provision*" means a mechanism that, once triggered, accelerates the reduction of the investor's interest in underlying exposures of a securitisation structure and allows investors to be paid out prior to the originally stated maturity of the securities issued;

(g) "*excess spread (or future margin income)*" means the difference between the gross finance charge collections and other income received by the special purpose entity (SPE) and certificate interest, servicing fees, charge-offs, and other senior SPE expenses.

(h) "*exposure amount*" of a securitisation exposure means the sum of the on-balance sheet amount of the exposure, or carrying value – which takes into account purchase discounts and writedowns/specific provisions the lender took on this securitisation exposure – and the off-balance sheet exposure amount, where applicable.

(i) "*first loss facility*" means the first level of financial support provided by the originator or a third party to a special purpose entity as part of the process to improve the creditworthiness of the securities issued by the SPE such that the provider of the facility bears the bulk (or all) of the risks associated with the assets held by the SPE;

(j) "*implicit support*" means the protection arising when a lender provides support to a securitisation in excess of its predetermined contractual obligation;

(k) "*mezzanine tranche*" means a tranche or tranches subordinated to the senior tranche, and to which a risk weight of less than 1250% is assigned under the provisions of Chapter VI of these directions;

(l) "*minimum holding period (MHP)*" means the minimum period for which an originator must hold the exposures before the same may be transferred to a special purpose entity for the purpose of securitisation such that the project implementation risk is not passed on to the investors, and a minimum recovery performance is demonstrated prior to securitisation;

(m)"*mortgage backed securities*" mean securities issued by the special purpose entity against underlying exposures that are all mortgages, which includes commercial as well as residential mortgages;

(n) "*notes*" mean securities issued by the special purpose entity as a part of securitisation;

(o) "*originator*" means the lender that transfers from its balance sheet assets eligible for securitisation to a special purpose entity as a part of a securitisation transaction;

(p) "*overcollaterisation*" means any form of credit enhancement by virtue of which underlying exposures are posted in value which is higher than the value of the securitisation positions;

(q) "*replenishment*" means the process of using the cash flows from the securitised assets to acquire more eligible assets, which will continue for a pre-announced replenishment period, following which the securitisation structure reverts to an amortising one;

(r) "*residential mortgage backed securities*" mean securities issued by the special purpose entity against underlying exposures that are all residential mortgages;

(s) "*resecuritisation exposure*" means 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;

(t) "*second loss facility*" means a second level of financial support providing a second (or subsequent) tier of protection to the special purpose entity against potential losses, and is invoked only after the first loss facility has been drawn down and exhausted;

(u) "*securitisation*" means the set of transactions or scheme wherein credit risk associated with eligible exposures is tranched and where payments in the set of transactions or scheme depend upon the performance of the specified underlying exposures as opposed to being derived from an obligation of the originator, and the subordination of tranches determines the distribution of losses during the life of the set of transactions or scheme;

Provided that the pool may contain one or more exposures eligible to be securitised;

(v) "*securitisation exposures*" include but are not restricted to exposures to securities issued by the special purpose entity including asset-backed securities and mortgage-backed securities, credit enhancements, underwriting

commitments, liquidity facilities, interest rate or currency swaps, credit derivatives and tranched cover;

Explanation: Reserve accounts, such as cash collateral accounts, which is earmarked to absorb credit losses arising from the securitisation, and is recorded as an asset by the originator must also be treated as securitisation exposures.

(w) "*senior tranche*" means a tranche which is effectively backed or secured by a first claim on the entire amount of the assets in the underlying securitised pool;

Provided that where all tranches above the first-loss piece are rated, the most highly rated position would be treated as a senior tranche.

Provided that when there are several tranches that share the same rating, only the most senior tranche in the cash flow waterfall would be treated as senior (unless the only difference among them is the effective maturity).

Provided that when the different ratings of several senior tranches only result from a difference in maturity, all of these tranches should be treated as a senior tranche.

(x) "*special purpose entity (SPE)*" means a corporation, trust or other entity organised for a specific purpose, the activities of which are limited to those appropriate to accomplish the purpose of the SPE, and the structure of which is intended to isolate the SPE from the credit risk of an originator;

Explanation: Any reference to SPE in these directions would also refer to the trust settled or declared by the SPE as a part of the process of securitisation.

(y) "*synthetic securitisation*" means a structure where credit risk of an underlying pool of exposures is transferred, in whole or in part, through the use of credit derivatives or guarantees that serve to hedge the credit risk of the portfolio;

(z) "*traditional securitisation*" means a structure where the cash flow from an underlying pool of exposures is used to service at least two different stratified risk positions or tranches reflecting different degrees of credit risk, where payments to the investors depend upon the performance of the specified

underlying exposures, as opposed to being derived from an obligation of the originator.

(aa) "*tranche*" means a contractually established segment of the credit risk associated with an exposure or a pool of exposures, where a position in the segment entails a risk of credit loss greater than or less than a position of the same amount in another segment, without taking account of credit protection provided by third parties directly to the holders of positions in the segment or in other segments;

(bb) "*tranche maturity*" means the tranche's effective maturity in years, and is measured as prescribed in Section E of Chapter VI of these directions;

(cc) "*tranche thickness*" means the measure calculated as detachment point (D) minus attachment point (A), where D and A are calculated in accordance with Section D of Chapter VI of these directions;

(dd) "*true sale*" means a transaction whereby the exposures sold by the originator to the special purpose entity are put beyond the bankruptcy of the originator and / or the reach of the creditors to the originator;

Chapter II: General requirements for securitisation

A. Assets eligible for securitisation

6. All on-balance sheet standard exposures, except the following, will be eligible for securitisation by the originators:

    a. Revolving credit facilities (e.g. Cash Credit accounts, Credit Card receivables etc.);
    b. Loans with bullet repayments of both principal and interest; and
    c. Securitisation exposures

7. Loans with tenor up to 24 months extended to individuals for agricultural activities (as described in Chapter III of Master Direction- Reserve Bank of India (Priority Sector Lending –Targets and Classification) Directions, 2016 and Master Direction - Reserve Bank of India - Priority Sector Lending – Targets and Classification - Small Finance Banks - 2019) where both interest and principal are due only on

maturity and trade receivables with tenor up to 12 months discounted/purchased by lenders from their borrowers will be eligible for securitisation. However, only those loans/receivables will be eligible for securitisation where a borrower (in case of agricultural loans) /a drawee of the bill (in case of trade receivables) has fully repaid the entire amount of last two loans/receivables (one loan, in case of agricultural loans with maturity extending beyond one year) within 90 days of the due date.

8. If the underlying exposures comprise of bank loans, lenders can securitise the loans only after a minimum holding period 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.

9. For assets other than residential mortgages, the minimum holding period that would be applicable depending upon the tenor and repayment frequency is given in the following table:

	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

Provided that where the repayment is at more than quarterly intervals, loans can be securitised after repayment of at-least two instalments.

Provided that in case of loans purchased from other entities by a transferor, such loans cannot be sold before completion of twelve months from the date on which the loan was taken to the books of the transferor.

10. In the case of loans with bullet repayments of only either principal and interest, the minimum holding period requirement as per clause 9 will be reckoned based on the repayment frequency of principal or interest, as the case may be, that has a periodic repayment schedule.

11. For residential mortgages, against which residential mortgage backed securities will be issued by the special purpose entity, the minimum holding period applicable will be six months or period covering six instalments whichever is later.

12. The MHP will be applicable to individual loans in the underlying pool of securitised loans. MHP will not be applicable to loans referred to in clause 7.

B. Securitisation activities / exposures not covered by these directions

13. Lenders in India, including overseas branches of banks in India, are not permitted to undertake the securitisation activities or assume securitisation exposures as mentioned below:
    a. Resecuritisation exposures;
    b. Synthetic securitisation; and
    c. Securitisation with revolving credit facilities as underlying – These involve underlying 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).

C. Minimum Retention Requirement (MRR)

14. The MRR is primarily designed to ensure that the originators 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 originators have stake in the performance of securitised assets for the entire life of the securitisation process. The originators should adhere to the MRR as detailed below while securitising loans leading to issuance of securities other than residential mortgage backed securities:

    a. For underlying loans with original maturity of 24 months or less, the MRR shall be 5% of the book value of the loans being securitised.

    b. For underlying loans with original maturity of more than 24 months as well as loans with bullet repayments of only either principal or interest, including the loans mentioned in clause 7, the MRR shall be 10% of the book value of the loans being securitised.

15. In the case of residential mortgage backed securities, the MRR for the originator shall be 5% of the book value of the loans being securitised.

16. The MRR may be maintained by the lenders in either of the following ways:

    a. the retention of the first loss tranche and, where such retention does not amount to the MRR, other tranches which are *pari passu* or subordinate to those transferred or sold to investors and not maturing any earlier than those transferred or sold to investors, including a second loss exposure, if any, so that the total retention equals not less than MRR; or

    b. the retention of the first loss tranche and, where such retention does not amount to the MRR, the retention of a first loss exposure of not less than MRR of every securitised exposure in the securitisation so that the total retention equals not less than MRR.

Discussion Question: ***Should the two approaches specified for meeting MRR requirements be prescribed as alternatives, or does one approach have a clear advantage over the other? Please support your positions with quantitative estimates, if any.***

17. 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.

18. 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 repayment or through the absorption of losses. The form of MRR should not change during the life of securitisation.

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

D. Origination standards

20. Underwriting standards should not be less stringent than those applied to credit claims and receivables retained on the balance sheet of the originator. Where underwriting standards change, the originator should disclose the timing and purpose of such changes.

21. In cases of securitisation of exposures purchased by originator from other lenders, the requirements applicable for underwriting standardsshall apply to the standards of due diligence process adopted by the originator which may include verification of consistency of loan origination process of the lender from whom the exposures were purchased by the originator.

E. Payment priorities and observability

22. To prevent investors being subjected to unexpected repayment profiles during the life of a securitisation, the priorities of payments for all liabilities in all circumstances should be clearly defined at the time of securitisation and appropriate legal comfort regarding their enforceability should be provided. In particular, junior liabilities

should not have payment preference over senior liabilities which are due and payable.

23. To help provide investors with full transparency over any changes to the cash flow waterfall, payment profile or priority of payments that might affect a securitisation, all triggers affecting the cash flow waterfall, payment profile or priority of payments of the securitisation should be clearly and fully disclosed in offering documents and in investor reports, with information in the investor report that clearly identifies the breach status, the ability for the breach to be reversed and the consequences of the breach.

24. Securitisations featuring a replenishment period should include provisions for appropriate early amortisation events and/or triggers of termination of the replenishment period, including, notably:
    a. deterioration in the credit quality of the underlying exposures;
    b. a failure to acquire sufficient new underlying exposures of similar credit quality; and
    c. the occurrence of an insolvency-related event with regard to the originator or the servicer.

F. Limit on Total Retained Exposures

25. The total exposure of a lender to the securitisation exposures belonging to a particular securitisation structure or scheme should not exceed 20% of the total securitisation exposures created by such structure or scheme.

26. Credit exposure on account of interest rate swaps/currency swaps entered into with the SPE will be excluded from this limit.

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

G. Listing of securities issued in a securitisation

28. If the value of the exposures underlying a residential mortgage backed securitisation is Rs.500 crore or above, the securities issued must be mandatorily listed. For securities issued in residential mortgage backed securitisations where the value of the exposures underlying is less than Rs.500 crore, and securities

issued in other securitisation transactions, listing of the securities or notes is optional.

Discussion Question: ***Should the notes issued in a securitisation be mandated to be listed if the issue size is above a certain threshold? What could be the costs and benefits of such mandatory listing? Do you agree with mandatory listing only in respect of RMBS, as proposed, or should it cover all classes of securitisation notes? Should the issue size of Rs.500 crore as the proposed threshold for mandatory listing be reconsidered?***

H. Conditions to be satisfied by the special purpose entity

29. The SPE should meet the following criteria to enable the originator to apply the guidelines on capital adequacy and other aspects as prescribed in these directions with regard to the securitisation exposures assumed by it:

    a. Any transaction between the originator and the SPE should be strictly on arm's length basis. Further, it should be ensured that any transaction with the SPE should not intentionally provide for absorbing any future losses of the SPE by the originator.

    b. The SPE and the trustee should not resemble in name or imply any connection or relationship with the originator of the assets in its title or name.

    c. The originator should not have any ownership, proprietary or beneficial interest in the SPE. The originator should not hold any share capital in the SPE.

    d. The originator may have not more than one representative, without veto power, on the board of the SPE provided the board has at least four members and independent directors are in majority.

    e. If the SPE is set up as a trust, then:

        i. The originator shall not exercise control, directly or indirectly, over the SPE and the trustees, if any, and shall not settle the trust deed, if any.

        ii. The SPE should be bankruptcy remote and non-discretionary.

iii. The trust deed, if any, should lay down, in detail, the functions to be performed by the trustee, their rights and obligations as well as the rights and obligations of the investors in relation to the securitised assets. The trust deed should not provide for any discretion to the trustee as to the manner of disposal and management or application of the trust property. In order to protect their interests, investors should be empowered in the trust deed to change the trustee at any point of time.

iv. The trustee, if any, should only perform trusteeship functions in relation to the SPE and should not undertake any other business with the SPE.

v. A copy of the trust deed, if any, and the accounts and statement of affairs of the SPE should be made available to the RBI, if required to do so.

f. The originator shall not support the losses of the SPE except under the facilities explicitly permitted under these directions and shall also not be liable to meet the recurring expenses of the SPE.

g. The SPE should make it clear to the investors in the securities issued by it that these securities are not insured and that they do not represent deposit liabilities of the originator, servicer or trustees.

30. In cases where the originator has purchased loans from another lender for the purpose of securitisation, the provisions of clause 29 shall apply to the lender from whom the originator has purchased the exposures, as well.

Provided that for the purpose of sub-clause (d) of clause 29, only one of either the originator or the lender from whom loans were purchased but the originator, shall have the representative on the board of the SPE.

I. Representations and Warranties

31. An originator that sells assets to SPE may make representations and warranties concerning those assets. Where the following conditions are met the originator 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 originator 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 originator 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 assets, the performance of the SPE and/or the securities the SPE issues.
e. The exercise of a representation or warranty, requiring an originator to replace assets (or any parts of them) sold to a SPE, must be:
    i. undertaken within 120 days of the transfer of assets to the SPE; and
    ii. conducted on the same terms and conditions as the original sale.
f. An originator 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:
    i. the onus of proof for breach of representation or warranty remains at all times with the party so alleging;
    ii. the party alleging the breach serves a written Notice of Claim on the originator, specifying the basis for the claim; and
    iii. damages are limited to losses directly incurred as a result of the breach.
g. An originator should notify RBI (Department of Supervision) of all instance where it has agreed to replace assets sold to SPE or pay damages arising out of any representation or warranty.

J. Accounting provisions

32. Lenders shall sell assets to SPE only on cash basis and the sale consideration should be received not later than the transfer of the asset to the SPE.

33. Any loss, profit or premium arising because of the sale, which is realised, should be accounted accordingly and reflected in the Profit & Loss account for the accounting period during which the sale is completed. However, profits / premium, if any, arising out of such sales, shall be deducted from CET 1 capital or net owned

funds for meeting regulatory capital adequacy requirements till the maturity of such assets.

34. Banks 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*".

35. The balance in this account may be treated as a provision against potential losses incurred on the credit-enhancing interest-only strip. The profit may be recognised in Profit and Loss Account only when credit-enhancing interest-only strip is redeemed in cash. The gain on sale represented by credit-enhancing interest-only strip need not be deducted from CET 1 capital since it is not recognised upfront.

36. The credit-enhancing interest-only strip may be amortising or non-amortising.

37. In the case of amortising credit-enhancing interest-only strip, a bank would periodically receive in cash, only the amount which is left after absorbing losses, if any, supported by the credit-enhancing interest-only 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*" account bringing down the book value of the credit-enhancing interest-only strip in the bank's books.

38. In the case of a non-amortising credit-enhancing interest-only strip, as and when the bank receives intimation of charging-off of losses by the SPE against the credit-enhancing interest-only strip, it may write-off equivalent amount against "*Unrealised Gain on Loan Transfer Transactions*" account and bring down the book value of the credit-enhancing interest-only strip in the bank's books. The amount received in final redemption value of the credit-enhancing interest-only strip received in cash may be taken to Profit and Loss account.

Chapter III: Simple, transparent and comparable (STC) securitisations

39. Only traditional securitisations that additionally satisfy all the criteria laid out in Annex 1 of these directions fall within the scope of the STC framework. The above criteria are based on the prescriptions of the Basel Committee on Banking Supervision. Exposures to securitisations that are STC-compliant can be subject

to the alternative capital treatment as determined by clauses 112 to 114 or clauses 127 to 128.

40. The originator must disclose to investors all necessary information at the transaction level to allow investors to determine whether the securitisation is STC-compliant. Based on the information provided by the originator, the investor must make its own assessment of the securitisation‘s STC compliance status before applying the alternative capital treatment.

41. For retained positions where the originator has achieved significant credit risk transfer in terms of the requirements of the clauses 79 and 80, the determination of compliance with STC requirements shall be made only by the originator retaining the position.

42. STC criteria need to be met at all times. Checking the compliance with some of the criteria might only be necessary at origination (or at the time of initiating the exposure, in case of guarantees or liquidity facilities) to an STC securitisation. Notwithstanding, investors and holders of the securitisation positions are expected to take into account developments that may invalidate the previous compliance assessment, for example deficiencies in the frequency and content of the investor reports, in the alignment of interest, or changes in the transaction documentation at variance with relevant STC criteria.

43. In cases where the criteria refer to underlying, and the pool is dynamic, the compliance with the criteria will be subject to dynamic checks every time that assets are added to the pool.

44. Investors should consider whether the originator, servicer and other parties with a fiduciary responsibility to the securitisation have an established performance history for substantially similar credit claims or receivables to those being securitised and for an appropriately long period of time.

Chapter IV: Provision of facilities supporting securitisation structures

A. General conditions

45. Lenders may provide supporting facilities such as credit enhancement facilities, liquidity facilities, underwriting facilities and servicing facilities. Since such facilities

may also be provided by entities that are not lenders, entities providing such facilities are generally referred to in these directions as “facility providers”.

46. The facilities, as above, provided by facility providers should satisfy the following conditions, in addition to the specific conditions applicable to each facility as prescribed in the remaining sections of this Chapter:

    a. Provision of the facility should be structured in a manner to keep it distinct from other facilities and documented separately from any other facility provided by the facility provider. The nature, purpose, extent of the facility and all required standards of performance should be clearly specified in a written agreement to be executed at the time of originating the transaction and disclosed in the offer document.

    b. The facility is provided on an 'arm's length basis' on market terms and conditions, and subjected to the facility provider’s normal credit approval and review process.

    c. Payment of any fee or other income for the facility is not subordinated or subject to deferral or waiver.

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

    e. The duration of the facility is limited to the earlier of the dates on which:
        i. the underlying assets are completely amortised;
        ii. all claims connected with the securities issued by the SPE are paid out; or
        iii. the facility provider's obligations are otherwise terminated.

    f. There should not be any recourse to the facility provider beyond the fixed contractual obligations. In particular, the facility provider should not bear any recurring expenses of the securitisation.

    g. The facility provider has obtained legal opinion that the terms of agreement protect it from any liability to the investors in the securitisation or to the SPE / trustee, except in relation to its contractual obligations pursuant to the agreement governing provision of the facility.

h. The SPE and/or investors in the securities issued by the SPE have the clear right to select an alternative party to provide the facility.

B. Credit enhancement facilities

47. Credit enhancement is the process of enhancing credit profile of a structured financial transaction through provision of additional security/financial support, for covering losses on securitised assets in adverse conditions. The enhancements can be broadly divided into two types viz. internal credit enhancement and external credit enhancement. A credit enhancement which, for the investors, creates exposure to entities other than the underlying borrowers is called the external credit enhancement. For instance, cash collaterals and first/second loss guarantees are external forms of credit enhancements. Investment in subordinated tranches, over-collateralisation, excess spreads, credit enhancing interest-only strips are internal forms of credit enhancements.

48. Credit enhancement facilities include all arrangements provided to the SPE that could result in a facility provider absorbing losses of the SPE or its investors. Such facilities may be provided by both originators and third parties. The facility provider providing credit enhancement facilities should ensure that the following conditions are fulfilled failing which such will be required to hold capital against the full value of the securitised assets as if they were held on its balance sheet:

    a. All conditions specified in clause 46.

    b. Credit enhancement facility should be provided only at the initiation of the securitisation transaction.

    c. The amount of credit enhancement extended at the initiation of the securitisation transaction should be available to the SPE during the entire life of the securities issued by the SPE.

    d. Any utilization / draw down of the credit enhancement should be immediately written-off by debit to the profit and loss account.

    e. A credit enhancement facility will be deemed to be a second loss facility only where:

        i. it enjoys protection given by a first loss facility;

ii. it can be drawn on only after the first loss facility has been completely exhausted;
iii. it covers only losses beyond those covered by the first loss facility; and
iv. the provider of the first loss facility continues to meet its obligations.

If the second loss facility does not meet the above criteria, it will be treated as a first loss facility.

C. Reset of credit enhancements

49. Resets can be applied to external forms of credit enhancements, which is in first or second loss position. The original amount of external credit enhancements provided at the time of initiation of securitisation transaction can be reset by the credit enhancement provider subject to the conditions enumerated below.

a. At the time of reset, all the outstanding tranches of securities should be re-rated (other than equity tranches which are not rated). The first reset of credit enhancement will not be permitted if the rating of any of the tranches has deteriorated vis-a-vis the original rating of these securitization positions. Subsequent resets would not be permitted if the rating of any of the tranches has deteriorated vis-à-vis the rating at the time of previous reset.

b. If reset is permissible in terms of (a) above, the amount of credit enhancement required for retaining the original or current outstanding rating, whichever is higher should be determined by the concerned rating agency for the first reset. Similarly, for subsequent resets, the amount of credit enhancement required for retaining the higher of the rating at the time of previous reset and current outstanding rating should be determined by the concerned rating agency.

Provided that only the rating agency which had rated the securitization transaction initially shall re-rate it for the purpose of reset of credit enhancement.

c. The reset of credit enhancement would be subject to the consent of trustees or the Board of Directors or any authority on which the responsibility of management of the affairs of the SPE is vested.

d. The reset of credit enhancement should be provided for in the contractual terms of the transaction and the initial rating of the transaction should take into account the likelihood of resets. Such contractual clause should include clearly defined “delinquency triggers”, which, if met, should result in the credit enhancement rests not available or possible.

e. In case such a contractual clause was not available originally, reset of credit enhancement may be carried out subject to the consent of all investors of outstanding securities.

f. In structures where external credit enhancements exist providing first loss credit enhancement (FLCE) and second loss credit enhancement (SLCE), the reset may be carried out simultaneously between FLCE and SLCE in a proportion such that the reset maintains the outstanding rating [as envisaged in (b) above] of SLCE.

g. Reset of equity tranche is not allowed as it would tantamount to a rest of an internal credit enhancement.

For all securitisations other than residential mortgage backed-securitisations, at the time of first reset, at least 50% of the total principal amount assigned at the time of initiation of the securitization transaction must have been amortised. The subsequent resets may be carried out after the pool principal has amortised in steps of 10%, i.e., up to at least 60%, 70% and 80% of the original level. However, a minimum gap of six months should be maintained between successive resets.

50. For residential mortgage-backed securitisations, at the time of first reset, at least 25% of the total principal amount assigned at the time of initiation of the securitization transaction must have been amortised. The subsequent resets may be carried out at every 10% (of the original level) further amortisation of the pool principal. A minimum gap of six months should be maintained between successive resets.

51. The excess credit enhancement can be released subject to the following conditions:

a. The release of credit enhancement would be subject to a reserve floor as a percentage of the initial credit enhancement provided at the time of

transaction, i.e., at any time, the level of credit enhancement available, following any reset shall not drop below the prescribed reserve floor. Thus, even if the required level of credit enhancement to maintain the ratings, as assessed by the credit rating agency during a reset, is lower than the reserve floor, the excess amount available for reset shall be computed as the difference between the available credit enhancement and the reserve floor.

b. The stipulation of the floor may be based on the transaction structure, depending on asset class, the track record of the originator and other pool specific factors such as concentration of long term contracts in a pool, and in no case should be less than:

    i. 30% of the initial credit enhancement for securitisations other than residential mortgage backed-securitisations; and

    ii. 20% of the initial credit enhancement for residential mortgage backed-securitisations.

c. A maximum of 60% of the credit enhancement in excess of that required to retain the credit rating of all the tranches as referred to in sub-clause (b) of clause 49 assigned to them can be considered for release, at any point of time subject to fulfilling the reserve floor indicated at (a) above.

d. The reset should not lead to exposures retained by originators along with credit enhancements offered by them falling below the level of MRR prescribed in Section C of Chapter II of these directions.

52. In order to facilitate a common understanding amongst stakeholders and to allow the market to understand the linkage between good pool performance and CE reset, credit rating agencies may disseminate information pertaining to CE reset via press release and may confirm that ratings will be not be adversely affected by such reset.

D. Liquidity facilities

53. A liquidity facility is provided to help smoothen the timing differences faced by the SPE between the receipt of cash flows from the underlying assets and the

payments to be made to investors. A liquidity facility should meet all of the following conditions to guard against the possibility of the facility functioning as a form of credit enhancement and/ or credit support:

a. All conditions specified in clause 46.

b. The securitised assets are covered by a first loss credit enhancement.

c. The documentation for the facility must clearly define the circumstances under which the facility may or may not be drawn on.

d. The facility should be capable of being drawn only where there is a sufficient level of non-defaulted assets to cover drawings, or the full amount of assets that may turn non-performing are covered by a substantial credit enhancement.

e. The facility shall not be drawn for the purpose of:
    i. providing credit enhancement;
    ii. covering losses of the SPE;
    iii. serving as a permanent revolving funding; and
    iv. covering any losses incurred in the underlying pool of exposures prior to a draw down.

f. The liquidity facility should not be available for the following purposes:
    i. meeting recurring expenses of securitisation;
    ii. funding acquisition of additional assets by the SPE;
    iii. funding the final scheduled repayment of investors; and
    iv. funding breaches of warranties.

g. Funding should be provided to SPE and not directly to the investors.

h. When the liquidity facility has been drawn the facility provider shall have a priority of claim over the future cash flows from the underlying assets, which will be senior to the senior tranche.

i. When the originator is providing the liquidity facility, an independent third party, other than the originator's related parties, should co-provide at least 25% of the liquidity facility that shall be drawn and repaid on a pro-rata basis. The originator must not be liable to meet any shortfall in liquidity support

provided by the independent party. During the initial phase, a facility provider may provide the full amount of a liquidity facility on the basis that it will find an independent party to participate in the facility as provided above. The originator will have three months to locate such independent third party.

54. If any of the conditions are not satisfied, a liquidity facility will be regarded as serving the economic purpose of credit enhancement. In such cases, the liquidity facility provided by a third party shall be treated as a first loss facility and the liquidity facility provided by the originator shall be treated as a second loss facility.

55. Since the liquidity facility is meant to smoothen temporary cash flow mismatches, the facility will remain drawn only for short periods. If the drawings under the facility are outstanding for more than 90 days it should be classified as NPA and fully provided for.

E. Underwriting facilities

56. An originator or a third-party service provider may act as an underwriter for the issue of securities by SPE and treat the facility as an underwriting facility for capital adequacy purposes subject to the following conditions:

    a. All conditions specified in clause 46 are satisfied.

    b. The underwriting is exercisable only when the SPE cannot issue securities into the market at a price equal to or above the benchmark predetermined in the underwriting agreement.

    c. The facility provider has the ability to withhold payment and to terminate the facility, if necessary, upon the occurrence of specified events (e.g. material adverse changes or defaults on assets above a specified level); and

57. In case any of the above conditions are not satisfied, the facility will be considered as a credit enhancement and treated as a first loss facility when provided by a third party and a second loss facility when provided by an originator.

58. An originator may underwrite only investment grade senior securities issued by the SPE. The holdings of securities devolved through underwriting should be sold to unrelated third parties within three-month period following the acquisition.

59. If a third party facility provider underwrites the securities issued by the SPE, the holdings of securities devolved through underwriting should be sold to third parties unrelated to the originator within three-month period following the acquisition.

F. Servicing Facilities

60. A servicing facility provider administers or services the securitised assets. Hence, it should not have any obligation to support any losses incurred by the SPE and should be able to demonstrate this to the investors in the securitisation exposures. A facility provider performing the role of a service provider for a proprietary or a third-party securitisation transaction should ensure that the following conditions are fulfilled:

    a. All conditions specified in clause 46.

    b. The service provider should be under no obligation to remit funds to the SPE or investors until it has received funds generated from the underlying assets except where it is also the provider of an eligible liquidity facility.

    c. 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.

61. Where any of the above conditions are not met, the service provider may be deemed as providing liquidity facility to the SPE or investors and treated accordingly for capital adequacy purpose.

Chapter V: Requirements to be met by lenders who are investors in securitisation exposures

A. Due Diligence Requirements

62. Lenders must have a comprehensive understanding of the risk characteristics of its individual securitisation exposures as well as the risk characteristics of the pools underlying its securitisation exposures, at all times. Lenders also have to demonstrate that for making such an assessment they have implemented formal policies and procedures as appropriate.

63. Lenders should be able to access performance information on the underlying pools on an ongoing basis. Such information may include, as appropriate, but not limited

to the following: the average credit quality through average credit scores or similar aggregates of creditworthiness, extent of diversification of the pool of loans, volatility of the market values of the collaterals supporting the loans, cyclicality of the economic activities in which the underlying borrowers are engaged, exposure type, prepayment rates, property types, occupancy, etc.

64. Lenders should have a thorough understanding of all structural features of a securitisation transaction that would materially impact the performance of their exposures to the transaction. Such information may include, as appropriate, but not limited to the following: 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, liquidity enhancements, availability of credit enhancements in the case of liquidity facilities, deal-specific definition of default, etc.

65. Apart from the above, lenders should take note of, analyse and record the following while taking the decision regarding a securitisation exposure:
    a. the reputation of the originators in terms of observance of credit appraisal and credit monitoring standards, due diligence standards in case the securitised assets had been purchased, adherence to minimum retention and minimum holding standards in earlier securitisations, and fairness in selecting exposures for securitisation;
    b. 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;
    c. 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
    d. 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.

B. Stress testing

66. Lenders 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 and drying of liquidity of the securities resulting in higher prudent valuation adjustments. Based on the results of stress tests, additional capital shall be held to support any higher risk, if required.

C. Credit monitoring

67. The counterparty for the investor in the securities would not be the SPE but the underlying assets in respect of which the cash flows are expected from the obligors. The securitisation exposures of lenders will be subject to the requirements of Paragraphs 8.3 to 8.10 of the circular DBR.No.BP.BC.43/21.01.003/2018-19 dated June 3, 2019 on “Large Exposures Framework”.

68. Lenders 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.

69. For this purpose, lenders should establish formal procedures appropriate to their banking book and trading book and commensurate with the risk profile of their exposures in securitised positions as stipulated in clauses 63 to 65. Where relevant, this shall include the exposure type, the percentage of loans more than 30, 60 and 90 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. Lenders may inter alia make use of the disclosures made by the originators in the form given in Annex 2 to monitor the securitisation exposures.

Discussion Question: ***For investments in securitisation notes, should there be regulatory prescriptions for valuation by the investors to ensure uniform recognition of the notes across all entities? If so, what could be the valuation methodologies that could be prescribed for uniform adoption by all financial entities?***

Chapter VI: Capital requirement for securitisation exposures

A. General Conditions

70. Lenders must maintain capital against all securitisation exposure amounts, including those arising from the provision of credit risk mitigants to a securitisation transaction, investments in asset-backed or mortgage-backed securities, retention of a subordinated tranche, and extension of a liquidity facility or credit enhancement. For the purpose of capital computation, repurchased securitisation exposures must be treated as retained securitisation exposures.

71. For the purpose of calculating exposure amount, a lender shall measure the exposure amount of its off-balance exposure as follows:

    a. for credit risk mitigants sold or purchased by the lender, the treatment set out in Paragraph 7 of the "Master Circular – Basel III Capital Regulations" dated July 1, 2015 will apply;

    b. for facilities that are not credit risk mitigants, use a credit conversion factor (CCF) of 100%. If contractually provided for, servicers may advance cash to ensure an uninterrupted flow of payments to investors so long as the servicer is entitled to full reimbursement and this right is senior to other claims on cash flows from the underlying pool of exposures. The undrawn portion of servicer cash advances or facilities that are unconditionally cancellable without prior notice may receive the CCF for unconditionally cancellable commitments. For this purpose, a national supervisor that uses this discretion must develop an appropriately conservative method for measuring the amount of the undrawn portion; and

c. for derivatives contracts other than credit risk derivatives contracts, such as interest rate or currency swaps sold or purchased by the lenders, the measurement approach set out in the circular dated November 10, 2016 on "Guidelines for computing exposure for counterparty credit risk arising from derivative transactions" will apply.

72. For the purposes of calculating capital requirements, a lender's exposure A overlaps another exposure B if in all circumstances the lender will preclude any loss for the lender on exposure B by fulfilling its obligations with respect to exposure A. For example, if a lender provides full credit support to some notes and holds a portion of these notes, its full credit support obligation precludes any loss from its exposure to the notes. If a lender can verify that fulfilling its obligations with respect to exposure A will preclude a loss from its exposure to B under any circumstance, the lender does not need to calculate risk-weighted assets for its exposure B.

73. To arrive at an overlap, a lender may, for the purposes of calculating capital requirements, split or expand its exposures, i.e., splitting exposures into portions that overlap with another exposure held by the lender and other portions that do not overlap; and expanding exposures by assuming for capital purposes that obligations with respect to one of the overlapping exposures are larger than those established contractually. For example, a liquidity facility may not be contractually required to cover defaulted assets in certain circumstances. For capital purposes, such a situation would not be regarded as an overlap to the notes issued by that securitisation. However, the lender may calculate risk-weighted assets for the liquidity facility as if it were expanded (either in order to cover defaulted assets or in terms of trigger events) to preclude all losses on the notes. In such a case, the lender would only need to calculate capital requirements on the liquidity facility.

74. Overlap could also be recognised between relevant capital charges for exposures in the trading book and capital charges for exposures in the banking book, provided that the lender is able to calculate and compare the capital charges for the relevant exposures.

75. In case of failure by lenders to off-load their holdings of securities devolved through underwriting within the stipulated time limit of three months from the date of

acquisition, any holding in excess of 20% of the original amount of issue, including secondary market purchases, shall receive a risk weight of 1250%.

76. Liquidity facilities provided by lenders that satisfy the requirements of Section D of Chapter IV of these directions shall attract risk weights as below:

    a. If the facility is rated, the risk weights shall be as per the SEC-ERBA approach prescribed in Section H of this Chapter.

    b. If the facility is unrated, the drawn and undrawn portions of an unrated eligible liquidity facility would attract a risk weight equal to the highest risk weight assigned to any of the underlying individual exposures covered by this facility, with the undrawn portion attracting a credit conversion factor of 100%.

77. Liquidity facilities provided by lenders that do not satisfy the requirements of Section D of Chapter IV of these directions shall be risk weighted at 1250%, after applying a credit conversion factor of 100% for the undrawn portion.

78. All securitisation exposures, which are not covered by these directions, or which do not satisfy the conditions prescribed in these directions, or which has exposures originated by an entity which is not a lender as referred to in clause 3, shall be risk weighted at 1250%.

B. Derecognition of transferred assets for the purpose of capital adequacy

79. An originator has to maintain capital against the exposures transferred to a special purpose entity, which then forms the underlying for securities issued by the SPE, i.e., the exposures transferred to a special purpose entity must be included in the calculation of risk-weighted assets of the originator, unless the following conditions are satisfied:

    a. Significant credit risk associated with the underlying exposures of the securities issued by the SPE has been transferred to third parties. For this purpose, significant credit risk will be treated as having transferred if the following conditions are satisfied:

        i. If there are at least three tranches, risk-weighted exposure amounts of the mezzanine securitisation positions held by the originator do not

exceed 50% of the risk-weighted exposure amounts of all mezzanine securitisation positions existing in this securitisation;

ii. In cases where there are no mezzanine securitisation positions, the originator does not hold more than 20% of the exposure values of securitisation positions that are first loss positions.

b. The nominal value of the total first loss positions available to a securitisation is not less than the product of the following: (i) exposure value of the underlying exposures; (ii) weighted average life of the underlying exposures; and (iii) weighted average asset-class slippage ratio of the underlying exposures in the past one year. The originator does not maintain direct or indirect control over the transferred exposures. Specifically, the originator should not be able to repurchase the transferred exposures unless it is done through invocation of a clean-up call option. Also, there should not be any obligation on the originator to retain the risk of the transferred exposures.

   Provided that the purchase on invocation of clean-up calls is conducted at arm's length, on market terms and conditions (including price/fee) and is subject to the originator's normal credit approval and review processes;

   Explanation: For the purpose of this sub-clause, retention of servicing rights in respect of the transferred exposures would not constitute control by the originator over the transferred exposures.

c. The transferred exposures are legally isolated from the originator in such a way that the exposures are put beyond the reach of the originator or its creditors, even in bankruptcy or administration.

d. The securities issued by the SPE are not obligations of the originator. Thus, the investors who purchase the securities have a claim only to the underlying exposures.

e. The holders of the securities issued by the SPE against the transferred exposures have the right to pledge or trade them without any restriction, unless the restriction is imposed by a statutory or regulatory risk retention requirement.

f. The exercise of the clean-up calls, if any, should not be mandatory on the originator, in form or substance and must be at the discretion of the originator.

g. The clean-up call options, if any, should not be structured to avoid allocating losses to credit enhancements or positions held by investors or otherwise structured to provide credit enhancements.

   Provided that if a clean-up call, when exercised, is found to serve as a credit enhancement, the exercise of the clean-up call should be considered a form of implicit support provided by the originator.

h. The threshold at which clean-up calls become exercisable shall not be more than 10% of the original value of the underlying exposures.

i. The securitisation does not contain clauses that require the originator to replace or replenish the underlying exposures to improve the credit quality of the pool in the event of deterioration in the underlying credit quality.

j. If the originator provides credit enhancement or first loss facility, the securitisation structure shall not allow for increase in the above positions after inception.

k. The securitisation does not contain clauses that increase the yield payable to parties other than the originator such as investors and third party providers of credit enhancements, in response to a deterioration in the credit quality of the underlying pool.

l. There must be no termination options or triggers to the securitisation exposures except eligible clean-up call options or termination provisions for specific changes in tax and regulation (regulatory or tax call options) or early amortisation provisions.

   Provided that early amortisation provisions, if any, are solely triggered by events not related to performance of underlying assets or the originator.

   Provided that early amortisation provisions do not subordinate the originator's senior or *pari passu* interest in the underlying to the interest of other investors, nor subordinate the originator's subordinated interest to an

even greater degree relative to the interest of other parties, nor in other ways increase the exposure of the originator to the losses associated with the underlying exposures shall be treated as in violation of the provisions of this clause.

80. The originator should obtain legal opinion that the transfer of exposures to a special purpose entity satisfies the above conditions if the exposures are to be excluded from the calculation of risk weighted assets.

C. Approaches for computation of risk weighted assets

81. Banks may apply either Securitisation External Ratings Based approach (SEC-ERBA) or Securitisation Standardised Approach (SEC-SA) for calculation of risk weighted assets for credit risk of securitisation exposures.

Discussion Question: *Should SEC-ERBA and SEC-SA approaches be prescribed as alternatives for banks, or should one of the approaches be prescribed as a preferred approached? Are there scenarios or situations in which one approach should be preferred over the other? Please support your positions with quantitative estimates, if any.*

82. NBFCs (including HFCs) shall apply only SEC-ERBA for calculation of risk weighted assets for credit risk of securitisation exposures.

83. Securitisation exposures to which none of the above approaches can be applied must be assigned a 1250% risk weight by lenders.

84. When a lender provides implicit support to a securitisation, it must, at a minimum, hold capital against all of the underlying exposures associated with the securitisation transaction as if they had not been securitised. Additionally, lenders would not be permitted to recognise in regulatory capital any gain on sale.

D. Determination of attachment point (A) and detachment point (D)

85. The attachment point (A) represents the threshold at which losses within the underlying pool would first be allocated to the relevant securitisation exposure. The attachment point (A) shall be expressed as a decimal value between zero and one

and shall be equal to the greater of zero and the ratio of the outstanding balance of the pool of underlying exposures in the securitisation minus the outstanding balance of all tranches that rank senior or *pari passu* to the tranche containing the relevant securitisation position including the exposure itself to the outstanding balance of all the underlying exposures in the securitisation.

86. The detachment point (D) represents the threshold at which losses within the underlying pool result in a total loss of principal for the tranche in which a relevant securitisation exposure resides. The detachment point (D) shall be expressed as a decimal value between zero and one and shall be equal to the greater of zero and the ratio of the outstanding balance of the pool of underlying exposures in the securitisation minus the outstanding balance of all tranches that rank senior to the tranche containing the relevant securitisation position to the outstanding balance of all the underlying exposures in the securitisation.

87. For the calculation of A and D, overcollateralisation and funded reserve accounts must be recognised as tranches; and the assets forming these reserve accounts must be recognised as underlying assets. Only the loss-absorbing part of the funded reserve accounts that provide credit enhancement can be recognised as tranches and underlying assets.

88. Unfunded reserve accounts, such as those to be funded from future receipts from the underlying exposures (eg unrealised excess spread) and assets that do not provide credit enhancement like pure liquidity support, currency or interest-rate swaps, or cash collateral accounts related to these instruments must not be included in the above calculation of A and D.

89. Lenders should take into consideration the economic substance of the transaction rather than the form and apply these definitions conservatively in the light of the structure.

E. Determination of tranche maturity

90. For risk based capital purposes, tranche maturity (M_T) can be measured at the lender's discretion in either of the following manners:

    a. As the rupee weighted-average maturity of the contractual cash flows of the tranche, as expressed below, where CF_t denotes the cash flows (principal,

interest payments and fees) contractually payable by the borrower in period *t*. The contractual payments must be unconditional and must not be dependent on the actual performance of the securitised assets. If such unconditional contractual payment dates are not available, the final legal maturity shall be used.

$$M_T = \frac{\sum_t tCF_t}{\sum_t CF_t}$$

b. On the basis of final legal maturity of the tranche, where M_L is the final legal maturity of the tranche.

$$M_T = 1 + 0.8(M_L - 1)$$

91. In all cases, M_T will have a floor of one year and a cap of five years.

92. When determining the maturity of a securitisation exposure, lenders should take into account the maximum period of time they are exposed to potential losses from the securitised assets. In cases where a lender provides a commitment, the lender should calculate the maturity of the securitisation exposure resulting from this commitment as the sum of the contractual maturity of the commitment and the longest maturity of the asset(s) to which the lender would be exposed after a draw has occurred.

93. For credit protection instruments that are only exposed to losses that occur up to the maturity of that instrument, a lender would be allowed to apply the contractual maturity of the instrument and would not have to look through to the protected position.

F. Caps for securitisation approaches

94. Lenders may apply a “look-through” approach to senior securitisation exposures, whereby the senior securitisation exposure could receive a maximum risk weight equal to the exposure weighted-average risk weight applicable to the underlying exposures, provided that the lender has knowledge of the composition of the underlying exposures at all times.

95. In the case of pools where the lender uses exclusively the standardised approach, the risk weight cap for senior exposures would equal the exposure weighted-

average risk weight that would apply to the underlying exposures under the standardised approach framework.

96. Where the risk weight cap results in a lower risk weight than the floor risk weight of 15%, the risk weight resulting from the cap should be used.

97. An originator using the SEC-ERBA or SEC-SA for a securitisation exposure may apply a maximum capital requirement for the securitisation exposures it holds equal to the capital requirement that would have been assessed against the underlying exposures had they not been securitised.

98. In applying the capital charge cap, the entire amount of any gain on sale arising from the securitisation transaction must be deducted from the calculations.

G. Treatment of credit risk mitigation for securitisation exposures

99. A lender may recognise credit protection purchased on a securitisation exposure when calculating capital requirements subject to the following:

    a. collateral recognition is limited to that permitted under Paragraph 7.3.5 of the “Master Circular – Basel III Capital Regulations” dated July 1, 2015. Collateral pledged by SPEs may be recognised;

    b. credit protection provided by the entities listed in Paragraph 7.5.6 of the “Master Circular – Basel III Capital Regulations” dated July 1, 2015 may be recognised. SPEs cannot be recognised as eligible guarantors; and

    c. where guarantees fulfil the minimum operational conditions as specified in Paragraph 7.5 of the “Master Circular – Basel III Capital Regulations” dated July 1, 2015, lenders can take account of such credit protection in calculating capital requirements for securitisation exposures.

100. When a lender provides full (or pro rata) credit protection to a securitisation exposure, the lender must calculate its capital requirements as if it directly holds the portion of the securitisation exposure on which it has provided credit protection (in accordance with the definition of tranche maturity).

101. Provided that the conditions set out in clause 99 are met, the lender buying full (or pro rata) credit protection may recognise the credit risk mitigation on the securitisation exposure in accordance with the CRM framework.

102. Under all approaches, a lower-priority sub-tranche must be treated as a non-senior securitisation exposure even if the original securitisation exposure prior to protection qualifies as senior as defined in sub-clause (w) of clause 5.

103. A maturity mismatch exists when the residual maturity of a hedge is less than that of the underlying exposure. When protection is bought on a securitisation exposure(s), for the purpose of setting regulatory capital against a maturity mismatch, the capital requirement will be determined in accordance with Paragraph 7.6 of the "Master Circular – Basel III Capital Regulations" dated July 1, 2015. When the exposures being hedged have different maturities, the longest maturity must be used.

H. Securitisation – External Ratings Based Approach (SEC-ERBA)

104. For securitisation exposures that are externally rated, risk-weighted assets under the securitisation external ratings-based approach (SEC-ERBA) will be determined by multiplying securitisation exposure amounts by the appropriate risk weights as determined by clauses 106 and 108 provided that the following operational criteria are met:

a. To be eligible for risk-weighting purposes, the external credit assessment must take into account and reflect the entire amount of credit risk exposure the lender has with regard to all payments owed to it. For example, if a lender is owed both principal and interest, the assessment must fully take into account and reflect the credit risk associated with timely repayment of both principal and interest;

b. The external credit assessments must be from an eligible external credit rating agency (CRA) as provided in Paragraph 6 of the "Master Circular – Basel III Capital Regulations" dated July 1, 2015. A rating must be published in an accessible form and included in the CRA's transition matrix. Also, loss and cash flow analysis as well as sensitivity of ratings to changes in the underlying rating assumptions should be publicly available. Consequently, ratings that are made available only to the parties to a transaction do not satisfy this requirement. Further, the external credit assessment provided by the eligible CRA should not be more than six months old.

c. Eligible CRAs must have a demonstrated expertise in assessing securitisations, which may be evidenced by strong market acceptance.

d. Where two or more eligible CRAs can be used and these assess the credit risk of the same securitisation exposure differently, Paragraph 6.7 of the "Master Circular – Basel III Capital Regulations" dated July 1, 2015 will apply.

e. Where credit risk mitigation (CRM) is provided to specific underlying exposures or the entire pool by an eligible guarantor as defined in Paragraph 7.5.6 of the "Master Circular – Basel III Capital Regulations" dated July 1, 2015 and is reflected in the external credit assessment assigned to a securitisation exposure(s), the risk weight associated with that external credit assessment should be used. In order to avoid any double-counting, no additional capital recognition is permitted. If the CRM provider is not recognised as an eligible guarantor, the covered securitisation exposures should be treated as unrated.

f. In the situation where a credit risk mitigant solely protects a specific securitisation exposure within a given structure (eg asset-backed security tranche) and this protection is reflected in the external credit assessment, the lender must treat the exposure as if it is unrated and then apply the CRM treatment outlined in Paragraph 7 of the "Master Circular – Basel III Capital Regulations" dated July 1, 2015.

g. A lender is not permitted to use any external credit assessment for risk-weighting purposes where the assessment is at least partly based on unfunded support provided by the lender. For example, if a lender buys asset-backed securities (ABS) where it provides an unfunded securitisation exposure extended to the securitisation (eg liquidity facility or credit enhancement), and that exposure plays a role in determining the credit assessment on the ABS, the lender must treat the ABS as if it were not rated. The lender must continue to hold capital against the other securitisation exposures it provides (eg against the liquidity facility and/or credit enhancement).

105. A lender may infer a rating for an unrated position by attributing equivalence to a rated reference securitisation position and use the SEC-ERBA provided that the following requirements are satisfied:

a. The reference securitisation exposure must rank *pari passu* or be subordinate in all respects to the unrated securitisation exposure.

b. The reference position does not benefit from any credit enhancements that are not available to the unrated position

c. The maturity of the reference securitisation exposure must be equal to or longer than that of the unrated exposure.

d. On an ongoing basis, any inferred rating must be updated continuously to reflect any subordination of the unrated position or changes in the external rating of the reference securitisation exposure.

e. The external rating of the reference securitisation exposure must satisfy the general requirements for recognition of external ratings as delineated in clause 104.

106. For exposures with short-term ratings, or when an inferred rating based on a short-term rating is available, the following risk weights will apply:

ERBA risk weights for short-term ratings				
External credit assessment	A1+/A1	A2	A3	All other ratings
Risk weight	15%	50%	100%	1250%

107. For exposures with long-term ratings, or when an inferred rating based on a long-term rating is available, the risk weights depend on:

a. the external rating grade;
b. the seniority of the position;
c. the tranche maturity; and
d. in the case of non-senior tranches, the tranche thickness.

108. Specifically, for exposures with long-term ratings, risk weights will be determined according to the following table and will be adjusted for tranche maturity and tranche thickness for non-senior tranches as prescribed in clause 109 of these directions.

ERBA risk weights for long-term ratings				
Rating	**Senior tranche**		**Non-senior (thin) tranche**	
	Tranche maturity (M_T)		**Tranche maturity (M_T)**	
	1 year	**5 years**	**1 year**	**5 years**
AAA	15%	20%	15%	70%
AA+	15%	30%	15%	90%
AA	25%	40%	30%	120%
AA-	30%	45%	40%	140%
A+	40%	50%	60%	160%
A	50%	65%	80%	180%
A-	60%	70%	120%	210%
BBB+	75%	90%	170%	260%
BBB	90%	105%	220%	310%
BBB-	120%	140%	330%	420%
BB+	140%	160%	470%	580%
BB	160%	180%	620%	760%
BB-	200%	225%	750%	860%
B+	250%	280%	900%	950%
B	310%	340%	1050%	1050%
B-	380%	420%	1130%	1130%

CCC+/CCC/CCC-	460%	505%	1250%	1250%
Below CCC-	1250%	1250%	1250%	1250%

109. The risk weight assigned to a securitisation exposure when applying the SEC-ERBA is calculated as follows:

a. To account for tranche maturity, lenders shall use linear interpolation between the risk weights for one and five years.

b. To account for tranche thickness, lenders shall calculate the risk weight for non-senior tranches as follows:

$$Risk\ weight = (risk\ weight\ from\ table\ after\ adjusting\ for\ maturity) * (1 - \min(T, 50\%))$$

where T is the tranche thickness.

110. In the case of market risk hedges such as currency or interest rate swaps, the risk weight will be inferred from a securitisation exposure that is *pari passu* to the swaps or, if such an exposure does not exist, from the next subordinated tranche.

111. The resulting risk weight is subject to a floor risk weight of 15%. In addition, the resulting risk weight should never be lower than the risk weight corresponding to a senior tranche of the same securitisation with the same rating and maturity.

Alternative capital treatment for term STC securitisations

112. For exposures with short-term ratings, or when an inferred rating based on a short-term rating is available, the following risk weights will apply:

ERBA STC risk weights for short-term ratings				
External credit assessment	A1+/A1	A2	A3	All other ratings
Risk weight	10%	30%	60%	1250%

113. For exposures with long-term ratings, risk weights will be determined according to the following table and will be adjusted for tranche maturity, and tranche thickness for non-senior tranches according to clauses 109 and 110.

ERBA STC risk weights for long-term ratings				
Rating	**Senior tranche**		**Non-senior (thin) tranche**	
	Tranche maturity (M_T)		**Tranche maturity (M_T)**	
	1 year	**5 years**	**1 year**	**5 years**
AAA	10%	10%	15%	40%
AA+	10%	15%	15%	55%
AA	15%	20%	15%	70%
AA-	15%	25%	25%	80%
A+	20%	30%	35%	95%
A	30%	40%	60%	135%
A-	35%	40%	95%	170%
BBB+	45%	55%	150%	225%
BBB	55%	65%	180%	255%
BBB-	70%	85%	270%	345%
BB+	120%	135%	405%	500%
BB	135%	155%	535%	655%
BB-	170%	195%	645%	740%
B+	225%	250%	810%	855%
B	280%	305%	945%	945%
B-	340%	380%	1015%	1015%
CCC+/CCC/CCC-	415%	455%	1250%	1250%

Below CCC-	1250%	1250%	1250%	1250%

114. The resulting risk weight is subject to a floor risk weight of 10% for senior tranches, and 15% for non-senior tranches.

I. Securitisation – Standardised Approach (SEC-SA)

115. To calculate capital requirements for a securitisation exposure to a standardised approach (SA) pool using the securitisation standardised approach (SEC-SA), a bank would use a supervisory formula and the following bank-supplied inputs: the SA capital charge had the underlying exposures not been securitised (K_{SA}); the ratio of delinquent underlying exposures to total underlying exposures in the securitisation pool (W); the tranche attachment point (A); and the tranche detachment point (D).

116. K_{SA} is defined as the weighted-average capital charge of the entire portfolio of underlying exposures, calculated using the risk-weighted asset amounts in Paragraph 5 of the "Master Circular – Basel III Capital Regulations" dated July 1, 2015 in relation to the sum of the exposure amounts of underlying exposures, multiplied by 9%. This calculation should reflect the effects of any credit risk mitigant that is applied to the underlying exposures (either individually or to the entire pool), and hence benefits all of the securitisation exposures. K_{SA} is expressed as a decimal between zero and one (that is, a weighted-average risk weight of 100% means that K_{SA} would equal 0.09).

117. In cases where a bank has set aside a specific provision or has a non-refundable purchase price discount on an exposure in the pool, K_{SA} must be calculated using the gross amount of the exposure without the specific provision and/or non-refundable purchase price discount.

118. The variable W equals the ratio of the sum of the nominal amount of delinquent underlying exposures to the nominal amount of underlying exposures. Delinquent underlying exposures are underlying exposures that are 90 days or more past due, subject to bankruptcy or insolvency proceedings, in the process of foreclosure, held as real estate owned, or in default, where default is defined within the securitisation deal documents.

119. The inputs K_{SA} and W are used as inputs to calculate K_A, as follows:

$$K_A = (1 - W) * K_{SA} + 0.5W$$

120. In case a lender does not know the delinquency status, as defined above, for no more than 5% of underlying exposures in the pool, the lender may still use the SEC-SA by adjusting its calculation of K_A as follows:

$$K_A = \left(\frac{EAD_{subpool\ 1\ where\ W\ known}}{EADTotal} * K_A^{subpool\ 1\ where\ W\ known}\right) + \frac{EAD_{subpool\ 2\ where\ W\ unknown}}{EADTotal}$$

121. If the lender does not know the delinquency status for more than 5%, the securitisation exposure must be risk weighted at 1250%.

122. Capital requirements are calculated under the SEC-SA as follows, where $K_{SSFA(K_A)}$ is the capital requirement per unit of the securitisation exposure and the variables a, u, and l are defined as:

(1) $a = -(1/(p * K_A))$

(2) $u = D - K_A$

(3) $l = max\ (A - K_A;\ 0)$

$$K_{SSFA(K_A)} = \frac{e^{au} - e^{al}}{a\ (u - l)}$$

123. The supervisory parameter p in the context of the SEC-SA is set equal to one.

124. The risk weight assigned to a securitisation exposure when applying the SEC-SA would be calculated as follows:

a. When D for a securitisation exposure is less than or equal to K_A, the exposure must be assigned a risk weight of 1250%.

b. When A for a securitisation exposure is greater than or equal to K_A, the risk weight of the exposure, expressed as a percentage, would equal times 12.5.

c. When A is less than K_A and D is greater than K_A, the applicable risk weight is a weighted average of 1250% and 12.5 times according to the following formula:

$$RW = \left(12.5 * \frac{K_A - A}{D - A}\right) + \left(12.5 * K_{SSFA(K_A)} * \frac{D - K_A}{D - A}\right)$$

125. The risk weight for market risk hedges such as currency or interest rate swaps will be inferred from a securitisation exposure that is *pari passu* to the swaps or, if such an exposure does not exist, from the next subordinated tranche.

126. The resulting risk weight is subject to a floor risk weight of 15%. Moreover, when a bank applies the SEC-SA to an unrated junior exposure in a transaction where the more senior tranches (exposures) are rated and therefore no rating can be inferred for the junior exposure, the resulting risk weight under SEC-SA for the junior unrated exposure shall not be lower than the risk weight for the next more senior rated exposure.

Alternative capital treatment for term STC securitisations

127. The supervisory parameter p in the context of the SEC-SA is set equal to 0.5 for an exposure to an STC securitisation.

128. The resulting risk weight is subject to a floor risk weight of 10% for senior tranches, and 15% for non-senior tranches.

Chapter VII: Disclosures

A. Disclosures to be made in Servicer/Investor/Trustee Report

129. The originators should disclose to investors the weighted average holding period of the assets securitised and the level of their MRR in the securitisation.

130. They 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.

131. The disclosure by an originator of its fulfilment 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. 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.

132. The aforesaid disclosures can be made in the format given in Annex 2. These disclosures should be made separately for each securitisation transaction throughout the life of the transaction.

B. Disclosures to be made in Notes to Annual Accounts

133. The Notes to Annual Accounts of the originators should indicate the outstanding amount of securitised assets as per books of the SPEs sponsored by the originator and total amount of exposures retained by the originator as on the date of balance sheet to comply with the MRR. These figures should be based on the information duly certified by the SPE's auditors obtained by the originator from the SPE.

134. These disclosures should be made in the format given in Annex 3.

Discussion Question: ***Are the level of disclosures mandated in the Annexures 2 and 3 of the draft sufficient? If not, what could be the additional disclosures that could be mandated for the various parties involved in a securitisation transaction?***

Annex 1

Simple, transparent and comparable securitisation – criteria for regulatory capital purposes

All the following criteria must be satisfied in order for a securitisation to receive the alternative regulatory capital treatment as determined by clauses 112 to 114 or clauses 127 to 128.

1. The assets underlying the securitisation should be credit claims or receivables that are homogeneous. Credit claims or receivables should have contractually identified periodic payment streams relating to rental (payments on operating and financial leases), principal, interest, or principal and interest payments. Any referenced interest payments or discount rates should be based on commonly encountered market interest rates, but should not reference complex or complicated formulae or exotic derivatives (financial assets or instruments with features making them more complex than simple, plain vanilla, products).

   Provided that interest rate caps and/or floors would not automatically be considered exotic derivatives

2. For this purpose, the "homogeneity" criterion should be assessed taking into account the following principles:

   a. The nature of assets should be such that investors would not need to analyse and assess materially different legal and/or credit risk factors and risk profiles when carrying out risk analysis and due diligence checks of each asset.

   b. Homogeneity should be assessed on the basis of common risk drivers, including similar risk factors and risk profiles.

   c. Credit claims or receivables included in the securitisation should have standard obligations, in terms of rights to payments and/or income from assets and that result in a periodic and well-defined stream of payments to investors.

   d. Repayment of noteholders should mainly rely on the principal and interest proceeds from the securitised assets. Partial reliance on refinancing or re-

sale of the asset securing the exposure may occur provided that re-financing is sufficiently distributed within the pool and the residual values on which the transaction relies are sufficiently low and that the reliance on refinancing is thus not substantial.

3. Credit claims or receivables being transferred to the securitisation may not, at the time of inclusion in the pool, include obligations that are in default or delinquent or obligations for which the originator, servicer and other parties with a fiduciary responsibility to the securitisation are aware of evidence indicating a material increase in expected losses or of enforcement actions.

4. To ensure that the quality of the securitised credit claims and receivables is not affected by changes in underwriting standards, the originator should demonstrate to investors that any credit claims or receivables being transferred to the securitisation have been originated in the ordinary course of the originator's business to materially non-deteriorating underwriting standards.

5. The originator should verify that the underlying credit claims or receivables meet the following conditions:

    a. the obligor has not been the subject of an insolvency or debt restructuring process due to financial difficulties within three years prior to the closing date of securitisation; and
    b. the obligor is not recorded on a database maintained by any credit information company with an adverse credit history showing 90 DPD or worse; and,
    c. the obligor does not have a credit assessment by a credit rating agency or a credit score indicating a significant risk of default; and
    d. the credit claim or receivable is not subject to a dispute between the obligor and the originator.

6. The assessment of these conditions should be carried out by the originator no earlier than 45 days prior to the closing date. Additionally, at the time of this assessment, there should, to the best knowledge of the originator, be no evidence indicating likely deterioration in the performance status of the credit claim or receivable.

7. In order to provide investors with sufficient information on an asset class to conduct appropriate due diligence and access to a sufficiently rich data set to enable a more accurate calculation of expected loss in different stress scenarios, verifiable loss performance data, such as delinquency and default data, should be available for credit claims and receivables with substantially similar risk characteristics to those being securitised, for a time period long enough to permit meaningful evaluation by investors.

8. Sources of and access to data and the basis for claiming similarity to credit claims or receivables being securitised should be clearly disclosed to all market participants.

9. The originator of the securitisation or the original lender of the exposures that are securitised, as the case may be, must have sufficient experience in originating exposures similar to those securitised. For capital purposes, investors must determine whether the performance history of the originator for substantially similar claims or receivables to those being securitised has been established for an "appropriately long period of time". This performance history must be no shorter than a period of seven years for non-retail exposures. For retail exposures, the minimum performance history is five years.

10. In all circumstances, all credit claims or receivables must be originated in accordance with sound and prudent underwriting criteria based on an assessment that the obligor has the "ability and volition to make timely payments" on its obligations.

11. The originator of the securitisation is expected, where underlying credit claims or receivables have been acquired from third parties, to review the underwriting standards (ie to check their existence and assess their quality) of these third parties and to ascertain that they have assessed the obligors' "ability and volition to make timely payments on obligations".

12. Whilst credit claims or receivables transferred to a securitisation will be subject to defined criteria as approved by the Board of the originator, the performance of the securitisation should not rely upon the ongoing selection of assets through active management on a discretionary basis of the securitisation's underlying portfolio.

Explanation: As long as they are not actively selected or otherwise cherry-picked on a discretionary basis, the addition of credit claims or receivables during the revolving periods or their substitution or repurchasing due to the breach of representations and warranties do not represent active portfolio management.

13. Credit claims or receivables transferred to a securitisation after the closing date may not be actively selected, actively managed or otherwise cherrypicked on a discretionary basis.

14. The securitisation should be such that the underlying credit claims or receivables:
    a. are enforceable against the obligor and their enforceability is included in the representations and warranties of the securitisation;
    b. are beyond the reach of the seller, its creditors or liquidators and are not subject to material recharacterisation or clawback risks;
    c. are not effected through credit default swaps, derivatives or guarantees, but by a transfer of the credit claims or the receivables to the securitisation;
    d. demonstrate effective recourse to the ultimate obligation for the underlying credit claims or receivables and are not a securitisation of other securitisations; and
    e. for regulatory capital purposes, an independent third-party legal opinion must support the claim that the true sale and the transfer of assets under the applicable laws comply with the above sub-clauses.

15. Securitisations employing transfers of credit claims or receivables by other means should demonstrate the existence of material obstacles preventing true sale at issuance and should clearly demonstrate the method of recourse to ultimate obligors. In such cases, any conditions where the transfer of the credit claims or receivable is delayed or contingent upon specific events and any factors affecting timely perfection of claims by the securitisation should be clearly disclosed.

16. The originator should provide representations and warranties that the credit claims or receivables being transferred to the securitisation are not subject to any condition or encumbrance that can be foreseen to adversely affect enforceability in respect of collections due.

17. To assist investors in conducting appropriate due diligence prior to investing in a new offering, sufficient loan-level data in accordance with applicable laws or, in the

case of granular pools, summary stratification data on the relevant risk characteristics of the underlying pool should be available to potential investors before pricing of a securitisation.

18. To assist investors in conducting appropriate and ongoing monitoring of their investments' performance and so that investors that wish to purchase a securitisation in the secondary market have sufficient information to conduct appropriate due diligence, timely loan-level data in accordance with applicable laws or granular pool stratification data on the risk characteristics of the underlying pool and standardised investor reports should be readily available to current and potential investors at least quarterly throughout the life of the securitisation. Cut-off dates of the loan-level or granular pool stratification data should be aligned with those used for investor reporting.

19. To provide a level of assurance that the reporting of the underlying credit claims or receivables is accurate and that the underlying credit claims or receivables meet the eligibility requirements, the initial portfolio should be reviewed for conformity with the eligibility requirements by an appropriate legally accountable and independent third party.

    Explanation: The review should confirm that the credit claims or receivables transferred to the securitisation meet the portfolio eligibility requirements. The review could, for example, be undertaken on a representative sample of the initial portfolio, with the application of a minimum confidence level. The verification report need not be provided but its results, including any material exceptions, should be disclosed in the initial offering documentation.

20. To help ensure that the underlying credit claims or receivables do not need to be refinanced over a short period of time, there should not be a reliance on the sale or refinancing of the underlying credit claims or receivables in order to repay the liabilities of the SPE, unless the underlying pool of credit claims or receivables is sufficiently granular and has sufficiently distributed repayment profiles. Rights to receive income from the assets specified to support redemption payments should be considered as eligible credit claims or receivables in this regard

21. To reduce the payment risk arising from the different interest rate and currency profiles of assets and liabilities and to improve investors' ability to model cash flows,

interest rate and foreign currency risks should be appropriately mitigated at all times, and if any hedging transaction is executed the transaction should be documented according to industry-standard master agreements. Only derivatives used for genuine hedging of asset and liability mismatches of interest rate and / or currency should be allowed.

22. For capital purposes, the term “appropriately mitigated” should be understood as not necessarily requiring a completely perfect hedge. The appropriateness of the mitigation of interest rate and foreign currency through the life of the transaction must be demonstrated by making available to potential investors, in a timely and regular manner, quantitative information including the fraction of notional amounts that are hedged, as well as sensitivity analysis that illustrates the effectiveness of the hedge under extreme but plausible scenarios.

23. If hedges are not performed through derivatives, then those risk-mitigating measures are only permitted if they are specifically created and used for the purpose of hedging an individual and specific risk, and not multiple risks at the same time (such as credit and interest rate risks). Non-derivative risk mitigation measures must be fully funded and available at all times.

24. Investor reports should contain information that allows investors to monitor the evolution over time of the indicators that are subject to triggers. Any triggers breached between payment dates should be disclosed to investors on a timely basis in accordance with the terms and conditions of all underlying transaction documents.

25. Following the occurrence of a performance-related trigger, an event of default or an acceleration event, the securitisation positions should be repaid in accordance with a sequential amortisation priority of payments, in order of tranche seniority, and there should not be provisions requiring immediate liquidation of the underlying assets at market value.

26. To assist investors in their ability to appropriately model the cash flow waterfall of the securitisation, the originator should make available to investors, both before pricing of the securitisation and on an ongoing basis, a liability cash flow model or information on the cash flow provisions allowing appropriate modelling of the securitisation cash flow waterfall.

27. To ensure that debt forgiveness, loan moratoriums, payment holidays, restructurings and other asset performance remedies can be clearly identified, policies and procedures, definitions, remedies and actions relating to delinquency, default or restructuring of underlying debtors should be provided in clear and consistent terms, such that investors can clearly identify debt forgiveness, loan moratoriums, payment holidays, restructuring and other asset performance remedies on an ongoing basis.

28. To help ensure clarity for note holders of their rights and ability to control and enforce on the underlying credit claims or receivables, upon insolvency of the originator, all voting and enforcement rights related to the credit claims or receivables should be transferred to the securitisation. Investors' rights in the securitisation should be clearly defined in all circumstances, including the rights of senior versus junior note holders.

29. To help investors to fully understand the terms, conditions, legal and commercial information prior to investing in a new offering and to ensure that this information is set out in a clear and effective manner for all programmes and offerings, sufficient initial offering and draft underlying documentation should be made available to investors (and readily available to potential investors on a continuous basis) within a reasonably sufficient period of time prior to pricing, or when legally permissible, such that the investor is provided with full disclosure of the legal and commercial information and comprehensive risk factors needed to make informed investment decisions.

    Explanation: For the purpose of this clause, initial offering documentation would typically mean draft offering circular, draft offering memorandum, draft offering document or draft prospectus, such as a "red herring" whereas draft underlying documentation would typically mean asset sale agreement, assignment, novation or transfer agreement; servicing, backup servicing, administration and cash management agreements; trust/management deed, security deed, agency agreement, account bank agreement, guaranteed investment contract, incorporated terms or master trust framework or master definitions agreement as applicable; any relevant inter-creditor agreements, swap or derivative documentation, subordinated loan agreements, start-up loan agreements and

liquidity facility agreements; and any other relevant underlying documentation, including legal opinions.

30. Final offering documents should be available from the closing date and all final underlying transaction documents shortly thereafter. These should be composed such that readers can readily find, understand and use relevant information.

31. To ensure that all the securitisation's underlying documentation has been subject to appropriate review prior to publication, the terms and documentation of the securitisation should be reviewed by an appropriately experienced third party legal practice, such as a legal counsel already instructed by one of the transaction parties. Investors should be notified in a timely fashion of any changes in such documents that have an impact on the structural risks in the securitisation.

32. To help ensure servicers have extensive workout expertise, thorough legal and collateral knowledge and a proven track record in loss mitigation, such parties should be able to demonstrate expertise in the servicing of the underlying credit claims or receivables, supported by a management team with extensive industry experience. The servicer should at all times act in accordance with reasonable and prudent standards.

33. Policies, procedures and risk management controls should be well documented and adhere to good market practices and relevant regulatory regimes. There should be strong systems and reporting capabilities in place. In assessing whether "strong systems and reporting capabilities are in place" for capital purposes, well documented policies, procedures and risk management controls, as well as strong systems and reporting capabilities, may be substantiated by a third-party review.

34. The party or parties with fiduciary responsibility should act on a timely basis in the best interests of the securitisation note holders, and both the initial offering and all underlying documentation should contain provisions facilitating the timely resolution of conflicts between different classes of note holders by the trustees, to the extent permitted by applicable law.

35. The party or parties with fiduciary responsibility to the securitisation and to investors should be able to demonstrate sufficient skills and resources to comply with their duties of care in the administration of the securitisation vehicle.

36. To increase the likelihood that those identified as having a fiduciary responsibility towards investors as well as the servicer execute their duties in full on a timely basis, remuneration should be such that these parties are incentivised and able to meet their responsibilities in full and on a timely basis.

37. To help provide full transparency to investors, assist investors in the conduct of their due diligence and to prevent investors being subject to unexpected disruptions in cash flow collections and servicing, the contractual obligations, duties and responsibilities of all key parties to the securitisation, both those with a fiduciary responsibility and of the ancillary service providers, should be defined clearly both in the initial offering and all underlying documentation.

    Explanation: For the purpose of this clause, “initial offering” and “underlying transaction documentation” shall have the same meaning as in the explanation to the clause 29 of this Annex.

38. Provisions should be documented for the replacement of servicers, bank account providers, derivatives counterparties and liquidity providers in the event of failure or non-performance or insolvency or other deterioration of creditworthiness of any such counterparty to the securitisation.

39. To enhance transparency and visibility over all receipts, payments and ledger entries at all times, the performance reports to investors should distinguish and report the securitisation’s income and disbursements, such as scheduled principal, redemption principal, scheduled interest, prepaid principal, past due interest and fees and charges, delinquent, defaulted and restructured amounts under debt forgiveness and payment holidays, including accurate accounting for amounts attributable to principal and interest deficiency ledgers.

40. At the portfolio cut-off date the underlying exposures have to meet the conditions under the Standardised Approach for credit risk, and after taking into account any eligible credit risk mitigation, for being assigned a risk weight equal to or smaller than:
    a. 40% on a value-weighted average exposure basis for the portfolio where the exposures are loans secured by residential mortgages or fully guaranteed residential loans;

b. 50% on an individual exposure basis where the exposure is a loan secured by a commercial mortgage;
c. 75% on an individual exposure basis where the exposure is a retail exposure; or
d. 100% on an individual exposure basis for any other exposure.

41. At the portfolio cut-off date, the aggregated value of all exposures to a single obligor shall not exceed 1% of the aggregated outstanding exposure value of all exposures in the portfolio.

Provided that the applicable maximum concentration threshold could be increased to 2% if the originator retains subordinated tranche(s) that form credit enhancements that are loss absorbing, and which cover at least the first 10% of losses. These tranche(s) retained by the originator shall not be eligible for the STC capital treatment.

Annex 2

Format for Disclosure Requirements in offer documents, servicer report, investor report, etc.

Name/Identification No. of securitisation transaction:

	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)	
			a) Credit Enhancement (i.e. whether investment in equity/subordinate tranches, first/second loss guarantees, cash collateral, overcollateralisation	
			b) Investment in senior tranches	
			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 more than 90 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 bank/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 (state-wise) (%)	
			State 1	
			State 2	
			State 3	
			State 4	

Annex 3

Disclosures to be made in Notes to Accounts by originators

Sl. No.	Particulars	No. / Amount in Rs. crore
	No of SPEs sponsored by the bank for securitisation transactions	
	Total amount of securitised assets as per books of the SPEs sponsored by the bank	
	Total amount of exposures retained by the bank 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	
	Amount of exposures to securitisation transactions other than MRR	
	a) Off-balance sheet exposures i) Exposure to own securitisations • First loss • Others 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	