To,
Mr Yogesh Dayal
Chief General Manager
Reserve Bank of India

Sub: Representation and comments on the Draft Directions on Securitisation of Standard Assets and Sale of Loan Exposures

Sir,

This is with reference to the Press Release dated June 08, 2020[1] issued by the Reserve Bank of India, inviting comments on "Draft Framework for Securitisation of Standard Assets" and "Draft Comprehensive Framework for Sale of Loan Exposures", seeking comments and responses to the discussion questions provided in the draft frameworks by 30th June, 2020.

In this regard, we, Indian Securitisation Foundation, on behalf of the securitisation and structured finance industry in India, hereby submit our comments on the each of the above mentioned draft frameworks.

Our comments on the 'Draft Framework for Securitisation of Standard Assets" have been annexed as "Annexure A".

Our comments on the 'Draft Framework for Sale of Loan Exposures" have been annexed as "Annexure B".

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About Indian Securitisation Foundation

ISF is a not-for-profit entity representing the securitisation industry in India. The membership of the Foundation includes banks, NBFCs, microfinance institutions, other issuers and investors and securitisation professionals for promoting interest of securitisation and fixed income securities in India.

Typical investors in securitisation include public sector banks, private sector banks, mutual funds, insurance companies and others. The insurance companies find AAA rated fixed income security with higher spreads particularly attractive and world-over insurance companies are significant investors in securitisation transactions.

As ISF is dedicated to the cause of promoting securitisation in India, we humbly submit our representation herein below on permitting insurance companies to invest in all securitised instruments.

Thanking you,

Yours truly,

For ***Indian Securitisation Foundation***

[1] https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=49920

Annexure A: Comments on Draft Framework for Securitisation of Standard Assets

Clause	Content	Our comment/ representation/ clarification sought
	Risk weight of the securitisation exposure having lowest rating or highest degree of risk	At several places, the risk weight assigned to the most risky class of securitisation exposure at 1250%. In India, banks are required to maintain capital at the rate 9% and NBFCs are required to maintain capital at the rate of 15%. Therefore, the risk weights for the lowest rating or unrated classes should be 1111% for banks and 667% for NBFCs. For HFCs, the CRAR is being increased on a phased manner, therefore, the risk weights for HFCs may be amended accordingly.
4	These directions, 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.	Clause 4 makes the provisions relating to capital relief and disclosure requirements applicable on existing transactions. The conditions for capital relief are new, and most of the existing transactions will fail to satisfy these. As a result, most of the originators will be denied capital relief, for something, which they were unaware of, at the time of structuring of the transactions. It is represented that for implementation of provisions relating to capital relief on existing transactions a longer timeframe may be granted, otherwise, it can have an adverse impact on the capital.
5(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.	1. The support provided need not be to the SPE, even if the support is at the originator level, it is still a first loss support. Accordingly, the words “to a special purpose entity” may be removed. 2. The definition states that the first loss facility should cover the bulk (or all) of the risks associated. The diversification of risk in a securitisation transaction can be achieved even with multiple layers of tranching. In such a situation, the first loss tranche need not always cover up the bulk (or all) of the risks associated. Ideally, for the first loss tranche, expected losses should be taken as a basis, and any other losses can be absorbed in one or more tranches, superior to the first loss tranche.
5(k)	“mezzanine tranche” means a tranche or tranches subordinated to the senior tranche, and to which a risk weight of less than 1250% is	The definition refers to a risk weight of 1250%. In India, banks are required to maintain capital at the rate 9% and NBFCs are required to maintain capital at the rate of 15%. Therefore, the risk weights for the lowest rating or unrated classes

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	assigned under the provisions of Chapter VI of these directions	should be 1111% for banks and 667% for NBFCs. For HFCs, the CRAR is being increased on a phased manner, therefore, the risk weights for HFCs may be amended accordingly.
5(n)	"notes" mean securities issued by the special purpose entity as a part of securitisation;	In practice, notes are not securities. Usually promissory notes or short term notes are referred to as notes. The term "certificates", "units" or "securities" may be used instead.
5(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;	By virtue of this definition, even single loan securitisation will become possible. Diversification of risk is a key aspect of securitisation, which is not possible in case of single asset securitisation. Further, the definition refers to tranching of exposures, as a key component of securitisation, which might not be possible in case of single asset securitisation. In any case, single loan securitisation will be a case of LSO, such a practice was subject to misuse prior to 2006 and may be abused by way of selling single loans in form of securities to mutual funds.
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.	We understand that the idea here is to consider loans, however, the clause refers to "bank loans". This may be amended to "loans" so as to cover loans extended by all types of financial institutions whether or not covered under these Directions. Further, the meaning of the term "acquisition of asset" may be clarified, as the term acquisition have may different meanings. For example, in case of residential mortgage loans, the acquisition of asset could mean taking over physical possession of asset or execution of sale deed or completion of the project etc.
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	Clause 16(a) is broad enough, there is no need 16(b). In any case there is no practical concept of first loss exposure other than first loss tranches. Additionally, other support in the form of cash collateral or overcollateralization may be included in the definition of first loss exposure.

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	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.	Therefore, clause 16(b) may be removed. Further, there is a clear contradiction between clause 16 and clause 79(a)(ii), which states: *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.* On one hand, clause 16 indicates that the first loss tranche should be retained as MRR, on the other hand, clause 79(a)(ii) states that in order to achieve capital relief, the originator should not hold more than 20% of the first loss tranche. A clarification in this regard may be provided.
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.	Please clarify if the amount of Rs. 500 crores will include loans offered as over-collateralisation as well. Further, currently, the listing of securitised debt instruments is governed by the SEBI (Issue and Listing of Securitised Debt Instruments) Regulations, 2008. Also, the SEBI (Listing Obligations and Disclosures) Requirements, 2015 has provisions relating to listing of SDIs. Both of these may be suitably amended, especially in the provisions dealing with corporate governance.
29 (e)	If the SPE is set up as a trust, then: 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.	Clause 29(e) deals with cases where SPEs are set up as trust. However, in sub-clause (iv), the words “if any” are redundant, since, a trust cannot function without trustee. Therefore, the aforesaid words may be removed.
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	Usually, origination or acquisition of loans for the sole purpose of securitisation is discouraged. However, if the intention of this clause is create an exemption for government promoted platform(s) created for promoting securitisation in the country, then the same may be expressly said so in the clause. For example, the Dr. Harsh Vardhan Committee report contemplates NHB to set up platform exclusively for securitisation; there must be a clear exception for such a platform.

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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	The conditions prescribed here conflicts with the provisions laid down in Ind AS 109. Therefore, there is a need for a specific carve out from these conditions where the seller is required to prepare financial statements as per Ind AS.
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”.	Same as above.
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.	The draft framework does not permit synthetic securitisations, hence, the use of words “only traditional securitisations” seems unnecessary. Hence, the same may be removed.
	Reset of credit enhancements	There is no concept of reset of credit enhancements globally. Therefore, the RBI may consider removal of this section.
79(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.	Usually, banks and financial institutions in India compute life time expected losses for the pool of loans assigned or securitised. Therefore, it will be appropriate of the thickness of the first loss position is pegged with lifetime expected losses of the asset(s) instead of the slippage ratio.

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	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.	
83	Securitisation exposures to which none of the above approaches can be applied must be assigned a 1250% risk weight by lenders.	In India, banks are required to maintain capital at the rate 9% and NBFCs are required to maintain capital at the rate of 15%. Therefore, the risk weights for the lowest rating or unrated classes should be 1111% for banks and 667% for NBFCs. For HFCs, the CRAR is being increased on a phased manner, therefore, the risk weights for HFCs may be amended accordingly.

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Annexure B: Comments on Draft Framework for Sale of Loan Exposures

Clause	Content	Our comment/ representation/ clarification sought
5(j)	"stressed assets" mean assets that are classified as NPA or as special mention account, and generally includes accounts which are in default as well as where lenders have given concessions for economic or legal reasons relating to the borrower's financial difficulty	The definition of stressed assets includes NPAs as well as special mention accounts. Technically, special mention accounts are also standard, and becomes sub-standard only when account becomes NPA. Of the different types of SMAs, SMA-0 captures such assets where the default in payment is for a period of 0-30 days. The definition of SMA was changed lately to include default in payment for a period of 0-30 days, however, before the change, the regulations required classification of an account as SMA-0 only when the account showed signs of incipient stress. We understand the change in definition of the SMA-0 was mostly for reporting purposes, however, using the same meaning for the purpose of sell of such assets and treating them at par with SMA-1, SMA-2 and NPA cases is not appropriate. Therefore, accounts becoming SMA-0, only by virtue of delay in payment for a period of 0-30 days, without showing signs of incipient stress, may be excluded from the definition of "stressed assets" and be treated at par with "standard" assets.
9	A loan sale should result in **immediate legal separation of the transferor from the assets which are sold to the extent that the interest has been transferred**. The transferred interest should stand completely isolated from the transferor, after its transfer to the buyer, i.e., put beyond the transferor's as well as its creditors' reach, even in the event of bankruptcy of the transferor. In case of any retained interest in the exposure by the transferor, the loan sale contract should clearly specify the distribution of the interest income from the transferred asset among the transferor and the transferee.	This highlighted text in clause 9 contradicts the definition of "transfer" in clause 5(k) – *"transfer" means a transfer of economic interest in loan exposures in the manner prescribed in these directions, and includes loan participations and transactions in which the loan exposure remains on the books of the transferor even after the said transaction.* The definition of transfer is wide enough to cover transfer of economic interests, with or without legal transfer of the receivables. However, clause 9 provides for immediate legal separation of assets which are sold. Further, at several places, the term "loan sales" has been used. In this regard, it should be clarified at the provisions relating to loan sales shall apply

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Clause	Content	Our comment/ representation/ clarification sought
		only in case of legal sale of assets, and not in case of economic transfer of risks by any other means.
13	The transferee shall, wherever applicable, ensure that the security interest, if any, underlying the loans purchased are properly registered, with the transferee as the beneficiary, directly or indirectly, and a mechanism for timely invocation of such interest, if the need arises, is properly documented and put in place.	Usually, in case of direct assignment or securitisation transactions, the underlying security interests in loans transferred are retained by the originator itself, however, it holds it in trust for the transferee. This is done in order to avoid logistical inconvenience, with respect to, modification of charge documents etc. If implemented, this will create large scale logistical inconvenience with respect to modification charge documents, change of registration certificates (in case of motor vehicles loans), registration of mortgage etc. Therefore, this condition may be reconsidered.
17	Lenders can purchase external commercial borrowings lent by eligible ECB lenders provided that the losses / haircuts, if any, occurring to the transferors on account of the loan sale should not be passed on to the transferees, and instead should be booked in the accounts of the transferors.	Clarification is sought on whether this clause will apply only when there is a transfer of loan between eligible lenders.
35	Transferors can transfer loans only after a minimum holding period counted from the date of first repayment of loans for an activity/purpose; date of acquisition of asset (i.e., car, residential house etc.) by the borrower for which the financing had been extended; or the date of completion of a project financed by the loan, as the case may be, whichever is later. The minimum holding period that would be applicable depending upon the tenor and repayment frequency is given in the following table: XX Provided that where the repayment is at more than quarterly intervals, loans can be	The clause on minimum holding period with respect to sale of loans other than to SPEs for securitisation does not allow the relaxation granted to residential loans in case of securitisation transactions. Unless the intention is to disincentivise sale of residential mortgage loans and incentivise securitisation of mortgage loans, the same relaxation may be extended here as well.

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Clause	Content	Our comment/ representation/ clarification sought
	transferred 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.	
38	**Any loss, profit or premium arising because of a 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.	The conditions prescribed here conflicts with the provisions laid down in Ind AS 109. Therefore, there is a need for a specific carve out from these conditions where the seller is required to prepare financial statements as per Ind AS.

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