FIDC

Finance Industry Development Council

(A Representative Body of Assets and Loan Financing NBFCs)

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Shri Shaktikanta Das
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June 30, 2020

Respected Sir,

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

This is with reference to the Press Release dated June 08, 2020 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, Finance Industry Development Council, on behalf of the NBFC industry in India, hereby submit our comments on the each of the above-mentioned draft frameworks.

A. Suggestions on Draft Framework for Securitisation of Standard Assets

Clause No.	As Per Draft Guidelines	Challenges	Request / Suggestion
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.	This clause 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 not aware of, at the time of structuring of the transactions.	We suggest implementation of the provision of Chapter VI be made applicable only for fresh securitisation transactions executed after this guideline is published.
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.,	We understand that the idea here is to consider loans, however, the clause refers to "bank loans". The term acquisition may have different meanings. For example, in case of residential mortgage loans, the acquisition	The clause may be amended to say 'loans' in place of 'Bank Loans' to cover loans extended by all the financial institutions whether covered under these Directions or not. The meaning of the term "acquisition of asset" may be

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	car, residential house etc.) by the borrower or the date of completion of a project, as the case may be.	of asset could mean taking over physical possession of asset or execution of sale deed or completion of the project etc.	clarified since in commercial parlance, for Mortgage loans, acquisition refers to full disbursement of credit facilities. The same may be appropriately incorporated in the clause.
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.	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.	Clause 16(b) may be accordingly amended.
29.e	If SPE is set up as a trust, then: iv. The trustee, if any, should only perform trusteeship functions in	This clause 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	The clause can be accordingly amended.

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	relation to the SPE and should not undertake any other business with the SPE.	trustee.	
48.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.	This is contrary to the CE reset allowed in this guideline.	We suggest that this clause may accordingly be amended.
49c	Reset of Credit Enhancement would be subject to consent of Trustees or Board of Directors or any authority on which the responsibility of management of the affairs of the SPE is vested.	The trustees need to seek approval from the Investors before providing consent for the reset. Investors are quite averse to providing the consent.	The reset of Credit Enhancement should be automatically triggered once underlying conditions of securitisation agreement and reset guidelines are met, and not be subjected to any approvals from the Trustee or any authority on which the responsibility of management of the affairs of the SPE is vested.
60c	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	Money being fungible, and since the servicer would remit money only periodically (usually once a month), there would be comingling of cash flow or else the cost of transaction would shoot up due to negative carry.	To safeguard, the condition of no co-mingling may be proposed on certain trigger events such as 2-notches downgrade of the Servicing entity.
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	First Time Borrowers form a significant portion of the customer base for NBFCs. Credit Bureau scores will hardly be available in such type of cases.	We request to do away with the requirement of Average Credit Scores.

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	economic activities in which the underlying borrowers are engaged, exposure type, prepayment rates, property types, occupancy, etc.		

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79.a	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: 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	An error seems to have crept in Clause 79.a.ii, as it is not in consonance with clause no. 25 which says that "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". Clause 79.a.ii is also not in consonance with clause no. 16.a which states: "MRR may be maintained by the lenders through 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". While 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	We request reconciliation of clause 16, 25 and 79.a.ii. We further request to remove clause 79.a.ii as it is not in consonance with clause 16 & 25

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	not hold more than 20% of the exposure values of securitisation positions ***that are first loss positions.***	tranche. There will hardly be any investor who would be interested in holding 80% of the first loss position. Hence, clause 79.a.ii may act as a permanent hurdle for future securitisation transactions.	
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. 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.	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 if the thickness of the first loss position is pegged with lifetime expected losses of the asset(s) instead of the slippage ratio.
79.h	The threshold at which clean-up calls become exercisable shall not be more than 10% of the original value of the underlying exposure.	It is generally observed that once the pool amortizes by 80%, the credit enhancement percentage becomes significantly higher - sometimes even higher than the outstanding exposure leading to huge cost to the originator.	The threshold for clean-up option made available to the originator may be amended to 20% of the value of the original exposure.
83.	Securitisation exposures to which none of the above approaches can be applied must be assigned a 1250% risk weight by lenders.	For NBFCs, Capital Adequacy requirement (CAR) is 15%.	We request to restrict the risk weight as per applicable Capital Adequacy, e.g., 667% for NBFCs.

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B. Suggestions on Draft Framework for Sale of Loan Exposures

Clause No.	As Per Draft Guidelines	Challenges	Request / Suggestion
5.l	"transferee" means the entity to which the economic interest in a loan exposure is transferred under these directions, and wherever appropriate, may include grantors under a loan participation transaction.	The term "transferee" includes "grantor". Grantor is defined to mean: *"grantor" means the entity in whose books the loan exposure transferred through a loan participation agreement resides.*	The phrase "participant" may be used in place of "grantor".
5.m	"transferor" means the entity which transfers the economic interest in a loan exposure under these directions, and wherever appropriate, may include participants under a loan participation transaction.	The term "transferee" includes "participant". Participant is defined to mean: *"participant" means the entity to which the grantor transfers its interest in a loan exposure, fully or partly, through a loan participation transaction.*	The phrase "participant" may be used in place of "grantor".
12. 20	The transferor should be able to demonstrate that it has taken all reasonable precautions to ensure that it is not obliged, nor will feel impelled, to support any losses suffered by the transferee during or subsequent to the transfer of loan exposures. If the transferor of loans acts as the servicing agent for loans under a separate servicing agreement for fee, such service obligations should not entail any residual credit risk on the sold assets or any additional liability for them beyond the contractual performance obligation in respect of such services. The transferor, in role of the servicing agent, should be under	Current recourse expectation of the transferee bank needs to be addressed. Transferee PSU Banks generally treat the purchase of Loan pool receivables as term loan facility in their books. Therefore, general expectation of many of these Banks is that the payment should be on scheduled basis and not on actual collection basis.	There may be provision in the guidelines for penalizing the transferee if it induces the transferor to re-purchase or fund the re-payment of the asset or any part of it or substitute assets held by the transferee or provide additional assets to the transferee at any time except those arising out of breach of warranties or representations made at the time of sale.

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21	no obligation to remit funds to transferee unless such funds are received from the borrowers. If the above conditions are not satisfied, transferor shall maintain capital on the loans transferred as if the loans had never been transferred from its books.		
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 / servicer 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 significant inconvenience with respect to modification charge documents, change of registration certificates (in case of motor vehicles loans), registration of mortgage etc. Further, with conditions of transfer of security, the loan transactions may attract substantial stamp duty making	We suggest that this clause may be dropped since the servicing of assigned / transferred loans is generally done by the originator.

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		the transactions unviable, unless the Stamp Duty laws are simultaneously also amended.	
19.h	The transferor shall hold in trust, on behalf of the transferee, the cash flows arising from the underlying and should avoid co-mingling of these cash flows with their own cash flows in case partial economic interest is retained by the transferor.	Money being fungible, and since the servicer would remit money only periodically (usually once a month), there would be comingling of cash flow or else the cost of transaction would shoot up due to negative carry.	To safeguard, the condition of no co-mingling may be proposed on certain trigger events such as 2-notches downgrade of the Servicing entity.
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.	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. Even if the profits / premium, if any, arising out of sale of Loan exposure, the deduction from CET 1 capital or net owned funds should be after adjustment of tax.
42.	Transferees may, if they so desire, have the pools of **loans rated** before purchasing so as to have a third party view of the credit quality of the pool in addition to their own due diligence. However, such rating cannot substitute for the due diligence that the transferees is required to perform.	Rating of pool of loans is not feasible without any credit enhancement. However, any form of credit enhancement is not permitted in case of sale of loan exposure.	We request to modify the clause as follows: 'Transferees may, if they so desire, obtain loss estimation report from SEBI affiliated rating agencies so as to have a third party view of the credit quality of the pool in addition to their own due diligence. However, such loss estimation cannot substitute for the due diligence that the transferees is required to perform'.

We sincerely appeal to the Reserve Bank of India to consider our suggestion given above.

Thanking you,

Yours faithfully,

For FINANCE INDUSTRY DEVELOPMENT COUNCIL

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