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STRUCTURED FINANCE

New securitisation guidelines to widen market participation in the long term

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HIGHLIGHTS

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New securitisation guidelines released on September 24, 2021, would only be a market enhancer in the long term.

Market for residential mortgage-backed securities could be the biggest beneficiary of the changes.

Indian securitisation market has become a deeper and wider market since the initial guidelines had been laid down by the regulator, viz. The Reserve Bank of India (RBI), in 2006. A better understanding of the product, healthy retail credit growth leading to higher funding needs for non-banking financial companies (NBFCs) and housing finance companies (HFCs) and relatively strong asset quality seen even during periods of economic headwinds has supported growth in the securitisation market. Securitisation volumes had seen a sharp uptick in FY2019 and FY2020 touching almost Rs 2 lakh crore before being affected by the Covid-19 pandemic, but the market is again witnessing a rebound as the pandemic-related worries recede.

With an aim to widen the market participation in securitisation transactions and loan sell-down and also refine some of the earlier regulations, the RBI had issued a draft regulatory framework for securitisation and sale of loans on June 8, 2020, seeking comments from market participants. **On September 24, 2021, the RBI issued new guidelines, viz. Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021 and Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021, that are effective immediately after ironing out gaps and interpretation issues in the earlier draft. In ICRA's view, the guidelines are not expected to disrupt the existing securitisation market but would only be a market enhancer in the long term.** Some of the salient features of the guidelines are highlighted below. This note provides a comparative snapshot on key parameters of the previous and the revised guidelines (the note does not cover the guidelines introduced for sale of stressed assets).

- Market for residential mortgage-backed securities would benefit with the downward revisions of minimum holding period and retention ratio as well as an earlier reset of credit enhancement as compared to other asset classes.
- Loans purchased from other lenders can also be securitised which would increase the extent of securitisable assets.
- Introduction of simple, transparent and comparable (STC) transactions would provide the benefit of lower risk weights that could improve the yield profile for established originators.
- Increase in risk weights for lower-rated securitisation notes would continue to keep the market skewed towards AAA-rated and near AAA-rated notes.
- Removal of minimum retention ratio requirement from loan sell-down could further enhance the assignment market.
- The guidelines emphasise the fact that the originator (or transferor) should not have any obligation to fund any shortfalls arising in these transactions.

EXHIBIT 1. Comparative snapshot of the guidelines: Securitisation of standard assets

Parameter	Previous guidelines	Revised guidelines	ICRA's Comments
Assets eligible for securitisation	On-balance sheet standard exposures, except the following: a. Revolving credit facilities b. Assets purchased from other entities c. Securitisation exposures d. Loans with bullet payments of both principal and interest	On-balance sheet standard exposures, except the following: a. Re-securitisation exposures b. Structures in which short term instruments such as commercial paper, which are periodically rolled over, are issued against long term assets c. Synthetic securitisation d. Securitisation with the following assets as underlying: • revolving credit facilities as underlying (e.g. credit card receivables and cash credit facilities) • Restructured loans and advances which are in the specified period • Exposures to other lending institutions • Refinance exposures of AIFIs • Loans with bullet payments of both principal and interest as underlying	Loans purchased from other lenders have now been allowed to be securitised after meeting a minimum holding period requirement of six months. This would increase the extent of securitisable assets and thus provide liquidity but may find limited usefulness in the current market setup as banks who typically purchase loans are not engaged much in securitisation of their assets. Among the newer categories that have been excluded from securitisation, exclusion of "exposures to other lending institutions" would have some negative impact on the securitisation market as a few lending NBFCs were securitising the loans extended by them to smaller NBFCs, though the volumes of such transactions have been limited. The other categories were not being securitised in the domestic market and thus their exclusion would not affect the current market depth.
Securitisation of single loan exposure	Not allowed	Allowed	As per the revised definition for securitisation, even a single loan exposure can be securitised which had been common before they were disallowed as per the 2012 guidelines. Reintroduction of the same may be beneficial in the long run, especially if we witness growth in PTC-oriented funds which may then be able to add exposures to specific companies to their portfolio.
Minimum Holding Period (MHP)	MHP is defined on basis of instalments paid, which varied from two instalments to twelve instalments depending on the original tenor of the loan and its repayment frequency.	MHP would be – a) three months for loans with tenor of up to two years; or b) six months for loans with tenor of more than two years.	Calculation of MHP has shifted from number of instalments paid to duration on book post registration of underlying security interest / first repayment of loan. The new MHP guidelines would particularly benefit HFCs who can now securitise loans with lower

Parameter	Previous guidelines	Revised guidelines	ICRA's Comments
		MHP would be counted from the date of registration of the underlying security interest. In case security does not exist or cannot be registered, MHP shall be calculated from the date of first repayment of the loan.	repayment track record as against at least 12-month repayment track record required in the erstwhile guidelines. In recent past, we observed HFCs use the temporary relaxation on MHP (to 6 months) provided by the RBI (between Sep-18 and Jun-20) and thus we expect the new MHP guidelines to be favourable for this sector in terms of enlarging the market for mortgage-backed transactions and increase liquidity for HFCs.
Minimum Retention Ratio (MRR)	MRR is 5% for non-bullet repayment loans with original maturity of upto two years and 10% otherwise.	MRR for all asset classes *other than residential mortgage backed securities (RMBS)* remains unchanged, i.e. 5% for non-bullet repayment loans with original maturity of up to two years and 10% otherwise. For RMBS, the MRR has been kept at 5% irrespective of the loan tenure.	The reduction in MRR for RMBS is significant at 5% as it would free up cash for the HFCs, though some investors may continue to insist on a higher MRR in the transactions to maintain adequate "skin in the game" for the originator. As market widens with more investors in the RMBS space, we expect the reduced MRR would become a norm in the market.
Calculation of MRR	MRR should represent the principal cash flows. Therefore, originator's 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.	MRR shall be retained as first loss facility, or equity tranche or any other tranche sold to investors. The first loss facility for this purpose shall not include overcollateralisation available, if any. 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.	The key difference between the two guidelines is that the new guidelines do not consider overcollateralization as a form of MRR which was the case earlier. Sizeable transactions in the domestic market, especially for A-category and lower-rated entities, have been using overcollateralization to achieve credit enhanced rating for senior tranche and meet MRR. We expect that the usage of overcollateralisation would reduce hereon and would get replaced with issuances of equity tranches or pari passu investment in senior tranches to achieve the same desired output.
Reset of Credit Enhancement	The reset of credit enhancement should be provided for in the contractual terms of the transaction. The reset of credit enhancement would be subject to the consent of trustees.	The reset of credit enhancement should be provided for in the contractual terms of the transaction. In case a contractual clause was not available originally, reset of credit enhancement may be carried out subject to the consent of all investors of outstanding securitisation notes.	The changes will make securitisation more lucrative for HFCs. For RMBS transactions, that are of a long tenure, originators will now be able to seek reset of credit enhancement at an earlier date as compared to previous guidelines and at an increased frequency which can improve the economics behind the

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	Reset can be done after minimum principal amortisation of 50% for all asset classes. Subsequent resets can be done after pool principal has amortised in steps of 10%.	Reset can be done after minimum principal amortisation of 25% for RMBS and 50% for all other asset classes. Subsequent resets can be done after pool principal has amortised in steps of 10%.	transactions. There is no material change for other asset classes. The new guidelines continue to maintain that only up to 60% of the CE which is allowed to be released by the rating agencies can be actually released, thus maintaining further cushion to safeguard the credit quality going forward.
	Minimum gap of six months and one year should be maintained between successive resets for transactions of up to 5 years' tenor and more than 5 years' tenor, respectively.	Minimum gap of six months should be maintained between successive resets for all transactions	
	No reset should happen if the 'Delinquency Trigger' is breached (Computation of delinquency trigger is defined by the RBI in the guidelines taking into account the overdues in the pool and amount outstanding).	Contractual clause should include clearly defined portfolio-level delinquency triggers, which, if met, should result in the credit enhancement resets not available or possible.	
	Minimum 30% of initial CE amount must be maintained.	Minimum 20% of initial CE amount must be maintained for RMBS transactions and 30% of initial CE amount for other asset classes	
	A maximum of 60% of the credit enhancement in excess of that required to retain the credit rating of all the tranches can be considered for release, at any point of time subject to fulfilling the reserve floor.	A maximum of 60% of the credit enhancement in excess of that required to retain the credit rating of all the tranches can be considered for release, at any point of time subject to fulfilling the reserve floor.	
Replenishment structures	No mention	Replenishment structures are defined in the guidelines. Securitisations featuring a replenishment period should include provisions for appropriate early amortisation events and/or triggers of termination of the replenishment period.	While a few replenishment structures exist in the market, the explicit clarity on the same through the guidelines could result in more originators and investors willing to explore such transactions which typically helps in creating a longer tenure transaction from short-term receivables.
Ticket size and listing	No mention	The minimum ticket size for issuance of securitisation notes shall be Rs. 1 crore. Listing of securitisation notes, especially in respect of certain product class, such as RMBS, and/or generally above a certain threshold is recommended, though not mandatory. In any case, any offer of securitisation notes to fifty or more persons in an issuance would be required to be listed.	As securitisation transactions are usually done basis private discussions between the originators and investors, the possibility of listing securitisation notes is low in the near term. While, in theory, listing can improve the secondary market for the securities and hence appeals to a wider investor base, there are still several hurdles to secondary market trading, especially for RMBS papers, such as tenure uncertainty owing to

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			high and volatile prepayment rates, interest rate risk (or basis risk), and an absence of a variety in investor categories.
Classification of securitisation transactions	No classification	Transactions classified into STC (simple, transparent and comparable) and non-STC	Based on certain criteria being met, securitisation transactions can be classified as STC which would carry lower risk weights. We expect the large-size originators to undertake STC-compliant transactions in the future to benefit from better yields, and this would even improve the extent of disclosures.
Accounting treatment	Realised gain from securitisation is amortised over the tenure of the transaction (though this underwent a revision once IndAS guidelines were adopted)	NBFCs which are required to comply with Indian Accounting Standards (IndAS) shall continue to be guided by the same. In case of other lenders, any loss, profit or premium realised at the time of the sale should be accounted accordingly and reflected in the Profit & Loss account for the accounting period during which the sale is completed.	Accounting treatment remains in line with the current procedures being followed.
Capital adequacy and Risk Weights	Risk weights are linked only to the rating of the securitisation exposure	Lenders shall apply Securitisation External Ratings Based approach (SEC-ERBA) for calculation of risk weighted assets for credit risk of securitisation exposures. Under SEC-ERBA approach, risk weights are determined on basis of - i) STC compliance; ii) Seniority of tranche; iii) Tenure of the tranche; and iv) Rating of tranche.	The risk weights for high rated senior tranches have been reduced (lowest risk weight is 10% for AAA-rated senior tranche of a STC-compliant transaction) compared to the current risk weights being followed, though the junior tranches – especially A-rated and below – carry much higher risk weights. Overall pricing scenario could undergo a change from the current levels with the divergence between AAA-rated and A-rated tranches increasing further. We expect the market structure to thus continue to remain skewed towards AAA-rated or near AAA-rated transactions.

EXHIBIT 2. Comparative snapshot of the guidelines: Transfer of loan exposures (Standard Assets)

Parameter	Previous guidelines	Revised guidelines	ICRA's Comments
Minimum Retention Ratio (MRR) [linked to due diligence]	MRR is 5% for non-bullet repayment loans with original maturity of up to two years and 10% otherwise.	There is no mandatory requirement to retain any portion by the originator (or transferor) if the assignee (or transferee) carries out due diligence at the level of each loan for entire loan pool. If the due diligence is carried out for a lesser portion, but not less than one-third of the loan pool by value and number of loans, the originator has to retain at least 10% of economic interest in the transferred loans.	The new guidelines provide a minimum due diligence requirement of one-third of the loans being transferred which may increase the execution time for certain banks that were carrying out a lower due diligence. However, many investors at present aim to carry out due diligence of each loan account. In such cases, the originator may not have to maintain any MRR. It is quite likely though that investors may insist on reasonable MRR to ensure quality of the pool sold by the originator, especially for newer originators, whereas established originators may be able to execute transactions without any MRR as the market deepens. If investors do not seek MRR to be kept by the originator, then such originators may favour loan sell down as against securitisation to free up their liquidity.
Minimum Holding Period (MHP)	MHP is defined on basis of instalments paid, which varied from two instalments to twelve instalments depending on the original tenor of the loan and its repayment frequency.	MHP would be – a) three months for loans with tenor of up to two years; or b) six months for loans with tenor of more than two years. MHP would be counted from the date of registration of the underlying security interest. In case security does not exist or cannot be registered, MHP shall be calculated from the date of first repayment of the loan.	Calculation of MHP has shifted from number of instalments paid to duration on book post registration of underlying security interest / first repayment of loan. The new MHP guidelines would particularly benefit HFCs who can now securitise loans with lower repayment track record as against at least 12-month repayment track record required in the erstwhile guidelines. In recent past, we observed HFCs use the temporary relaxation on MHP (to 6 months) provided by the RBI (between Sep-18 and Jun-20) and thus we expect the new MHP guidelines to be favourable for this sector in terms of enlarging the market for mortgage-backed transactions and increase liquidity for HFCs.
Need for borrower-wise accounts	Previous guidelines emphasised on borrower-wise accounts being maintained, but in the event the purchasing entity was not maintaining individual obligor-wise accounts for the portfolio of loans purchased, it	The transferee and the transferor in case of retention of economic interest, should maintain borrower-wise accounts.	Few banks who would not have maintained borrower-wise accounts would have to change their systems.

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	should have an alternative mechanism to ensure application of prudential norms on individual obligor basis.		
Treatment of unrealised profits	Unrealised profits are accounted for while calculating capital adequacy ratio.	Unrealised profits, if any, arising out of such transfers, shall be deducted from CET 1 capital or net owned funds for meeting regulatory capital adequacy requirements till the maturity of such loans.	Originators undertaking high share of loan transfers would report lower capital adequacy figures due to the change, but this is not expected to impact the market volumes in our opinion.
Servicer fee payments	While the servicer is under no obligation to remit funds to the buyer unless and until these are received from the borrowers, the guidelines are silent on collection-linked fee payments.	Payment of any fee or other income arising from the role as a servicing facility provider is not subject to deferral or waiver in a way that would directly or indirectly provide credit enhancement or liquidity facility.	The servicing fee structure is likely to change for some parties and would be a flat fee structure.
Loan participation	Not mentioned	Defined in new guidelines as a transaction through which the transferor transfers all or part of its economic interest in a loan exposure to transferee without the actual transfer of the loan contract, and the transferee funds the transferor to the extent of the economic interest transferred.	--.

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