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Professional Risk Opinion

New Master Directions on Securitization and Transfer of Loan Assets

Positive in the short term – a paradigm shift in the long run

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The Reserve Bank of India ("RBI") issued new 'Master Directions' on (a) securitization of standard assets and (b) transfer of loan exposures. These directions come into immediate effect replacing existing guidelines on the subject. These directions further elaborate and give clarity on many issues which were not explicitly addressed earlier. CARE notes that there are many relaxations compared to existing regulations and RBI has also introduced the concept of STC (Short, Transparent and Comparable) Securitization. Key takeaways are as under:

Securitization of standard assets

- Synthetic securitization and re-securitization continue to be prohibited
- Securitization of assets purchased from third party has now been permitted
- Securitization of single asset has also been now permitted
- Securitization of exposure to other lending institutions is now prohibited
- RMBS and replenishment structures have been recognized
- Limit of total retained exposures by originators is retained at 20%
- MHP reduced to max of 6 months; another major change is MHP to be counted from date registration of security interest where security can be registered
- MRR continues at 5% or 10% (depending on original tenor of loan), with RMBS having MRR of 5% irrespective of tenor; over-collateral (OC) not to be counted towards MRR.
- Favorable terms for reset of credit enhancement for RMBS compared to other asset classes
- STC Securitization shall have favorable capital treatment compared to non-STC transactions.
    - The guidelines have stipulated conditions to be met for a transaction to qualify as STC. These include homogeneity of assets, performance history made public for at least 5 years, healthy credit score, obligor concentration, etc.
- Overseas branches of Indian lenders not to assume securitization exposure in jurisdictions not having MRR stipulations but can do so where MHP stipulations are not prescribed
- While de-recognition of securitized assets will continue to be guided by IndAS, RBI has stipulated conditions for de-recognition of securitized assets ***for the purposes of assessing capital adequacy***.
    - The yield to investors may change consequent to changes in the benchmark to which the underlying loans are linked.
    - Any clause allowing increase in yield to the investors based on deterioration in credit quality would lead to de-recognition of the securitized assets.

Transfer of Loan exposure (standard assets)

- Lenders barred from acquiring (or transferring) loans from (to) other than specified Lenders [i.e., SCB, AIFI, SFB and NBFCs (inc. HFCs)] unless otherwise permitted, specifically or generally.
    - Consequently, covered bond deals involving transfer of loan to SPV (outside securitization framework) would not be possible unless so permitted by RBI.
- Restriction on Lenders to give credit enhancement continues – this applies even to Lenders who are not the Sellers.
- Loan participation (~ risk participation) outside Inter Bank Participation Certificate (IBPC) recognized
- MRR made optional; MHP requirement like securitization.
- The due diligence can be done at portfolio level (in case buyer is unable to do so at loan level for entire portfolio) provided (a) there is minimum MRR of 10% and (b) due diligence for at least 1/3rd of portfolio (by both number and value) is done at loan level.

Outlook

These directions will enable securitization of certain loans which were earlier not permissible and reduced MHP, would help increase the stock of eligible loans available with originators on an immediate basis, helping securitization volumes in the near term. These directions (concept of STC Securitization) could signal a paradigm shift in the long run, likely leading to a deepening of the Indian securitization market with greater transparency and robust disclosure practices.

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