

Section B

Transfer of Assets through Direct Assignment of Cash Flows and the underlying securities

REQUIREMENTS TO BE MET BY THE ORIGINATING BANKS

1.1 Assets Eligible for Transfer

1.1.1 Under these guidelines, banks can transfer a single standard asset or a part of such asset or a portfolio of such assets to financial entities through an assignment deed with the **exception** of the following:

- (i) Revolving credit facilities (e.g. Cash Credit accounts, Credit Card receivables etc.)
- (ii) Assets purchased from other entities
- (iii) Assets with bullet repayment of both principal and interest [However, Loans with tenor upto 24 months extended to individuals for agricultural activities where both interest and principal are due only on maturity and trade receivables with tenor up to 12 months discounted / purchased by banks from their borrowers will be eligible for such transfer 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.]

1.1.2 However, these guidelines do not apply to:

- (i) Transfer of loan accounts of borrowers by a bank to other bank/FIs/NBFCs and vice versa, at the request/instance of borrower;
- (ii) Inter-bank participations;
- (iii) Trading in bonds;
- (iv) Sale of entire portfolio of assets consequent upon a decision to exit the line of business completely. Such a decision should have the approval of Board of Directors of the bank;
- (v) Consortium and syndication arrangements and arrangement under Corporate Debt Restructuring mechanism;
- (vi) Any other arrangements/transactions specifically exempted by the Reserve Bank of India.



1.2 Minimum Holding Period (MHP)

Originating banks / FIs / NBFCs can securitize loans only after these have been held by them for a minimum period in their books. The criteria governing determination of MHP for assets listed below reflect the need to ensure that:

- the project implementation risk is not passed on to the investors, and
- a minimum recovery performance is demonstrated prior to securitisation to ensure better underwriting standards.

Banks / FIs / NBFCs can securitise loans only after a MHP 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. MHP would be defined with reference to the number of instalments to be paid prior to securitisation. MHP applicable to various loans depending upon the tenor and repayment frequency is given in the following table;

Minimum Holding Period (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	12	6	3	2
Loans with original maturity of more than 2 years and up to 5 years	18	9	6	3
Loans with original maturity of more than 5 years	-	-	12	4

1.3 Minimum Retention Requirement (MRR)

The MRR is primarily designed to ensure that the originating banks / FIs 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. The originating Bank / FIs should adhere to the MRR detailed in the table below:



1.3.1 The originating banks should adhere to the MRR detailed in the Table below while transferring assets to other financial entities:

Type of asset	MRR
Assets with original maturity of 24 months or less	Retention of right to receive 5% of the cash flows from the assets transferred on pari-passu basis.
i) Assets with original maturity of above 24 months; and ii) Loans referred in para 1.1.1(iii) as exception.	Retention of right to receive 10% of the cash flows from the assets transferred on pari-passu basis.

1.3.2 In the case of partial sale of assets, if the portion retained by the seller is more than the MRR required as per para 1.3.1 above, then out of the portion retained by the seller, the portion equivalent to 5% of the portion sold or 10% of the portion sold, as the case may be, would be treated as MRR. However, all exposures retained by the selling bank including MRR should rank pari-passu with the sold portion of the asset.

1.3.3 Banks / FIs should not offer credit enhancements in any form and liquidity facilities in the case of loan transfers through direct assignment of cash flows, as the investors in such cases are generally the institutional investors who should have the necessary expertise to appraise and assume the exposure after carrying out the required due diligence. Banks should also not retain any exposures through investment in the Interest Only Strip representing the Excess Interest Spread/ Future Margin Income from the loans transferred. However, the originating banks will have to satisfy the MRR requirements stipulated in para 1.3.1 above. Banks' retention of partial interest in the loans transferred to comply with the MRR indicated in para 1.3.1 should be supported by a legally valid documentation. At a minimum, a legal opinion regarding the following should also be kept on record by the originator:

- (a) legal validity of amount of interest retained by the originator;
- (b) such arrangement not interfering with assignee's rights and rewards associated with the loans to the extent transferred to it; and
- (c) the originator not retaining any risk and rewards associated with the loans to the extent transferred to the assignee.

1.3.4 MRR will have to be maintained by the entity which sells the loans. In other words, it cannot be maintained by other entities which are treated as 'originator' in terms of para 5(vi) of the RBI circular dated February 1, 2006 containing guidelines on securitisation of standard assets.

1.3.5 The level of commitment by originators i.e., 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 on-going basis except for reduction of retained exposure due to proportionate repayment or through the absorption of losses. The form of MRR should not change during the life of transaction.



1.3.6 For complying with the MRR under these guidelines, banks should ensure that proper documentation in accordance with law is made.

1.4 Booking of Profit Upfront

1.4.1 The amount of profit in cash on direct sale of loans may be held under an accounting head styled as "Cash Profit on Loan Transfer Transactions Pending Recognition" maintained on individual transaction basis and amortised over the life of the transaction. The amortisation of cash profit arising out of loan assignment transaction will be done at the end of every financial year and calculated as under:

Profit to be amortised = Max {L, [(X*(Y/Z)), [(X/n)]}

X = amount of unamortised cash profit lying in the account 'Cash Profit on Loan Transfer Transactions Pending Recognition' at the beginning of the year

Y = amount of principal amortised during the year

Z = amount of unamortised principal at the beginning of the year

1.4.2 Accounting, Asset Classification and provisioning norms for MRR

The asset classification and provisioning rules in respect of the exposure representing the MRR would be as under:

- a) The originating bank may maintain a consolidated account of the amount representing MRR if the loans transferred are retail loans. In such a case, the consolidated amount receivable in amortisation of the MRR and its periodicity should be clearly established and the overdue status of the MRR should be determined with reference to repayment of such amount. Alternatively, the originating bank may continue to maintain borrower-wise accounts for the proportionate amounts retained in respect of those accounts. In such a case, the overdue status of the individual loan accounts should be determined with reference to repayment received in each account.
- b) In the case of transfer of a pool of loans other than retail loans, the originator should maintain borrower-wise accounts for the proportionate amounts retained in respect of each loan. In such a case, the overdue status of the individual loan accounts should be determined with reference to repayment received in each account.
- c) If the originating bank acts as a servicing agent of the assignee bank for the loans transferred, it would know the overdue status of loans transferred which should form the basis of classification of the entire MRR/individual loans representing MRR as NPA in the books of the originating bank, depending upon the method of accounting followed as explained in para (a) and (b) above.



1.5 Disclosures by the Originating Banks / FIs / NBFCs

1.5.1 Disclosures to be made in Servicer / Originator Report

The originating Banks / FIs / NBFCs should disclose to investors the weighted average holding period of the assets securitised and the level of MRR in the securitisation. The originating banks should ensure that prospective investor 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 the collateral values supporting the underlying exposures. The disclosure by an originator of its fulfilment of the MHP and MRR should be made available publicly and should be appropriately documented. 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 originator / servicer / investor report or any similar document published. The aforesaid disclosures can be made in the format given in Appendix 1.

1.5.2 Disclosures to be made by the originators in Notes to Annual Accounts

The Notes to Annual Accounts of the originating banks should indicate the outstanding amount of securitised assets as per their books and total amount of exposures retained by them as on the date of balance sheet to comply with the MRR. These figures should be based on the information duly certified by the originators Statutory Auditors. These disclosures should be made in the format given in Appendix 2.

1.6 Loan Origination Standards

The originating banks / FIs should apply the same sound and well- defined criteria for credit underwriting to exposure to be securitised as they apply to exposures to be held on their book. To this end, the same process for approving and, where relevant, amending, renewing and monitoring of credits should be applied by the originators.

1.7 Treatment of Assets sold not Meeting the Requirements stipulated above

If an originating bank fails to meet the requirement laid down in paragraphs 1.1 to 1.6 above, it will have to maintain capital for the assets sold as if these were still on the books of the originating bank / FIs



2. REQUIREMENTS TO BE MET BY THE PURCHASING BANKS

2.1 Restrictions on Purchase of loans

Besides Bank can purchase loans from other banks/FIs/NBFCs in India only if the seller has explicitly disclosed to the purchasing banks that it will adhere to the MRR indicated in para 1.3 on an on-going basis. In addition, for domestic transactions, purchasing banks should also ensure that the originating institution has strictly adhered to the MHP criteria prescribed in the guidelines in respect of loans purchased by them. Once a pool of securitised assets is offered by the originator to the purchasing Bank the purchasing bank is required to duly verify each loan account of the pool in the Originator books / system in order to satisfy them regarding compliance of MHP criteria by the originator and then pool should be finalised. The overseas branches of Indian banks may purchase loans under securitisation deal in accordance with the regulations laid down in those jurisdictions.

2.1.1 Standard Criterion for Originators:

Banks/ FIs/ NBFCs complying with the following criteria, as per their last audited balance sheet, should be preferably considered for purchasing their securitised portfolio;

Sr No	Parameters	Compliance
1.	External Credit Rating of Originator	Minimum A & above
2.	Internal Credit Rating of Originator	Minimum "NBFC 4" & above
3.	CRAR	Minimum 15%
4.	Gross NPA	Not Exceeding 7.5%
5.	Net NPA	Not Exceeding 5%
6.	Minimum Net Owned Funds (NOF)	Rs 5 Crores
7.	Major Financial Indicators	Should be Satisfactory
8.	Area of Operation	Generally Diversified across various states
9.	Asset Under Management (AUM)	Minimum Rs 500 Crores

2.1.2 Exposure Cap for Originators:

Bank's exposure under Portfolio buy out through direct assignment of assets for a single NBFC will be within 15% of AUM, of the last preceding quarter of the particular NBFC.

2.1.3 Exposure Cap for Obligors:

The transaction involves transfer of portfolio of standard assets or a part of such assets to the Bank and as such our exposure will be on individual obligor/borrower. Under this scenario it is to be ensured that the maximum quantum of loan extended by the originator to a single obligor/borrower, (proposed to be assigned) should not exceed Rs 5 Crore, and accordingly our exposure on the obligor upon transfer and after adhering to the MHP and MRR, be less than Rs 5 Crore.



2.2 Standards for Due Diligence:

2.2.1 Skilled manpower and systems to carry out the due diligence of the loans/portfolios of loans before purchasing them is required on part of the Bank. Therefore Credit Team of Branches / Zonal office should carry out the due diligence exercise before finalising the pool for purchase. Due diligence exercise should inter alia include the following;

- Verification of KYC documents of each loan account (100 %) ;
- Verification of Inspection reports of originating bank / FI officials.
- Physical inspection of the hypothecated assets / mortgaged properties to be carried out to the extent of 10% of number of accounts in a pool
- Verification of Copy of RC book (wherever applicable) and insurance policies covering the asset with originating bank's hypothecation clause duly noted;
- Verification of CIBIL or similar records of other credit information bureaus, in respect of each account available with the originators;
- Evaluate credit quality of underlying loans including ascertaining priority sector status of account offered under Priority Sector Pool. *(this should be done as though the loans are sanctioned by the bank official)*
- Verification of repayment record of the borrower in the books of originating bank or in their system and following should be confirmed
 - No overdue in accounts on the date of purchase
 - MHP requirement is duly adhered to by the originator
 - If pool accounts represent priority sector assets, then maximum interest spread should not exceed 8% with respect to Bank's prevailing base rate on the date of transaction.
- In case loan account is secured by mortgage of immovable properties then property document / title deed is required to be verified in each case along with verification of CERSAI records.
- During due diligence exercise Branch may request the originator to replace the accounts which inter alia
 - (a) not adhering to credit parameters of bank ;
 - (b) Showing signs of sickness;
 - (c) **Not eligible for priority sector classification for PSL Pool;** and
 - (d) not adhering to RBI guidelines.



2.2.2 Following parameters must also be adhered to before purchase of securitised assets;

- a) Loss estimation report in respect of finalised pool should be obtained by any reputed credit rating agency and should be scrutinised by the Zone / Branch. Maximum probability of default at 2.5% of securitised assets in normal circumstances can be accepted. However, in stressed environment it can maximum go up to 3% of securitised assets. Upfront provisioning of the estimated loss for the portfolio to be done at HO level and amortization of the same to be done as per extant guidelines
- b) Information disclosed by the originators regarding as per Appendix -1 should be thoroughly examined.
- c) Pool accounts should be examined in respect of its credit quality, extent of diversification and homogeneity, sensitivity of the repayment behaviour of individual borrowers, volatility of the market values of the collaterals security supporting the loans, cyclicalities of the economic activities in which the underlying borrowers are engaged, etc Branch should endeavour to select pools having homogeneous loan accounts and spread across different states.
- d) the reputation of the originators should also be taken into account in terms of their observance of credit appraisal and credit monitoring standards, adherence to MRR and MHP standards in earlier transfer of portfolios and fairness in selecting exposures for transfer;
- e) loss experience in earlier transfer of loans/portfolios by the originators in the relevant exposure classes underlying and incidence of any frauds committed by the underlying borrowers, truthfulness of the representations and warranties made by the originator;
- f) the statements and disclosures made by the originators, or their agents or advisors, about their due diligence on the assigned exposures and, where applicable, on the quality of the collateral supporting the loans transferred; and
- g) where applicable, the methodologies and concepts on which the valuation of loans transferred is based and the policies adopted by the originator to ensure the independence of the valuer.
- h) Draft documents to be vetted by ZO legal cell before execution of the same. Legal department (HO) may be consulted for any clarification.
- i) All other extant guidelines including carrying out CPA, Vetting of security documents by empanelled advocate should be strictly adhered to.



2.2.3 Additional Safeguards to be adopted:

In cases of transactions wherein underlying assets constitute immovable properties, following procedure is to be followed:

- a) The deed of assignment between the assignor and assignee with regard to transfer of security interest in mortgaged property should be executed and be registered with the competent authority/Registration authority.
- b) In case where individual obligor is a Company, modification of charge with ROC in all cases is to be filed within the stipulated time period.
- c) Modification of Charge with CERSAI (wherever applicable) is to be filed, if available.
- d) Management Certificate/Certificate from legal counsel of originator to be obtained from the originator, that all the properties assigned to the Bank are mortgagable, marketable and enforceable.

2.3 Stress Testing

Stress Testing of each pool will be carried out at least once in a financial year taking into account the pool outstanding position as on 31st March. Stress testing exercise will be carried out at Head office level every year however, Zones are required to furnish required information to carry out the exercise. In order to have third party independent view on the health of pools acquired, services of reputed credit rating agency may be obtained for carrying out stress testing exercise. The various factors required to be considered for Stress Testing will be i) default rate in underlying portfolio in situation of economic downturn ii) rise in pre-payment rates due to fall in rate of interest or rise in income levels of the obligors etc. The results of stress test should be conveyed to the Risk Management Department for consideration in Pillar II exercise (Internal Capital Adequacy Assessment Process-ICAAP) under Basel II framework and additional capital be held to support any higher risk, if required.

2.4 Credit monitoring

2.4.1 The accounts to be monitored by the concerned Branch/Zonal Office/NBG/HO – CrMD on an on-going basis regarding the performance of the underlying loan portfolio and take appropriate action. To ensure timely detection of signs of weaknesses in individual accounts and identification of non-performing borrowers as per RBI guidelines for asset classification. Monthly report submitted by the Assignee Representative should be effectively used for the purpose. The disclosures made by the originating banks (Appendix I to be furnished by them periodically) may also be used for monitoring purpose. Information available in reports of concurrent auditors/internal auditors can be utilised for the purpose.

2.4.2 Annual review of accounts is to be carried out as per extant guidelines.



2.4.3 IDBI Trusteeship Services Ltd or GDA Trusteeship Ltd or any company rendering such services may act as a Assignee Representative. However, their role will be limited to the following

- a) Operation of collection and pay out account opened at the disbursing branch by the originator
- b) Preparation of obligor wise report each month on the basis of dump data provided by the originator
- c) Hold in custody the documents executed by the Bank and the originator / servicer , if specifically asked for the same
- d) Monitor the performance of servicer

2.5 True Sale Criteria

2.5.1 The assets should stand completely isolated from the selling bank, after its transfer to the buyer, i.e., put beyond the selling bank's as well as its creditors' reach, even in the event of bankruptcy of the selling/assigning/transferring bank.

2.5.2 The selling bank should effectively transfer all risks/ rewards and rights/ obligations pertaining to the asset and shall not hold any beneficial interest in the asset after its sale except those specifically permitted under these guidelines. The buyer should have the unfettered right to pledge, sell, transfer or exchange or otherwise dispose of the assets free of any restraining condition. The selling bank shall not have any economic interest in the assets after its sale and the buyer shall have no recourse to the selling bank for any expenses or losses except those specifically permitted under these guidelines.

2.5.3 There shall be no obligation on the selling bank to re-purchase or fund the repayment of the asset or any part of it or substitute assets held by the buyer or provide additional assets to the buyer at any time except those arising out of breach of warranties or representations made at the time of sale. The selling bank should be able to demonstrate that a notice to this effect has been given to the buyer and that the buyer has acknowledged the absence of such obligation.

2.5.4 The selling bank should be able to demonstrate that it has not taken all reasonable precautions to ensure that it is not obliged, nor will feel impelled, to support any losses suffered by the buyer.

2.5.5 The sale shall be only on cash basis and the consideration shall be received not later than at the time of transfer of assets. The sale consideration should be market-based and arrived at in a transparent manner on an arm's length basis.



2.5.6 If the seller of loans acts as the servicing agent for the loans, it would not detract from the 'true sale' nature of the transaction, provided such service obligations do not entail any residual credit risk on the sold assets or any additional liability for them beyond the contractual performance obligations in respect of such services.

2.5.7 An opinion from the selling bank's Legal Counsel should be kept on record signifying that: (i) all rights, titles, interests and benefits in the assets have been transferred to the buyer; (ii) selling bank is not liable to the buyer in any way with regard to these assets other than the servicing obligations as indicated in para 2.6.6 above; and (iii) creditors of the selling bank do not have any right in any way with regard to these assets even in case of bankruptcy of the selling bank.

2.5.8 Any re-schedulement, restructuring or re-negotiation of the terms of the underlying agreement/s effected after the transfer of assets to the buyer, shall be binding on the buyer and not on the selling bank except to the extent of MRR.

2.5.9 The transfer of assets from selling bank must not contravene the terms and conditions of any underlying agreement governing the assets and all necessary consents from obligors (including from third parties, where necessary) should have been obtained.

2.5.10 In case the selling bank also provides servicing of assets after the sale under a separate servicing agreement for fee, and the payments/repayments from borrowers are routed through it, it shall be under no obligation to remit funds to the buyer unless and until these are received from the borrowers.

2.6 Representations and Warranties

An originator that sells assets to other financial entities may make representations and warranties concerning those assets. Where the following conditions are met the seller 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 seller 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 seller 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 loans/underlying borrowers.
- (e) The exercise of a representation or warranty, requiring an originator to replace asset (or any parts of them) sold, on grounds covered in the representation or warranty, must be:
 - * undertaken within 120 days of the transfer of assets; and
 - * conducted on the same terms and conditions as the original sale.

