APSA
亚太结构融资公会
Asia-Pacific Structured Finance Association

Reserve Bank of India
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By email

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Dear RBI Securitisation Consultation Panel

Response to the Draft Framework for Securitisation of Standard Assets

On behalf of the Asia-Pacific Structured Finance Association (**APSA**) and its members, we welcome the opportunity to comment on the draft securitisation guidelines (the **Draft Guidelines**) released for consultation by the Reserve Bank of India (the **RBI**) on 8 June 2020. The "Draft Framework for Securitisation of Standard Assets" are expressed to be aimed at developing a strong and robust securitisation market in India, while incentivising simpler securitisation structures.

This response focusses on key points in relation to the Draft Guidelines from the perspective of international investors who may be participating or may seek to participate in the Indian securitisation market. As such, the comments in this response relate primarily to matters which present particular challenges for international investors.

One preliminary remark we feel is important to make to set the context, is the global nature of the securitisation markets and the corresponding issues which would arise for international investors if the RBI adopted rules which did not take account of the views of international market participants. While the Draft Guidelines are primarily domestic in focus, they will have an impact on the manner in which Indian securitisation participants interact with global securitisation market participants, particularly international investors, and the Draft Guidelines should seek to do this in a manner which benefits all issuers and investors.

The interaction of the requirements contemplated by the Draft Guidelines with those which apply under the existing securitisation frameworks in, among other places, the US, the European Union (the **EU**) and Japan is a source of interest for APSA members, many of which are subject to, or are required to frequently assess the interoperability of these frameworks. Given the way in which these frameworks are framed, in general, it will be necessary for issuers to comply with multiple requirements if they wish to place deals on a cross-border basis. Securitisation is a valuable funding tool for real economy assets, and the ability for frameworks to be flexible, to allow issuers to comply with all relevant regimes is an area of importance such that the economic efficiency of cross-border transactions is not compromised.

We consider consultation question (a) most relevant to international investors and will make comments on that question before sharing some observations on the other questions and some other topics we wish to note.

(a) Should the two approaches specified for meeting MRR requirements be prescribed as alternatives, or does one approach have a clear advantage over the other? Please support your positions with quantitative estimates, if any.

They should be prescribed as alternatives.

The Draft Guidelines outline "first-loss retention" as the primary method of meeting MRR requirements and provide further that "vertical retention" may be permissible when used in addition to first-loss retention in order to reach the applicable quantitative threshold, of either 5% or 10% depending on the characteristics of the underlying assets in question. Where both first-loss retention and vertical retention are used together, this is colloquially referred to as "L-shaped retention".

In the US, Europe and Japan the quantitative threshold for risk retention has been set at 5% and none of these regimes are prescriptive over which permitted method of retention must be used:

Jurisdiction	**Permitted 5% Retention Methods**
United States	First loss retention, vertical retention, L-shaped retention (NB: other methods are also permissible for certain asset classes, like CMBS and credit card securitisations)
European Union	First-loss retention, vertical retention, "segregated pool retention", "seller's interest retention" and "individual exposure first-loss retention" (NB: L-shaped retention is not permitted in the EU)
Japan	First-loss retention, vertical retention, L-shaped retention

There may be issues which arise if only first-loss risk retention were permitted. For instance, it may be difficult to ever achieve significant credit risk transfer (under clauses 79 and 80 if the Draft Guidelines) if the originator were required to retain first-loss risk. Further, it may not prove optimal where seeking to attract US investors, where the 5% first loss must be calculated on the accounting fair value of the securitised exposures, rather than their nominal value or book value – this accounting fair value calculation is not necessarily straightforward leading to vertical retention (which does not require a fair value calculation in the US) being used on many non-US securitisation transactions targeting US investors.

Another thought relates to pricing – if only first-loss retention were permitted it may exclude investors who are seeking higher returns (because the higher yielding first loss tranches must be retained) or, on the flip side, if only vertical retention were permitted it may make a deal incredibly expensive if there were no investors in the market wishing to take the most junior positions.

We are also aware that third party second-loss credit facilities are common in the Indian market. Such third party provided facilities may interfere with the operation of "first-loss retention" under the EU rules meaning these transactions would not be compliant with "first-loss retention" under the EU rules.[1] As "L-shaped retention" is not permitted under the EU rules, Indian transactions which include these second-loss credit facilities may consequently need to also have a vertical retention of at least 5% otherwise EU

[1] The reason for this is because the second loss-facility may overlap with other tranches which the originator holds to comply with first-loss retention under the Indian rules and, under the EU rules, such an overlap is not permitted.

investors would be unable to invest. Therefore, the ability to opt to use vertical retention (rather that first-loss retention) on such transactions is important otherwise EU investors may be excluded.

Overall, the flexibility to use multiple methods for meeting the MRR requirements would give Indian securitisation issuers the most opportunities when seeking to attract international investor participation from various jurisdictions as they can choose a retention method which is optimal for them, both in terms of the types of investors they are seeking and the economic benefit they would receive form undertaking the securitisation.

(b) For investments in securitisation notes, should there be regulatory prescriptions for valuation by the investors to ensure uniform recognition of the notes across all entities? If so, what could be the valuation methodologies that could be prescribed for uniform adoption by all financial entities?

With respect to international investors subject to accounting standards applicable outside of India, we would recommend that there be no mandatory requirement for securitisation notes to be valued in accordance with prescribed Indian methodologies as this may lead to inconsistencies.

(c) Should the notes issued in a securitisation be mandated to be listed if the issue size is above a certain threshold? What could be the costs and benefits of such mandatory listing? Do you agree with mandatory listing only in respect of RMBS, as proposed, or should it cover all classes of securitisation notes? Should the issue size of `500 crore as the proposed threshold for mandatory listing be reconsidered?

Provided investments are liquid and easily tradable on a secondary market, we express no strong views on this topic.

(d) Should SEC-ERBA and SEC-SA approaches be prescribed as alternatives for banks, or should one of the approaches be prescribed as a preferred approached? Are there scenarios or situations in which one approach should be preferred over the other? Please support your positions with quantitative estimates, if any.

Allowing alternative approaches to be adopted by Indian lending institutions may result in a degree of arbitrage from transaction-to-transaction and may hinder fair participation by international investors who are required to use one or other approach or have other fixed bases for determining the risk and cost of their investments.

We would make a couple of observations to assist the RBI in considering this question:

- in the EU, SEC-ERBA is preferred over SEC-SA (a) where the application of the SEC-SA would result in a risk weight higher than 25% for positions qualifying as positions in an STS[2] securitisation, (b) where the application of the SEC-SA would result in a risk weight higher than 25% or the application of the SEC-ERBA would result in a risk weight higher than 75 % for positions not qualifying as positions in an STS securitisation and (c) for securitisation transactions backed by pools of auto loans, auto leases and equipment leases. In the EU an institution may also opt to use SEC-ERBA but only if it does so for <u>all</u> rated securitisation positions which it holds; and

- in Hong Kong and Singapore (assuming SEC-IRBA is not available), SEC-ERBA is applicable in all cases where a rating is available.

[2] STS is the EU equivalent of the STC regime introduced by the Draft Guidelines

As a final point, to the extent SEC-ERBA is used, we would recommend that only ratings provided by appropriately independent and regulated rating agencies should be considered when assigning risk weightings to securitisation exposures.

(e) Are the level of disclosures mandated in the Annexures 2 and 3 of the draft sufficient? If not, what could be the additional disclosures that could be mandated for the various parties involved in a securitisation transaction?

In this respect, we would note that most international investors are subject to varied due diligence requirements which differ quite significantly from jurisdiction to jurisdiction. The disclosures mandated in Annexures 2 and 3 may be sufficient for some investors, but not others. Provided there is no prohibition on investors seeking and being provided with further information, where required for their investment due diligence, there are no additional points to make on question (e) from an international investor perspective.

STC Regime

We support the introduction of an STC regime in the manner laid out in the Basel guidelines and believe such a regime will help to achieve more risk-sensitive allocations of regulatory capital for securitisations and create securitisation markets which are more stable and resilient.

SRT securitisation

We note that clause 13 of the Draft Guidelines prohibits synthetic securitisations. Certain types of synthetic securitisation transaction can bring great benefits to institutions in helping them manage their balance sheets, through efficient allocation of regulatory capital and risk mitigation. It can also be used as a tool to transfer risk out of the domestic banking sector and to international capital markets investors who are experienced investors in such transactions. We would request that the RBI considers permitting such transactions in due course and we would be happy to participate in any consultation or industry discussion exercises on this topic.

Credit cards securitisation

We note that clause 13 of the Draft Guidelines also prohibits credit card securitisations. Securitisation transactions have proved a valuable source of funding for credit card issuing banks and companies in many jurisdictions, including Australia, Korea, the United Kingdom and the United States and see significant participation from international investors. We would welcome the opportunity to explore any general concerns and provide examples of how credit card securitisations can be and have been undertaken in a structurally robust and transparent manner – for instance, the STS regime in the EU caters for the inclusion of credit card securitisations.

Maximum Exposure

Clauses 25 to 27 of the Draft Guidelines limits the exposure a lender may have to a securitisation to 20% of the total exposures in that securitisation. The title to section F "*Limit on Total Retained Exposures*" suggests this limitation applies only to "retained" exposure – i.e., the exposures retained by the lender which is doing the securitisation transaction and not exposures acquired by lenders which may invest in securitisations. We would request a clarification is made that clauses 25 to 27 of the Draft Guidelines do not apply to investors in securitisations but rather only to the lender which is the originator of the relevant transaction. We note separately that Chapter V of the Draft Guidelines sets out a list of requirements for lenders which invest in securitisations.

This will be important to international investors because it is common for a single international investor to subscribe for an entire tranche, or all the senior tranches – a volume well in excess of this 20% threshold.

Representations and warranties

The protections laid out in clause 31 of the Draft Guidelines are important to ensure the credit risk of securitised exposures are sufficiently isolated from the credit risk of the originator. However, we would make one observation with respect to clause 31(e)(i) – from the perspective of an international investor, it would be unfair to remove its right to recourse to the originator for a breach of representation or warranty after only 120 days in circumstances where audits may not be conducted so soon after a particular asset has been transferred. We would request this be clarified that the 120 day period commences when the investor becomes aware of such a breach.

Thank you for allowing us the opportunity to respond to this consultation. We hope our contribution will be of assistance to the RBI as it finalises and calibrates its implementation of the Draft Guidelines. If you would like to discuss any aspects of this letter please do contact us as follows:

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Yours faithfully

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