Draft of the directions on prudential norms proposed to be issued by the Reserve Bank of India to Securitisation Companies / Reconstruction Companies

Reserve Bank of India
Department of Non-Banking Supervision
Central Office
World Trade Centre, Mumbai

The Securitisation Companies/ Reconstruction Companies Prudential Norms (Reserve Bank) Directions, 2002

The Reserve Bank of India, having considered it necessary in the public interest, and being satisfied that, for the purpose of enabling the Bank to regulate the financial system to the advantage of the country and to prevent the affairs of any Securitisation Company/Reconstruction Company from being conducted in a manner detrimental to the interest of investors or in any manner prejudicial to the interest of such Securitisation Company/Reconstruction Company, it is necessary to issue the directions relating to the prudential norms as set out below hereby, in exercise of the powers conferred by Section 12(1) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (Second) Ordinance, 2002, issues to every Securitisation Company/Reconstruction Company, the directions hereinafter specified.

<u>Short title, commencement and applicability of the directions</u>

1. (1) These directions shall be known as the "Securitisation Companies/ Reconstruction Companies Prudential Norms (Reserve Bank) Directions, 2002".

   (2) These directions shall come into force with effect from ………………..

   (3) All the provisions of these directions shall apply to transactions relating to securitisation / reconstruction of financial assets undertaken by Securitisation Companies/Reconstruction Companies registered with the Reserve Bank of India under Section 3(4) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (Second) Ordinance, 2002.

<u>Definitions</u>

2. (1) For the purpose of these directions, unless the context otherwise requires: -
   (i) "Date of acquisition" means the date on which all ‘significant risks and rewards’ of ownership of financial assets have been acquired by Securitisation Company/Reconstruction Company irrespective of whether or not physical transfer of secured assets has taken place or agreement has been entered into.
   (ii) “Non-performing Asset” means an asset in respect of which
      (a) interest or principal (or instalment thereof) is overdue for a period of more than 180 days;
      (b) interest for principal is overdue for a period of more than 180 days from the expiry of planning period, wherever applicable;

(c) any other receivable, if it is overdue for a period of more than 180 days.

(iii) "Ordinance" means the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Ordinance, 2002 ;

(iv) "Overdue" means an amount which remains unpaid beyond the due date;

(v) "Owned Fund" means aggregate of paid up equity capital, preference shares which are compulsorily convertible into equity and free reserves as reduced by accumulated balance of loss, deferred revenue expenditure, book value of intangible assets and under / short provision against NPA/diminution in value of investments, and over-recognition of income, if any; and further reduced by book value of the company's investments in shares, bonds, debentures and outstanding loans and advances made to and deposits with related parties as defined in AS 18 of Institute of Chartered Accountants of India (ICAI), other than investments in joint ventures for asset reconstruction permitted by Reserve Bank of India ;

(vi) "Planning period" means a period not exceeding 12 months from the date of acquisition of assets for reconstruction, allowed for formulating a plan for realisation of such assets.

(vii) "Standard asset" means an asset in respect of which, no default in repayment of principal or payment of interest is perceived and which does not disclose any signs of impairment nor carry more than normal risk attached to the business.

(2) Other words or expressions used but not defined herein and defined in the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (Second) Ordinance, 2002, shall have the same meaning as assigned to them in that Ordinance. Any other words or expressions not defined in that Ordinance, shall have the same meaning assigned to them in the Companies Act, 1956.

<u>Income recognition</u>

3. (1) The income recognition shall be based on recognised accounting principles;

(2) All the Accounting Standards and Guidance Notes issued by the Institute of Chartered Accountants of India shall be followed in so far as they are not inconsistent with these directions;

(3) Income including interest or any other charges in respect of all the NPAs shall be recognised only when it is actually realised, i.e. `Cash' method of accounting shall be applicable for recognising the income on all the NPA. Any such income recognised before the asset became non-performing and remaining unrealised shall be reversed.

<u>Income from investments</u>

4. Income from State/Central Government Securities shall be recognised on accrual basis, provided that the interest rate on these instruments is pre-determined and interest is serviced regularly and is not in arrears for a period of 180 days.

<u>Valuation of Investments</u>

5. All investments held by the Securitisation and Reconstruction Company shall be marked to market and accounted for as per the accounting standards and guidance notes issued by the ICAI of the ICAI.

Asset Classification

6. (1) Every Securitisation / Reconstruction Company shall, after taking into account the degree of well defined credit weaknesses and extent of dependence on collateral security for realisation, classify the assets it has acquired for reconstruction and held by it, into the following categories namely, -

(i) Standard assets; and

(ii) Non-Performing Assets

(2) The Non-Performing Assets held by the Securitisation Company/Reconstruction Company for the purpose of reconstruction shall be classified

(a) as \`sub-standard asset' for a period of 12 months from the date it was classified as non-performing.

(b) as \`doubtful asset' if the asset remains a substandard asset for a period exceeding 12 months.

(c) as \`loss asset' if the asset is non-performing for a period exceeding 36 months or if the asset is adversely affected by a potential threat of non-recoverability due to either erosion in the value of security or non-availability of security or if, it has been identified as loss asset by the Securitisation Company/Reconstruction Company or its internal or external auditor.

(3) Assets acquired by the Securitisation Company/Reconstruction Company for the purpose of reconstruction will be treated as standard assets during the planning period.

(4) Every registered Securitisation / Reconstruction Company may, wherever appropriate and on the basis of circumstances for the purpose of enforcement of security interest, classify an asset as non-performing within the planning period .

7. **Plan for realisation**

(1) Every Securitisation Company/Reconstruction Company shall, within the planning period, formulate a plan for realisation of assets which may provide for one or more of the following measures namely,

a. rescheduling of payment of debts payable by the borrower;
b. enforcement of security interests in the financial assets in accordance with the provisions of the Ordinance;
c. settlement of dues payable by the borrower;
d. taking possession of secured assets in accordance with the provisions of the Ordinance.

(2) The plan for realisation shall clearly spell out the plan to reconstruct the assets and realise the same within a specified timeframe, which shall not in any case exceed five years from the date of acquisition.

Renegotiation / Reschedulment of financial assets acquired for reconstruction

8. (1) If the Securitisation Company/Reconstruction Company renegotiates any of the terms of the realisation plan with the borrower within a period of 6 months from the date of such an agreement / review, the asset shall be classified as substandard.

(2) The NPA may be upgraded to the category of performing asset on satisfactory performance for a period of 12 months as per the renegotiated / rescheduled terms.

Provisioning requirements

9. Every Securitisation Company/Reconstruction Company shall, after taking into account the time lag between an account becoming non-performing, its recognition as such, the realisation of security and erosion over time in the value of security charged, make provision thereagainst as under :-

Asset Category	**Percentage of Provision**
Substandard Assets	A general provision of 10% of the outstanding;
Doubtful Assets	(i) 100% provision to the extent the advance is not covered by the estimated realisable value of security; (ii) In addition to item (i) above, 50% of the remaining outstanding.
Loss Assets	The entire asset shall be written off. If the assets are permitted to remain in the books for any reason, 100% thereof shall be provided for.

Disclosure in the balance sheet

10. Every Securitisation Company/Reconstruction Company shall, in addition to the requirements of schedule VI of the Companies Act, 1956, prepare the following schedules and annex them to its balance sheet:

(i) the names and addresses of the banks/FIs from whom financial assets were acquired and the value of such assets procured from each such bank/FI;

(ii) dispersion of various financial assets industry wise and sponsor wise. The dispersion is to be indicated as a percentage to the total assets;

(iii) Names and address of all the QIBs and the amounts invested by them in the various schemes of the Company formulated in pursuance of section 7(2) of the Ordinance;

(iv) Calculation of Owned Fund and Capital Adequacy ratio;

(v) Details of related parties as per AS-18 and the amounts due to and from them;

(vi) Rating obtained for its various schemes and a copy of the rating rationale made available by the rating agency;

(vii) A statement clearly charting therein the migration of financial assets from standard to non-performing and from thereafter to loss assets;and

(viii) A statement of all significant accounting policies adopted in preparation and presentation of the balance sheet and profit and loss account.

Notes

(i) The accounting policies adopted in preparation and presentation of the financial statements shall be in conformity with the applicable prudential norms prescribed by the RBI.

(ii) Where any of the accounting policies is not in conformity with these directions and the particulars of departures shall be disclosed together with the reasons therefor and the financial effect thereof. Where such effect is not ascertainable, the fact shall be so disclosed.

(iii) An inappropriate treatment of an item in Balance Sheet or Profit and Loss Account cannot be deemed to have been rectified either by disclosure of accounting policies used or by disclosure in notes to balance sheet and profit and loss account.

Accounting Year

11. Every Securitisation/Reconstruction Company shall prepare its balance sheet, and profit and loss account as on March 31 every year.

Requirement as to capital adequacy

12. Every Securitisation/Reconstruction Company shall maintain, on an ongoing basis, a minimum capital adequacy ratio, which shall not be less than 15 percent of its total risk weighted financial assets. The risk weighted asset shall be calculated as the weighted aggregate of funded items as detailed hereunder :

Weighted risk assets - On-Balance Sheet items	**Percentage weight**
(i) Cash and bank balances including fixed deposits and certificates of deposits with scheduled commercial banks	0
(ii) Investments	
State/Central Government securities	0
(iii) Other financial assets	100

Exemptions

13. The Reserve Bank of India may, if it considers it necessary for avoiding any hardship or for any other just and sufficient reason, grant extension of time to comply with or exempt all Securitisation Companies/Reconstruction Companies or a particular Securitisation Company/Reconstruction Company or class of Securitisation Companies/Reconstruction Companies, from all or any of the provisions of these directions either generally or for any specified period, subject to such conditions as the Reserve Bank of India may impose.