Date: 31st August, 2017

To,

Mr. Ananta Barua
Executive Director,
Investment Management Department,
Securities and Exchange Board of India,
Plot No. C4-A, "G" Block, Bandra Kurla Complex,
Bandra (East) Mumbai - 400 051
India

Sub: Representation recommending changes to SEBI (Mutual Funds) Regulations, 1996 with regard to investment in securitized debt instruments

Dear Sir,

On behalf of the Indian Securitisation Foundation (ISF), a not-for-profit entity representing the securitisation industry in India, we hereby submit our representation recommending few changes to the Securities Exchange Board of India (Mutual Funds) Regulations, 1996 pertaining to investment in debt securities including securitized debt instruments as prescribed in Securities Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2016[1] (hereinafter referred to the "Amendment").

The securitization industry in the past few years has picked up significant pace and with the taxation issues being resolved, the industry is now forward looking and trying several innovative deals. Mutual funds have been a significant investor in the securitized instruments and have contributed significantly in broad-basing the investor base for securitized instruments which would have been otherwise limited to banks and non-banking financial companies.

Having said this, the Amendment causes limitations to investments. The recommendations in the representation are with the objective of highlighting the changes in the provisions of the Amendment regulation that will allow the mutual funds to invest more in the securitized instruments.

[1] http://www.sebi.gov.in/sebi_data/commondocs/mfamendmentregu2016_p.pdf

INDIAN SECURITISATION FOUNDATION
(A Not-For-Profit Company Licensed under Section 25 of Companies Act, 1956)
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Corporate Identity Number: U65923MH2013NPL242178

ISF was incorporated with the objective of promoting and representing the industry to government, regulators, the public, investors and others who have an interest or potential interest both in India and overseas, regarding the benefits of securitisation in India and aspects of the securitisation industry. Our members include banks, NBFCs, microfinance institutions. A detailed profile of ISF forms a part of the enclosures as **Annexure II**.

On behalf of the ISF, we hereby assimilated the suggestions from the market participants and do hereby submit our representation for your kind consideration. Our representation on the matter has been enclosed with this letter as **Annexure I**.

Should you need any further clarification, we would be glad to provide the same. In case there is a discussion required on the matter, we will be happy to come down to your office.

Kindly look into the matter and oblige.

Thanking You,

For Indian Securitisation Foundation

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(Authorised Signatory)

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Annexure I: Representation

Mutual funds have been a significant investor to the PTCs till mutual funds were caught in the litigations pertaining to tax evasion which eventually dissuaded mutual funds from investing in PTCs. Thereafter the tax provisions pertaining to securitization trusts was amended causing distribution tax to be applicable on the income distributed by the securitization trusts[2].

Thereafter, the distribution tax provisions were replaced with the pass-through status being granted to securitization trusts, which persuaded mutual funds to reconsider investment in PTCs.

The securitization volumes in India were around Rs. 92,700 crores in the financial year 2016-17 of which Rs. 43,000 crores worth of securitization was done through pass-through certificates route[3]. The total securitization volumes grew by 40% in FY 2017 and it is assumed that the growth was attributable to the investments by mutual funds. Mutual funds, driven by availability of liquidity and restoration of pass-through status for securitized debt instruments, invested close around 10%-15% of the total PTC issuances. It is estimated that the market has a potential to cross Rs. 1 lakh crores in FY 18 and mutual funds may have a significant role to play in rallying the volumes.

The Amendment to the SEBI mutual funds regulations provides for investment restrictions in case of debt instruments including mortgage backed securities forming part of the Seventh Schedule of the Mutual Funds Regulations. The Amendment prescribes that -

> *"…A mutual fund scheme shall not invest more than 10% of its NAV in **debt instruments** comprising money market instruments and non-money market instruments **issued by a single issuer** which are rated not below investment grade by a credit rating agency authorised to carry out such activity under the Act…"*

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[2] Chapter XII EA of the Income Tax Act, 1961 was introduced by the Finance Act, 2013. The provisions of the chapter required the securitisation trusts to deduct distribution tax on the income distributed to the investors, at the rates prescribed in the chapter.

[3] http://www.careratings.com/upload/NewsFiles/SplAnalysis/Securitisation%20market%20touches%20a%20new%20peak%20in%202017.pdf

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> *"….Provided further that investment within such limit can be made in mortgaged backed securitised debt which are rated not below investment grade by a credit rating agency registered with the Board…"*

As is apparent from the provisions of the Amendment, the limit is applicable to investment in debt securities issued by a ***single issuer***.

PTCs are asset-backed securities subscribed by the investors relying on the quality of the underlying pool of receivables for repayment. The issuer of the PTCs is a special purpose vehicle (SPV) which, in India, is usually in the form a trust. The SPV is formed with the objective of holding receivables for the investors and undertakes has no other business of its own. Therefore, in the context of the mutual funds regulations, the objective would be to limit the exposure of the funds on a single originator in the present case, rather than an SPV, which is largely an automated entity.

An originator usually identifies several loan pools in a financial year and securitizes the receivables pooled vide multiple transactions. These pools can be of different qualities, may be associated with different risk features, correlation features, geographical concentricity which may be part representative of originator but not reflective of the originator in entirety. Therefore, the restrictions on investment by mutual funds should be on the pools rather than on the single originator or issuer as it restricts the potential of investments that mutual funds can make in different receivables representative of different industry risks/ customer segment risks. Kindly note that the in case of securitized debt instruments, technically, the issuer is an SPV which has no credit history or credit standing. The originator is the entity behind the origination of the pool, but the investors are acquiring an exposure in the pool rather than in the originator. A transaction is structured on a non-recourse basis, achieving a true sale and distancing from the originator.

The intent of the Amendment is to take care of concentration risk in investing in debt securities of a single or a few investors. In case of asset backed securities, the right approach will be to take a see-through approach, and look at the underlying pool rather than either the originator or the issuer. Notably, even the RBI guidelines on priority sector investments take a see-through approach.

If the Amendment regulations are revised to alter the investment restrictions from a single issuer to single pool of receivables in case of securitized debt instruments, it would open up the potential of investments in securitized debt instruments by mutual funds, thereby facilitating securitization volumes to reach its true potential in the Indian market. At the same time, such amendment will only carry forward the objective of the SEBI in putting up the Amendment.

Further to add, currently the investment restrictions make a mention of mortgage-backed securities which is fractional representation of the entire securitization market in India. Securitized debt instruments issued by the SPVs get their name from the type of the underlying pools, for instance, if the pool consists of receivables arising out of mortgage loans/ housing loans, the PTCs issued to the investor is known as mortgage-backed securities. Where the underlying receivables are representative of auto loans, commercial vehicle loans, the PTCs are referred to as asset-backed securities. The nomenclature of the securitized debt instrument, as explained above, is a global phenomenon.

If the Amendment, makes a mention of investment conditions for mortgage-backed securities only, it leaves scope of ambiguity, as to what investment restrictions will apply in case of securitized debt instruments other than mortgage-backed securities. The SEBI regulations on listing of securitized debt instruments[4] also generically makes a reference to 'securitized debt instruments' instead of mortgage-backed or asset-backed securities to include all sorts of securitized debt instruments issued by the SPV irrespective of the nature of the underlying pool of receivables. Therefore, we recommend that the word – mortgage-backed securities to securitized debt instruments, as is otherwise used by the other SEBI regulations.

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[4] http://www.sebi.gov.in/legal/regulations/apr-2015/sebi-public-offer-and-listing-of-securitised-debt-instruments-amendment-regulations-2015_29573.html

Annexure II: About Indian Securitisation Foundation

Indian Securitisation Foundation (ISF) is a not-for-profit organisation incorporated under section 25 of the Companies Act, 1956, a representative body of the securitisation industry in India. ISF is formed with the objective of developing, promoting and protecting the securitisation, structured finance markets in India in particular, and market for fixed income securities in general.

Securitisation in India is not just a fixed income investing instrument, but essential for the idea of financial inclusion, in form of priority sector lending. Banks meet their priority sector targets partly through portfolio acquisitions and securitisation, thereby putting securitisation at par with the banking book.

Infrastructure sector also depends substantially on securitisation for equity extraction.

In essence, the significance of securitisation to India's financial sector cannot be under-estimated.

Over time, credit default swaps are also expected to be prevalent as ways of synthetically replicating credit risk.

It is a clear policy choice to have a strong market for fixed income securities in India: structured finance securities are an essential part of that market, to provide variety, choice and alignment to investor needs.

In this background, ISF was conceptualised to provide direction, leadership, advocacy and support to the securitisation and structured finance industry.

Some of the functions of the Foundation include:

a. **Advocacy** – making representation to various authorities from time to time on matters as may concern securitisation and similar capital market instruments.
b. **Industry forums and networking** - holding periodic conventions and educational courses.

c. **Development of industry standards** - framing self-regulatory standards on disclosures, reporting, servicing reporting, DOs and DONTs for securitisation and direct assignment transactions, etc. Development of standards such as standard assignment agreements, assignment procedures, notification procedures, etc. on the lines of ISDA agreements and encouraging members over period to start using such standard templates.
d. **Information exchange** – on matters of common interest, collateral performance, etc.

Advisory Committee

Mr. M.R Umarji

Mr. Madhukar R Umarji, Chief Advisor - Legal of the Indian Banks' Association is acknowledged as an authority on Secured Transactions Law in India. He began his career as a Legal Assistant for the state government simultaneously pursuing his Masters in law. Following his Masters, he shifted to being a Legal Advisor in commercial banks and completed his transition to a commercial banker by becoming Executive Director of a public sector bank. Later he was taken on deputation at Reserve Bank of India as Executive Director in charge of Department of Non-Banking Supervision. He has been a part of several Expert Committees set up by the Government and Working Groups concerned with Banking Sector Reforms in India. His pivotal role in the drafting of secured transactions legislation in India shaped the way for a path-breaking reform for the Indian banking industry. Presently, he is actively involved with Working Group VI of UNCITRAL on Secured Transactions as an expert from India.

Mr. Sanjay Chamria

Mr. Chamria founded Magma in 1988, along with Mr. Mayank Poddar. As the Vice Chairman and Managing Director of Magma, he anchors policy formation, strategy planning and execution. He was born and educated in Kolkata, and graduated as one of the country's youngest chartered accountants in 1985 with national ranking. For the past 23 years, he has steered the organization from a three-employee, one-office set up to a company with 225+ branch offices and more than 6000 employees.

Mr. Chamria uses his position as one of the foremost leaders in India's asset financing industry to articulate his views on critical issues facing the industry and its future. He has represented the BFSI and NBFC industry at various forums, including RBI, and before the finance ministry and other government bodies. He has also chaired committees at the FICCI, the Hire Purchase & Lease Association of India, the CII, the Finance Industry Development Council (FIDC) and the Indian Merchants Chamber in Mumbai.

Mr. D.K. Vyas, CEO, SREI BNP

Mr. D K Vyas, CEO of Srei BNP, has catapulted Srei BNP Paribas to a dominant leadership position in the infrastructure and construction equipment finance business, with over 33% market share, leading a team of over 1,000 professionals, and with distribution across the country. Demonstrating a judicious balance between growth and prudence in lending, the company under his leadership has registered a CAGR of over 35% over the past five years, disbursed over Rs. 10,010 crore in FY 11 and has one of the lowest NPA’s in the industry.

Mr. V. S Rangan

Mr. V. Srinivasa Rangan is Executive Director at Housing Development Finance Corporation Limited (HDFC Ltd). He has been associated with the company since 1986. Mr. Rangan is a Graduate in Commerce, CWA and an Associate member of the Institute of Chartered Accountants of India with national ranking.

Mr Rangan has worked on international consulting assignments in housing finance in countries such as Ghana and the Maldives. He has also been a member of various committees constituted by the regulators in the areas of development of Mortgage Backed Securitisation and Secondary Mortgage Markets which includes RBI's

Committee on Asset Securitisation and Mortgage Backed Securitisation and Technical Group formed by National Housing Bank for setting up of a Secondary Mortgage market institution in India.

Mr Rangan was recently conferred the "Best CFO in the Financial Sector for 2010" by "The Institute of Chartered Accountants of India" (ICAI) for exceptional performance and achievements as CFO in the Financial Sector for the year 2010 .

Mr. T.T Srinivasraghavan

Mr. T. T. Srinivasaraghavan is the Managing Director at Sundaram Finance Ltd. He served as Joint Managing Director of Sundaram Finance Ltd. Mr. Srinivasaraghavan serves as Chairman of Infreight Logistics Solutions Ltd. He serves as an Executive Director of Sundaram Finance Ltd, and Director of Sundaram BNP Paribas Home Finance Limited and Sundaram BNP Paribas Asset Management Co. Ltd. Mr. Srinivasaraghavan has a vast experience in the Banking and Finance sectors. He serves as President of International Finance & Leasing Association, United Kingdom. Mr. Srinivasaraghavan holds an M.B.A. in Finance Degree.

Executive Committee

Executive functions of the ISF are currently being discharged by team of Vinod Kothari Consultants P. Ltd. The team is led by Vinod Kothari and Nidhi Bothra.

Mr. Vinod Kothari

Mr. Kothari is a noted scholar on securitisation and has lectured all over the World on securitisation. Vinod Kothari has been consulted by regulators in various countries, and has structured transactions in several markets. Vinod Kothari is the author of several books on the subject including Securitisation: Financial Instruments of Future, Introduction to Securitization (co-author with Frank Fabozzi), Credit Derivatives, Structured Credit Trading and Guide to Structured Finance etc. For detailed profile of Vinod Kothari, see www.vinodkothari.com/profile

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Ms. Nidhi Bothra

Ms. Bothra is a consultant on securitisation, structured finance and corporate finance and is Executive Vice President in Vinod Kothari Consultants P Ltd. Nidhi has conducted training workshops on securitisation in India and outside India, and has handled several consulting assignments on structured finance in different markets. See profile at http://vinodkothari.com/nidhi-bothra-profile/

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