

STATE BANK OF PAKISTAN
BANKING POLICY DEPARTMENT
I.I. CHUNDRIGAR ROAD
KARACHI.

BPD CIRCULAR NO.31

NOVEMBER 14, 2002

The Presidents/ Chief Executives,
All Banks/DFIs

Dear Sirs / Madam,

Assets Securitization through Special Purpose Vehicle (SPV)

State Bank of Pakistan has received requests from a number of financial institutions desirous of performing various roles in assets securitization transactions through special purpose vehicle. These requests have been considered in consultation with concerned quarters and it has been decided that banks/DFIs can participate in assets securitization through SPV. However, in doing so and performing various roles in assets securitization through this mode, they shall adhere to the guidelines prescribed below:

General Guidelines

2. Banks/DFIs participating in a securitization transaction in any capacity shall ensure that:
 - i) they do not own any share capital in the SPV
 - ii) the SPV and the ABS (Assets Backed Securities) issued by it do not carry the same or similar name as that of the bank/DFI. SPV shall not include the name of the bank/DFI in its name or imply any connection with the bank/DFI, for example, by using a symbol closely associated with the bank/DFI.
 - iii) all reasonable steps are taken to ensure that investors are informed in writing that their obligations to the SPV and investors in the ABS of the SPV are limited to the extent expressed in their written agreement with SPV.
 - iv) all transactions between them and SPV are conducted at arms length and are market based.

Arranger/Structuring Agent

3. The financial institution in this role may structure the transaction keeping in view the requirements of the originator, the market appetite, internal and external credit enhancement, quality of receivables, etc. Banks/DFIs performing this role shall ensure that:

- i) their legal advisers are satisfied that the terms of the asset securitization issue protect them from any liability to investors in the scheme or the vehicle
- ii) any offering circular contains a highly visible, unequivocal statement that the banks/DFIs, serving in this capacity, do not stand behind the issue or the vehicle and will not make good any loss in the portfolio.
- iii) a fee at least at market terms and conditions is charged for the services performed.

Administrator/Trustee/Servicing Agent

4. The role envisages collection of the assigned/purchased receivables, defraying them to investors and taking appropriate enforcement actions when necessary to ensure their payment. The banks/DFIs performing this role shall comply with the following guidelines:

- i) The bank/DFI should have clearly defined process flow and roles and responsibilities of personnel needed to carry out these activities.
- ii) There should be a written contract/agreement between the bank/DFI, originator and SPV specifying the services to be provided as also other functions antecedent and ancillary there to.

- iii) The written contract/agreement shall specifically state that the bank/DFI is under no obligation to remit funds to the SPV or the investors in the ABS unless and until they are received from the obligor.
- iv) The banks/DFIs shall ensure that any offering circular precisely mentions a highly visible, prominent and unequivocal statement that serving in this capacity, they do not stand behind the issue or the SPV and will not make good any losses in the portfolio.
- v) The bank/DFI shall place in record the written opinions from its legal advisers that the terms of agreement protect it from any liability to investors in the securitization transaction or the SPV (except normal contractual obligations relating to its role as servicing agent).
- vi) The bank/DFI may receive a performance-related payment (or benefit from any surplus income generated¹), in addition to its base fee, provided the same is on market terms and conditions and any performance-related payment does not commit it to any additional obligation. Such payment shall be recognized for profit and loss purposes only after it has been irrevocably received.

Investor

5. The conditions prescribed under Prudential Regulation IV & V and NBFIs Rules 7 & 8 are relaxed only in cases where banks/DFIs desire to invest in marketable ABS representing distinct, identifiable and recurring cash flows, issued by SPVs established under Asset Backed Securitization Rules 1999 and duly registered with Securities and Exchange Commission of Pakistan. They will, however, adhere to the guidelines indicated below:

- i) The banks/DFIs holding Asset Backed Securities (ABS) have risk exposure to these underlying ABS assets. While determining total exposure under PR-I/NFBI Rule 9 to any particular obligor, they shall therefore take into consideration the exposure against the ABS assets of that particular obligor.
- ii) The banks/DFIs shall invest in only those ABS, which are listed on the Stock Exchange and have a minimum credit rating of A or equivalent from a Credit Rating Agency approved by SBP or an international credit rating agency viz. Standard & Poor, Moody or Fitch.
- iii) Total exposure of a bank/DFI towards ABS issued by a SPV shall not exceed 5% of its own paid up capital or 15% of the total value of the ABS issued by a SPV which ever is less. Further, the aggregate exposure on account of ABS shall not exceed 20% of the total paid up capital of the bank/DFI. (This will encourage banks/DFIs to (a) invest in and sell-down these ABS, i.e. to churn their ABS portfolio to stay within the 20% cap and to (b) actively trade in ABS to develop a secondary market, rather than to simply purchase these ABS and hold them till maturity)
- iv) For Capital Adequacy purposes, the banks holding ABS shall treat them at par with investment in TFCs and accordingly apply the risk weights prescribed by State Bank.
- v) The banks/DFIs will not invest in ABS in cases where originator/the company setting up the SPV is defaulter of any financial institution. For this purpose, banks/DFIs shall obtain report from CIB of State Bank before making investment decisions.

Originator

6. The banks/DFIs under this role would act as supplier of the assets/receivables that are securitized. In this respect they shall comply with the following guidelines:

- i) The banks/DFIs can securitize their assets relating to lease financing (with acknowledged assignment of lease rental proceeds), mortgage financing and toll

¹ This refers to any surplus income generated by the underlying assets of the SPV after meeting all payment obligations of the securities issued, operating costs of the SPV, and/or losses or bad debts on the underlying assets.

- financing (for infrastructure developmental projects). Other assets may be securitized by banks with prior approval of State Bank, on a case to case basis.
- ii) The securitizing bank/DFI shall ensure that there are no impediments (contractual or otherwise) that prevent the transfer of the assets, or the rights in relation to such assets, to an SPV and all the necessary consents have been obtained. The transfer of the assets should not contravene the terms and conditions of any underlying agreement governing the assets.
 - iii) The securitizing bank/DFI must have legal and accounting opinions on record to the effect that it has retained no liability for the loans so securitized.
 - iv) The securitizing bank/DFI must ensure that it is not obliged to support any losses suffered by investors in the ABS issued by the SPV.
 - v) The assets should be transferred at fair value. A fixed amount of consideration for the securitized assets must be received not later than the time of the transfer of the assets.
 - vi) The securitizing bank/DFI shall have no obligation to repurchase any securitized asset at any time.
 - vii) The transfer of assets must comply with the true sale criteria, which at a minimum should have the following characteristics:
 - a. The underlying assets must have been isolated from an originator i.e., put beyond the reach of the originator and its creditors even in receivership or bankruptcy.
 - b. The risk that a transfer of assets by an originator to an SPV might be re-characterized as a financing transaction rather than a sale of assets be completely eliminated. In this regard, the originator must effectively transfer all rights and obligations in the underlying assets to the SPV and should not retain any residual beneficial interest in the underlying assets.
 - c. An originator must not hold any equity stake, directly or indirectly, in an SPV. In addition, the originator must not be in a position to exercise effective control over the decisions of the SPV in relation to the securitization transaction. The originator thus should not have any director, officer or employee on the board of the SPV
 - d. An SPV must have no recourse to an originator for losses arising from those assets.
 - e. Where an originator is also the Administrator/Trustee, the services must be provided on an arms length basis and on market terms and conditions.
 - viii) Investors must be clearly informed in the offering circular that the ABS they invest in do not represent deposits or constitute other liabilities of the securitizing bank/DFI and the securitizing bank/DFI does not in any way stand behind the value or performance of the ABS issued by the SPV or of the assets held by the SPV.
 - ix) Investors must be informed that their holdings of ABS are subject to investment risk, including repayments or interest rate risks, possible delays in repayments and loss of income, principal invested, etc.
 - x) The securitizing bank/DFI shall not support any loss arising from the securitization transaction or by investors involved in it. It will also not bear any of the recurring expenses of the transaction.
 - xi) The securitizing bank/DFI shall not underwrite or invest in the ABS issued by the SPV.

Underwriter

7. Banks/DFIs can underwrite the ABS issued by an SPV, however, its share should not exceed 5% of its own paid up capital or 15% of total value of the ABS whichever is less.

Provider of Fund Based/Non-Fund Based Facilities

8. Banks/DFIs are not allowed to extend any fund based facility (for instance, temporary liquidity support) to the SPV or provide any non-fund based facility (like credit enhancement support in the form of stand-by letter of credit or guarantee) to the ABS. However, in the following circumstances, banks/DFIs may allow fund based facility

(temporary liquidity support) to the SPV or provide non-fund based facility (credit enhancement support in the form of stand-by letter of credit or guarantee) to the ABS:

- i) Where the facilities are fully secured against the guarantee of an International Ist Class Bank rated at least A or equivalent by a recognized credit rating agency viz. Standard & Poor, Moody or Fitch.
- ii) Where facilities are fully secured against cash or near cash collateral under perfected lien of the bank after taking into account the margin requirements as prescribed by State Bank of Pakistan. Cash or near cash collateral for the purpose of this clause shall mean the bank deposits, deposit certificates and Government Securities.

9. In addition to these guidelines, banks/DFIs desirous of participating in the assets securitization transactions should formulate policies and develop controls, checks and balances to effectively manage the associated risks.

10. State Bank of Pakistan will closely monitor the market developments and review the guidelines, as and when necessary, to meet the needs of the market, while ensuring prudent conduct of securitization transactions by banks/DFIs.

11. Please acknowledge receipt.

Yours faithfully,

(MUHAMMAD KAMRAN SHEHZAD)
Director