





REGULATORY PRESPECTIVES ON INTRODUCTION OF COVERED BONDS IN INDIA


03-09-2015




- The National Housing Bank had constituted a Working Group to suggest measures for promoting Residential Mortgage Backed Securities (RMBS) and other alternative capital market instruments such as Covered Bonds with a view to strengthening the linkage between the Indian housing finance sector and the capital market.

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- The Report of the Working Group included the recommendation for introducing the Covered Bonds in the Indian housing finance market under the extant legislative framework and has also suggested measures (including regulatory) for facilitating the same.
 - Based on the Report of the Working Group, NHB had issued a Consultation Paper outlining the proposal for issuance of Covered Bonds by HFCs.

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- The Draft Guidelines framed on the subject of issuance of Covered Bonds by HFCs were discussed with Reserve Bank of India in the context of Banks acting as Investors/Issuers in Covered Bonds.
 - RBI has welcomed the introduction of covered bonds as a new instrument for funding and the bond market development and highlighted the need for legal clarity and adequate risk management framework for issuance of covered bonds being put in place.

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- Board of NHB has accorded in-principle approval for issue of Guidelines on issuance of Covered Bonds by HFCs.
 - SEBI has confirmed that Covered Bonds would fall within the definition of “Bonds” specified in Section 2(h)(i) of the SCRA and moreover, it is akin to marketable security of an incorporated body. No specific clarification is needed to include Covered Bonds under Section 2(h) of the SCRA for allowing listing and trading of Covered Bonds on recognised stock exchanges.

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- The Working Group had suggested a 'Segregation Structure' involving sale of assets in the cover pool to a Special Purpose Vehicle (SPV).
 - The sale was proposed to be a sale in legal parlance, but not a sale from accounting/ regulatory perspectives.
 - The reason for the same being that accounting standards do not go by true sale – accounting standards look at transfer of risks and rewards, and since despite the so-called legal sale, the covered bonds are proposed to be a full-recourse obligation of the issuer, the risks and rewards on the asset pool are fully with the issuer, and therefore the assets are on the Issuer's (Originator) balance sheet.

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- ▶ While there are a few legal and regulatory issues on issuance of Covered Bonds , we are hopeful to overcome them and not very far from now Covered Bonds may become an financial instrument in India.