# Securitisation accounting under Indian Accounting Standards

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# Background

Accounting for securitisation is one of the significant motives of securitisation itself. If a transaction of securitisation fails to achieve off-balance sheet treatment, then several of the significant drivers for securitisation will cease to be relevant. This only explains why it is crucial to ensure, of course subject to conditions, that the transaction does achieve off-balance sheet treatment.

Under the-pre IFRS regime, Accounting Standard (AS) 30 – Financial Instruments: Recognition and Measurement [based on International Accounting Standard (IAS) 39 - Financial Instruments: Recognition and Measurement] used to contain the accounting principles for securitisation. However, the same was later on withdrawn.

As accounting transitions to IFRS/ Ind AS, the specific accounting principles for financial instruments are contained in IFRS 9/ Ind AS 109. Accounting for securitisation transactions is also covered by the same IFRS, as would be evident in the discussion below.

For the sake of clarity on definition terms, the key expressions in respect of financial instruments are (a) financial asset; (b) de-recognition; and (c) carrying values on on-going basis, and the treatment of changes in carrying values..

Securitisation mostly consists of assignment of receivables. A receivable is an example of financial assets. A financial asset is defined by Ind AS 32 to mean any asset that is:

a. Cash;
b. An equity instrument of another entity;
c. A contractual right:
    i. To receive cash or another financial asset from another entity; or
    ii. to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
d. a contract that will or may be settled in the entity's own equity instruments and is:
    i. a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
    ii. a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 16A and 16B of Ind AS 109, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 16C and 16D of Ind AS 109, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

Since a receivable consists of right to receive cash, they will form part of "financial assets". Even if it were a securitisation of bonds or similar debt securities, it will also be a case of securitisation of financial assets. Receivables may be existing or future receivables – the above definition will still capture the same.

Off-balance sheet treatment, in accounting parlance, is called "de-recognition", implying the reversal of recognition. When the financial asset, already on the balance sheet of the originator, is removed from there, it is a case of de-recognition.

While IFRS 9 deals with a gamut of issues pertaining to accounting for financial instruments, specifically relevant to securitisation accounting, the answers to the following questions, at least, can be found in the IFRS:

- Whether the transaction of securitisation will result into the receivables being de-recognised, that is, moving off the balance sheet?
    - If yes, whether there will be a corresponding gain/loss on de-recognition? What will be the inherent retained assets/liabilities that will appear on the books of the seller?
    - If not, what will be the continuing recognition of the receivables? What will happen to the money raised by securitisation?
- As regards the investor in the securitised instrument (PTCs, other asset backed securities), how will the investor account for the same? Can these securities be subjected to amortised cost basis of accounting, based on whether the payments thereunder consist of "simply payment of principal and interest"?
- Whether impairment provisions will be applicable to assets securitised by the originator? Will such provisions be applicable to the investor?

### Direct assignments and securitisation

Indian securitisation practice consists of a substantial activity in the so-called direct assignment segment. Direct assignment implies a transfer of loans, mostly in form of a pool, from a seller to the buyer, without the involvement of a special purpose vehicle. The buyer is mostly a financial entity, typically a bank. Since there is a direct portfolio transfer, there is no resulting "security" in this case. The practice of direct assignments emerged as a rival to securitisation when the RBI issued guidelines in 2006 which disciplined securitisation transactions, but did not apply to direct assignments at all. The market, therefore, moved to this unregulated product. Subsequently, direct assignments were brought under regulatory purview in 2012, but then tax issues have intermittently favoured direct assignments.

The question for the purpose of this Paper is – are direct assignments also subject to IFRS 9/ IndAS 109? The answer must be clearly "yes", since, after all, there is a transfer of a financial asset in case of direct assignments too. Hence, the question of de-recognition comes, in the hands of the transferor. Of course, as the later part of this Paper examines more closely, the conditions for off-balance sheet treatment may actually be easier to comply in case of direct assignments, given the regulatory requirement of zero credit enhancement in this case.

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