Developments in the Securitization Markets In India

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INDIAN SECURITISATION FOUNDATION

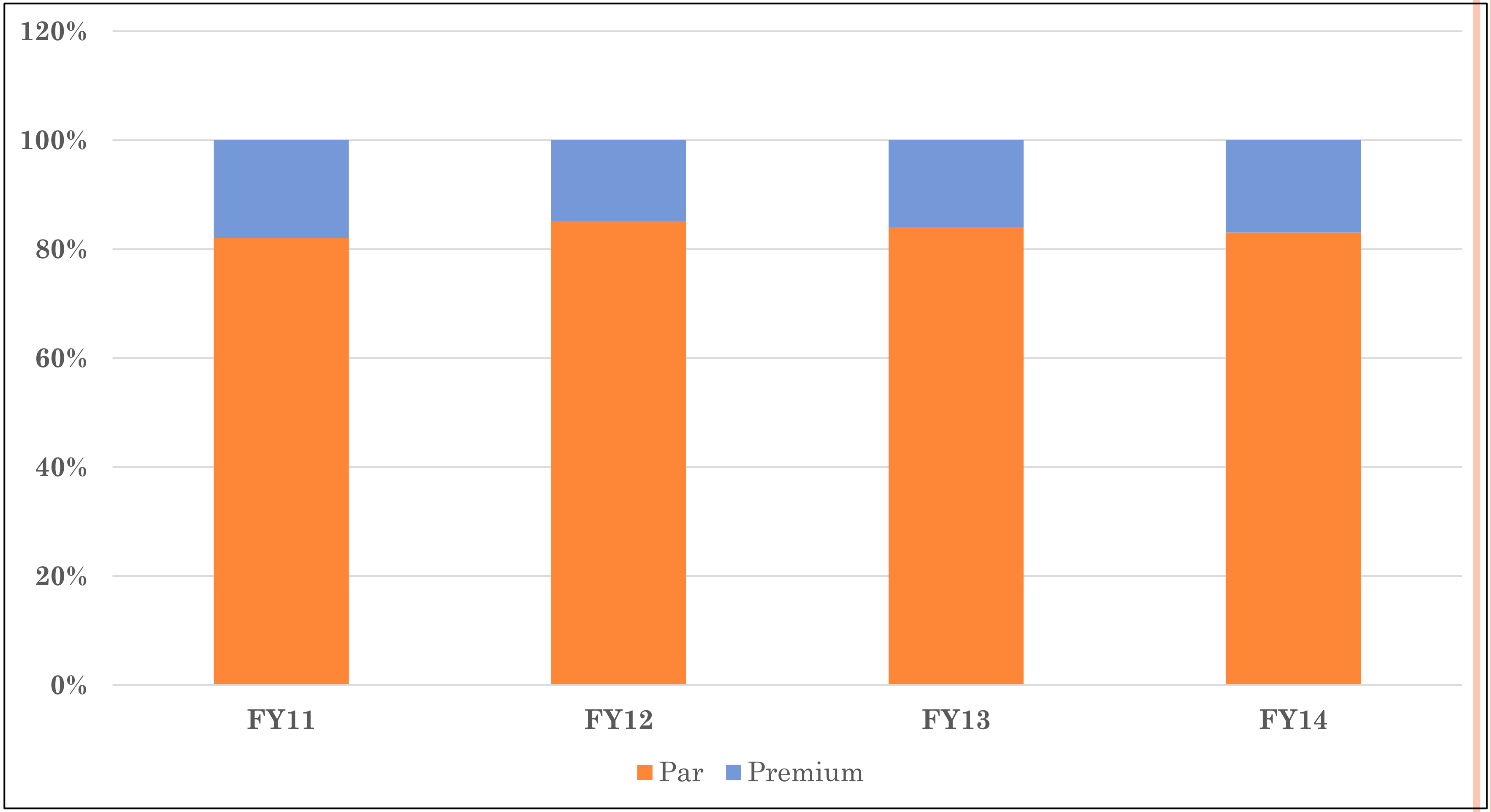
History of Securitization in India

- Securitization has been in existence since 1990s.
- There is no specific law pertaining to securitization
  - There are regulations on securitization activities of banks and NBFCs issued by the central bank, Reserve Bank of India
- There are two securitization structures prevalent in India
  - Bilateral assignments, also called direct assignments
    - Probably the only country, where assignment of receivables is called securitization
  - Securitization using the SPV structures, also called PTC (pass-through certificates) structures
- Securitization is largely a device for bilateral acquisition, in India
  - Dominant in Indian market, around 80% of securitisation is bilateral assignment

OVERVIEW

- Securitization has not been truly a capital market window and almost all asset backed securities are privately placed
  - There is one listed ABS paper so far
  - There is no market for securitized paper rated below AA.
- ABS is a dominant class in India
- Most PTCs securitization transactions are par structures
- Transaction structures are simple. Credit enhancements are limited to subordination of EIS and cash collateral
- Also, there are separate guidelines for securitization of standard assets and non-performing assets

Preference for par structures



Source: ICRA Estimates

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Overview (Cont..)

- Securitisation market is largely driven by the need for meeting the priority sector targets for banks
  - Greater dependence on demand for priority sector loans
    - Priority sector are identified sectors, mandating banks to have minimum exposure in such sectors to bring financial inclusion. These sectors include agriculture, small and medium enterprises, education loans etc.
  - Very recently, there is a demand for non-priority sector pools as well
- Market is almost entirely concentrated around priority sector lending
  - Non-banking financial institutions use securitisation as a route to sell priority sector loans to banks, as banks fall short of their target amounts

Overview (Cont..)

- Securitization in India is often confused with the law pertaining to asset reconstruction companies and enforcement of security interests
  - In 2002 the Securitisation and Asset Reconstruction and Enforcement of Security Interests (SARFAESI) law was enacted
  - In lines of KAMCO, Danharta for creating a business model out of asset reconstruction business
  - SARFAESI law is completely different from the financial instrument, yet often confused
- Distribution tax
  - Investors are charged to tax on gross income basis
    - Tax was imposed to grant tax transparency to securitisation; however, it ended up taxing deals on gross basis
- FPIs are not explicitly allowed to invest in securitisation
  - Strangely, FPIs are allowed to invest in security receipts (SRs) but not asset backed securities.

Overview (Cont..)

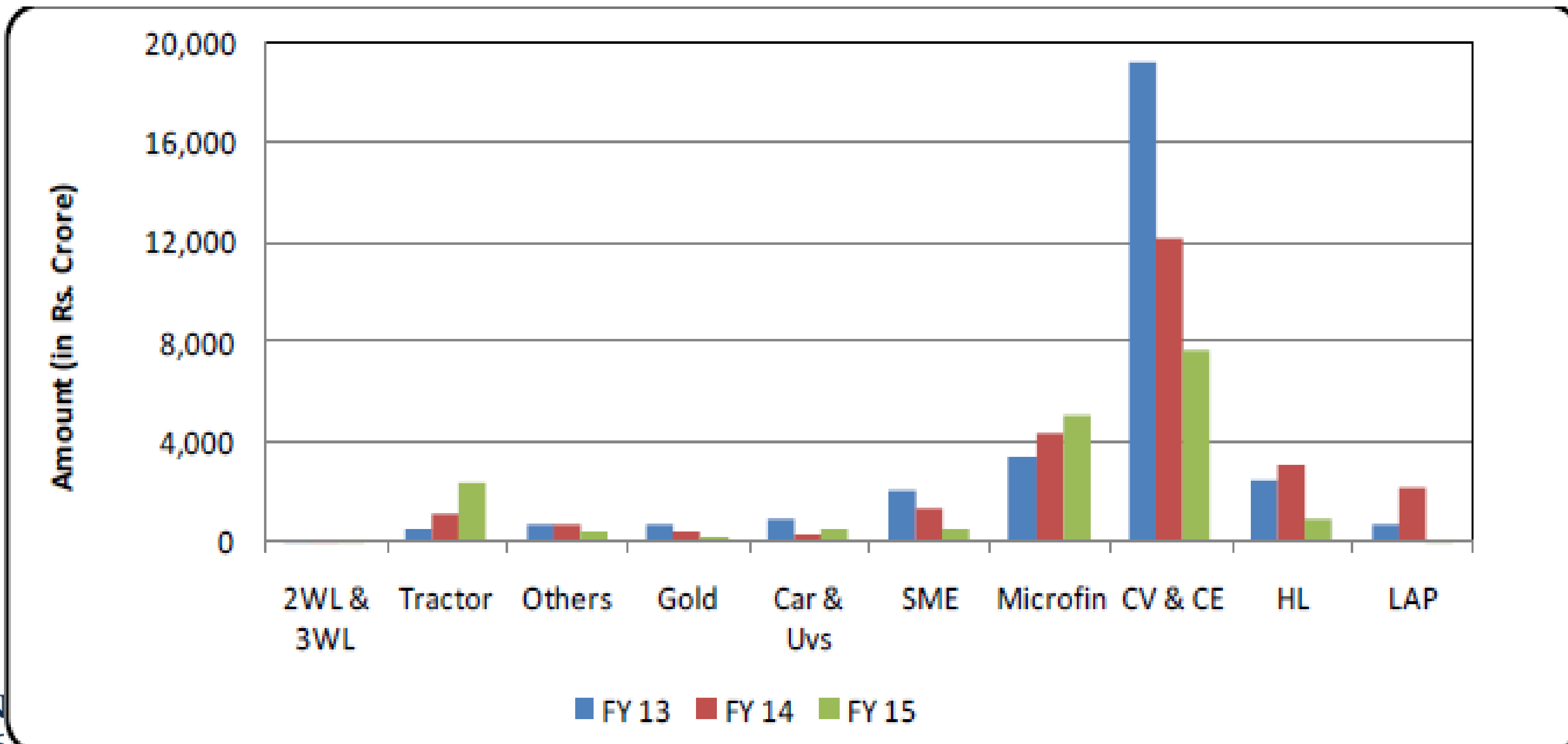
- Mutual funds that were a significant investor in securitised paper till 2011 have remained aloof from the market owing to the tax disputes from tax officers
  - Investment in securitised debt instruments make eminent sense for a mutual fund as ratings, performance and yield on the securitised paper are better than corporate bonds.
  - While the tax amendments of 2013 resolved some of the issues faced by mutual funds and distribution tax was made inapplicable in case of mutual funds, the industry has continued to refrain from investing in securitised paper.
- There is lack of RMBS issuances in the country
  - High stamp duty and inter state complexities are largely the reason for low activity in the asset class
  - Also RBI requires minimum risk retention of 10% whereas historically the default rates have been less than 0.5%.
- Another striking feature of Indian securitisation market is that banks are buyers and are not sellers in securitisation market. Despite stringent capital adequacy requirements, banks have not acted as originators/ sellers in the securitisation market.

Asset Classes

- Major asset classes in securitization market in India have been
  - Car loans
  - Commercial vehicle loans
  - Construction equipment loans
  - Housing loans
  - Microfinance loans
  - Gold Loans
  - LSOs
    - Was the single component of securitization market till 2009.
- Over the years there have been newer asset classes like commercial mortgages, trade receivables etc

Asset Classes

- Commercial Vehicle (CV) is the most dominant class in asset securitization
- Next, micro loans have a 33% market share



Source: ICRA estimates

Growth of Securitization in India

- The Indian securitisation market has been facing internal challenges over the last few years rather than the market being impacted by any external factors
- Between the two – PTC and Direct assignment structures, there has been a shift in preference over years, basis the regulations issued by central bank
  - Pre 2006, PTC route was favoured; regulations pertaining to PTCs were issued in 2006 and the market shifted to direct assignment.
  - In 2012, RBI issued regulations facilitating PTC route and the market was dominated with PTC structures till 2013
    - About 80% of securitization was through PTC route
  - In 2013, the new tax regime dis-incentivized PTCs structures
    - Volumes fell by 5% and 40% in FY 14 and FY 15 respectively
    - Bilateral assignments surged by 150% in FY 14

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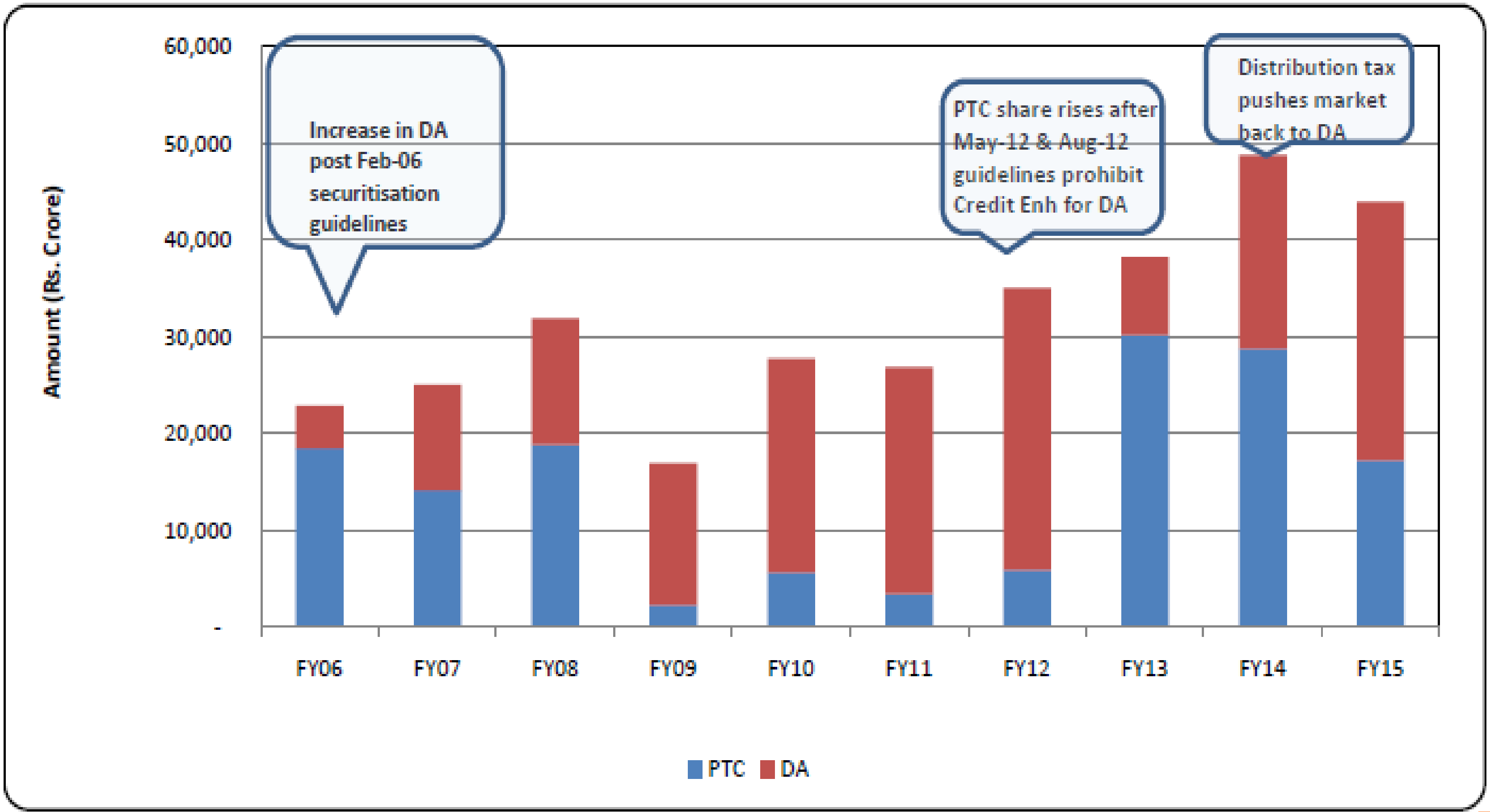
PTCs vs. Direct Assignment



RMBS in India

- Residential mortgage backed transactions are regulated by a subsidiary of Reserve Bank called the National Housing Bank (NHB)
  - NHB is the regulatory for housing finance companies in India and has is to develop the secondary mortgage market in India
- A lot of RMBS transactions in India have happened through NHB intermediation, where NHB sets up an SPV and acts as a trustee to the transaction
- MBS is in the nature of trust certificates, representing undivided beneficial interest in the pool
- First RMBS was placed in 2000 and had been a major asset class till 2007. Thereafter RMBS revived in 2012-13.
- While the current transactions are happening without NHB intermediation, NHB offers guarantee to senior RMBS for rating upliftment
- Currently the originators side of the market is highly skewed with one of the housing finance companies holding 70% of the market share in securitisation volumes.

Originators and Investors

- Originators and investor classes in India have been restricted to:
  - Banks
    - Both public and private sector banks
  - Non-bank financial institutions
  - Housing finance companies
  - Microfinance companies
- Mutual funds have been an investor class
  - The tax litigation on mutual funds around 2011-12 have kept them away from subscribing to PTCs or ABS in India
- Insurance companies are also permitted to invest in ABS, however they have stayed away from the market mostly.
- The limited investors class has been a limiting factor in growth of securitization in India

Key Drivers

Transaction structures, choice of asset class etc driven by regulatory prescription

Originator

- Capital relief
- Pricing benefit
- Alternate funding source
- Managing exposure norms

Investors

- Plugging PSL shortfall
- Better credit quality than Originators in some cases
- Possibility of customizing underlying loan pool

Regulatory Highlights

- The guidelines on securitization issued by Reserve Bank has
  - The risk retention requirements have been recently in 2012 following the global trends
  - There is minimum holding period requirement in the books of the originator, before the pool can be securitized (to mitigate originate-to-distribute risks)
  - Reset of credit enhancement has been permitted conditionally
  - There is distribution tax levied on the SPV level, in PTC structures
    - Most unfavourable structures for growth of SPV structures in India
  - Direct assignment structures cannot have credit enhancements
  - Transactions cannot have deferred purchase considerations, the consideration for the pool needs to be paid upfront
  - Re-securitization is not permitted

- **Feb 2006** – Securitisation guidelines for standard asset
- **May 2008** – Securities and Exchange Board of India (Public offer and listing of securitised debt instruments) Regulations, 2008
- **July 2011** – Revision in PSL guidelines – priority loans originated by NBFCs to qualify for PSL
- **Oct 2011** – Tax officers contention of revenue leakage and contention to tax SPVs at MMR
- **May 2012** – Revised securitisation guidelines issued by RBI
- **Feb 2013** – Introduction of Chapter on taxation of SPVs in the Union Budget
- **July 2013** – RBI amends the Guidelines on Securitisation Transactions to include Reset on Credit Enhancement

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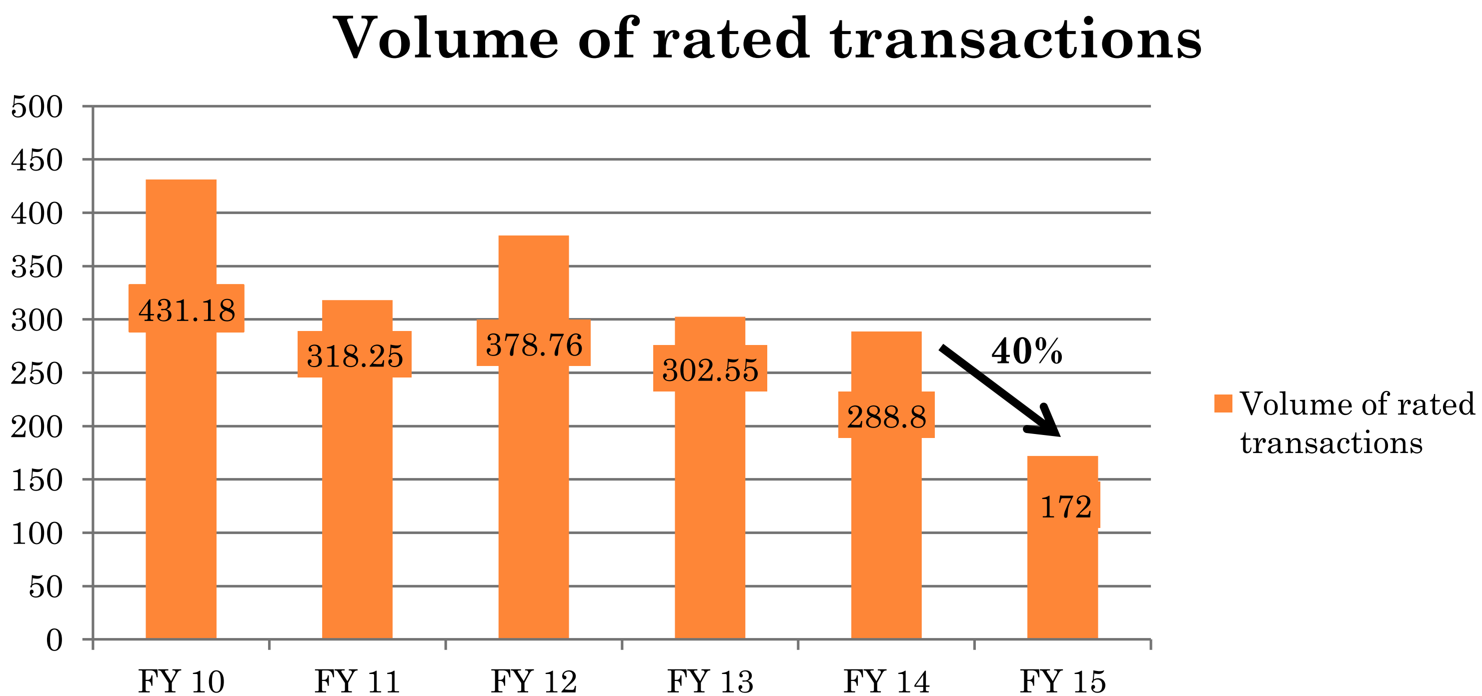
Securitisation Issuances over 5 years

	FY 11		FY 12		FY 13		FY 14		FY 15	
Amount in INR Billions										
	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share
ABS	218.19	69%	273.44	71%	272.30	90%	235.04	82%	164.53	95.65 %
RMBS	50.29	16%	76.80	21%	30.25	10%	52.96	18%	7.47	4.35%
Total Retail Securitisation	268.48	84%	350.24	92%	302.55	100%	288.00	100%	172.00	100%
LSO	44.41	14%	2217	6%	-	-	-	-		-
Others	5.36	2%	635	2%	-	-	-	-		-
Overall Total	318.25	100%	378.76	100%	302.55	100%	288.00	100%	172.00	100%
Growth	(26%)		19%		(20%)		(5%)		(40%)	
Average Deal Size	200		174		151		149		-	

Source: ICRA Estimates

- ABS dominant asset class in last 5 years
- Volume of ABS transactions declined by about 30% in FY15; volume of RMBS transactions showed a sharp decline of 80% as compared to last year

Trend in Securitisation - by value



Source: ICRA Estimates

Rs.in Billions

Securitisation market fell 40% in FY15; mainly owing to distribution tax amendments in the Priority Sector Lending norms

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Capital Market window for Securitized Paper

- Securitization is largely a capital market window globally.
  - In India, the securitized paper is largely privately placed
  - The incentives/ motivations to list the papers and reaching out to the retail investors at large is currently not there
  - Securities Exchange Board of India has set up facilitating guidelines for listing of securitized debt.
    - There is only one ABS that has been listed so far.

Need for Securitization in India and Way Forward

- Various industries in India need securitization
  - The need for meeting priority sector targets through securitization will continue
  - Need for long term fixed sources of funding for mortgage lenders shall also drive the market
  - In case of infrastructure lending as well, securitization provides a takeout financing option for the sponsors
  - For non-banks capital relief and refinancing is critical and securitization facilitates that
- There is need for classes of investors to be introduced in the market
  - The regulators intend to allow foreign institutional investors, provident funds and pension funds to invest in ABS. This should broaden the investor class for growth of insurance
  - Likewise originators from different segments need to enter the market
- Internationally SPVs are pass-through entities, the dis-incentives of distribution tax need to be addressed for SPV structures to grow
- Market for mezzanine class of ABS also needs to grow, currently there is no demand for ABS below AA rated paper.

THANK YOU