Article

India's first infrastructure debt NBFC's fund ranted AAA ratings: will it move or shake infrastructure financing?

Vinod Kothari
Vinod@vinodkothari.com
Vinod Kothari & Company
July 6, 2013

Check at: http://india-financing.com/staff-publications.html for more write ups.

Copyright:
This write up is the property of Vinod Kothari & Company and no part of it can be copied, reproduced or distributed in any manner.
Disclaimer:
This write up is intended to initiate academic debate on a pertinent question. It is not intended to be a professional advice and should not be relied upon for real life facts.

India's first NBFC-infrastructure debt fund (IDF) got a AAA-rating from rating agency Crisil. The IDF, known as India Infradebt Ltd. (http://infradebt.in), a joint venture of ICICI with Bank of Baroda, Citicorp and LIC, was operationalised around Feb 2013 and has now received rating for a Rs 5 billion debenture issue.

IDFs were permitted talked about several years ago – in Budget 2010. Subsequently, the RBI came out with IDF Guidelines in September 2011. There were, however, several remaining glitches, particularly the formalisation of the tripartite concession agreement.

IDFs are permitted in the mutual fund route, under SEBI regulations, or under the NBFC route, under RBI regulations.

Several players have reportedly been working on IDFs in either format. The ICICI-led IDF has chosen the NBFC route, while iIFCL went ahead with a mutual fund.

The AAA-rating assigned by Crisil primarily has 2 premises: first, there is a 15% capital requirement for an IFC, though the infrastructure loans acquired by the IDF themselves have a 50% risk weight. This will essentially amount to a 7.5% capital requirement on the loan pool of the IDF. This 7.5% capital remains subordinated to the bonds issued by the NBFC, thereby providing first loss protection to the investors. Crisil's rating rationale primarily talks about the "credit enhancement" mechanism inherent in the working of IDFs. Proper jargon for the mechanism should be credit risk mitigation, and not credit enhancement. This, essentially, is the provisions in the tripartite agreement where the concession-granting authority will transfer payments under the concession to the fund, provide it priority in respect of termination payments, etc.

If the mechanism of credit risk mitigation provided under the IDF guidelines is the basis for a AAA rating, does it mean every IDF will get a AAA rating? In fact, an NBFC-IDF is nothing but a CDO consisting of infrastructure loans. Infrastructure loans are large in size, and the pool of an IDF cannot be granular. Large-sized loans may mean high severity of losses should any of the loans in the pool go bad. Infrastructure loans are not free from risk of default – the public authority granting the concession does not guarantee payments. Hence, properly speaking, a rating agency should have sized up the required equity of the fund by stress-testing the potential pool of infrastructure loans, and the selection criteria, diversification standards and quality of management of the fund. However, the evolution of the ratings over time, as also the performance of the IDFs, need to be seen over time.

Also see our other related write-ups:

Infrastructure Debt Funds to accelerate the growth of Infrastructure Sector
https://india-financing.com/Infrastructure_Debt_Funds_to_accelerate_the_growth_of_Infrastructure_Sector.pdf

SEBI amends Mutual Fund Regulations for Infrastructure Debt Funds
https://www.india-financing.com/SEBI_amends_Mutual_Fund_Regulations_for_Infrastructure_Debt_Funds.pdf

Infrastructure Debt Funds: The mutual fund route and the NBFC Route
https://india-financing.com/Infrastructure_debt_funds_and_infrastructure_mutual_funds.pdf

Infrastructure Debt Financing Companies:Will this new vehicle garner infrastructure financing?
https://www.india-financing.com/Article_on_IDFCs-will_this_new_vehicle_garner_infrastructure_financing.pdf

Infrastructure & Asset Finance Summit, 2012
http://vinodkothari.com/assetfinsummit.htm

To know more on infrastructure Financing visit https://india-financing.com/infrastructure-financing.html

Other articles on NBFCs at: https://india-financing.com/staffpublications-nbfc.html