Retail Asset Securitization market in FY15: Overview

PTC volume drops in FY15; revised PSL sub-segment to drive PTC volumes in FY16, Direct Assignments continue to grow

Total Market (PTC/Rated + DA) volume reduced in FY15

The overall securitization market saw a drop of 12% yoy i.e. from Rs.49,316 crore in FY14 to around Rs. 43,000 crore in FY15.

	FY 14	FY 15
PTC/Rated Transaction (Rs. Crore)	28,316	17,000
- ABS (Rs. Crore)	24,033	15,549
- MBS (Rs. Crore)	4,283	1,451
Direct Assignment Transactions (Rs. Crore)	21,000	26,000
Total Market Volume	**49,316**	**43,000**

Source: CARE Rating estimates

Rated transaction volume at its 6-year low

The Indian Securitization market witnessed the de-growth for the third consecutive year as the total rated volume fell to around Rs. 17,000 crore in FY15 as against Rs. 28,316 crore in FY14 (and Rs. 30,315 crore in FY13). This can be primarily attributed to RBI's circular (in May 2014) permitting inclusion of outstanding RIDF investments for PSL targets, relatively higher return on RIDF investments, taxation on PTCs and weak credit growth of banks. For details on taxation and outstanding RIDF invest treatment, please refer to our previous publication.

Share of ABS and MBS

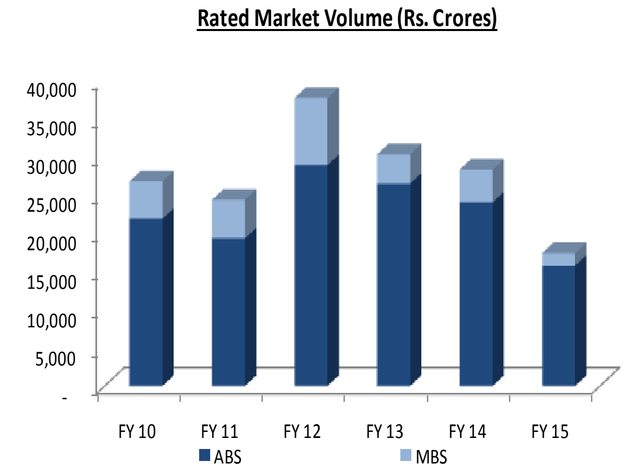
During FY15, both the segments witnessed contraction in volume. The share of MBS fell to 8.5% of the overall volume with corresponding increase in the share of ABS from approximately 85% in FY14 to 90% in FY15. We have seen that the rated volume of MBS has seen drop in last 2 years but this segment is making shift to direct assignment space.

Segments of ABS

The Commercial Vehicle (CV), Construction Equipment (CE) and Passenger Vehicle (PV) segment reported securitization transactions of about Rs.100 bn in FY15. A significant part of these loans are extended to Small Road Transport Operators (SRTO) which qualifies as advances to priority sector.

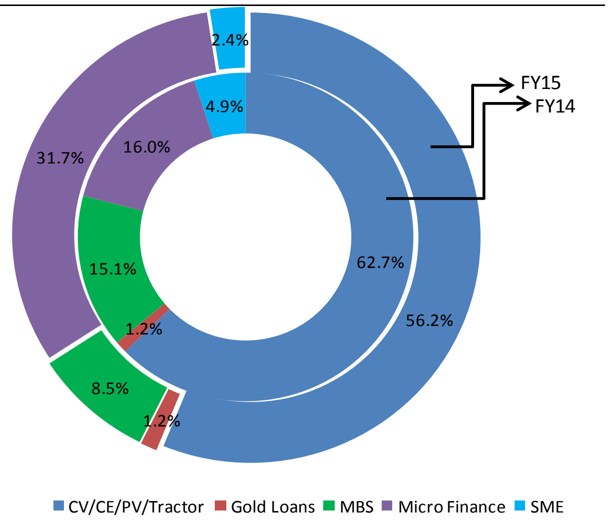
The share of microfinance loan securitizations witnessed huge growth over the last two years, @16% in FY14 and 30% of total volume in FY15. MFI segment witnessed increase in rated volume (by 20% yoy) due to MFI loans being qualified under 'agriculture' and 'weaker' as a part of PSL segments this resulted into substantial increase in its share in FY15.

Rated volume witnessed steep drop in FY15



Source: CARE Ratings

Asset-class wise total rated transactions

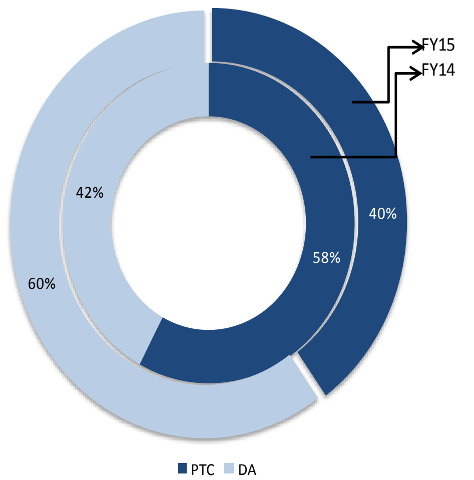


Source: CARE Ratings

DA volume achieves new highs in FY15

As per CARE estimates, the volume of Direct Assignment (DA) transactions registered a growth of 24% yoy and reported a volume of approximately Rs. 26,000 crore in FY15 as compared with approximately Rs. 21,000 crore in FY14. Mortgage segment continued to be favourite as it constituted more 70% of the total DA volumes in FY15. The share of bilateral retail loan pool assignments (i.e. direct assignment) increased to 60% of the overall market volume (PTC+DA) in FY15 from 42% in FY14 due to its attractive proposition for both originator and investors. FY15 observed increased participation from PSU banks as purchaser of retail loan pool (PSL/Non-PSL) as it helped them to expand their loan books. CARE Ratings already wrote in its previous publication about "DAs expected to be the flavour of the season". Going forwards, CARE is of the view that the fate of DA volumes would depend on the performance of the DA transaction done in FY13, FY14 and FY15, as well as loan book growth of PSU banks.

Shifting gear: DA higher than PTCs/rated volume



Source: CARE Ratings

Regulatory Aspects

Revised PSL Guidelines: broadening coverage a boon for banks; sub-segment targets a concern

RBI, vide its circular dated April 23, 2015, introduced the revised final guidelines on PSL wherein it has accepted majority of the recommendations of Internal Working Group (IWG)'s report on existing PSL guidelines. The revised guidelines have increased the directed sub-targets from existing 28% of ANBC to 35.5%. Due to this, a small proportion has been left (i.e. from 12% to 4.5% of ANBC) to be met from sectors like export, housing and small & medium enterprises. Hence, CARE is of the view that MBS PTC volumes will continue to remain very small.

Categories under New PSL guidelines (as % of ANBC)		Categories under Old PSL guidelines (as % of ANBC)	
Agriculture - SMF (7% by FY16 and 8% by FY17)	18%	Agriculture - Direct Agri (13.5%) - Indirect Agri (4.5%)	18%
Micro Enterprises	7.5%	Micro and Small Enterprises	NS
Small and Medium Enterprise	NS	Export Credit	NS
Export Credit	NS	Education	NS
Education	NS	Housing	NS
Housing	NS	-	-
Social Infrastructure	NS	-	-
Renewable Energy	NS	-	-
Weaker Section	10%	Weaker Section	10%
Total PSL	**40%**	**Total PSL**	**40%**

Underscore represents additions of segments in PSL
NS - Not Specified

Overall agriculture target (18%) achievable; sub-sector SMFs target (8%) to pose a challenge

While the sub-target of 18% for overall Agri remains unchanged, the new guidelines introduced a target of 8% for small and micro farmers (SMFs) within Agri while doing away with indirect/direct Agri, which would help banks to achieve the overall Agri target. As per IWG report on PSL, share of Small and Marginal Farmers of Domestic Banks (PSU and Private) was 6.30% of ANBC in FY14. CARE believes that achievement of sub-targets under small and micro farmers would be challenging for the private banks as against PSU banks primarily due to their relatively limited presence and low exposure to agricultural credit (skewed towards large ticket loans given to co-operative farmers/Primary Agricultural Credit Societies/Farmers' Service Societies etc.). CARE estimates that SCBs will require credit of around Rs. 500 billion under SMF category to reach 7% target by FY16.

In CARE's view, these guidelines will augment the demand for Inter-Bank Participation Certificates (IBPCs[1]) of RRBs that have majority of their portfolio (approximately 80%) in Agri and weaker segments. Our channel check suggests that issuances of IBPCs have taken place significantly in FY15. Also, IWG recommendation of introduction of PSLCs will enable bank to buy it in order to undershoot PSL requirement in agri segment, as it has broaden the coverage by including SCB, Local area banks, RRBs, and Urban co-operative banks.

Micro, Small and Medium Enterprises (7.5% to Micro Enterprise)

During November 2013 to March 2014 (for 5 months), RBI provided a window to enhance the liquidity support to MSMEs by extending the PSL status to all incremental loans to medium enterprises. The Revised PSL guidelines have permanently extended PSL status to medium enterprises in addition to its existing micro and small enterprises. However in order to maintain the focus towards micro enterprises, RBI has stipulated a target of 7.0% of ANBC in FY16 to Micro enterprises specifically which will subsequently increase to 7.5% by FY17.

The guidelines specify that priority sector lending status would stay with MSME units for up to three years after they grow out of the category of MSMEs. It will encourage MSMEs to not remain small merely to be eligible for PSL status. CARE understands that stipulated target of loans to Micro Enterprises would be difficult for banks to comply with as their existing SME portfolio is not classified in Micro or Small specifically and achieving the said 7% target within one year would be an uphill task. Our enquiry with banks suggests that buying loan portfolio and PTC investments would be a preferred route of investment for achieving the Micro enterprise target in FY17.

Weaker Section (10% of ANBC)

The guidelines have maintained the target of 10% on weaker section which traditionally has been a tough goal to achieve for Private Banks. As per RBI, private banks achieved 5.7% of ANBC for loan against weaker section in FY14.

CARE notes that "Loans to Small and Marginal Farmers" have been covered twice in Agri and Weaker section individually. Our channel check suggests that coverage of small and marginal farmers in Weaker and Agri segment of PSL would result into shortfall in either of the two segments. Private Banks have regularly fallen short of meeting sub-targets of weaker section, they would now find it all the more difficult to meet the new targets under both.

[1] For meaning of IBPCs refer to page no. 5

Effective monitoring of PSL targets on an ongoing basis

The guidelines have mentioned about change in monitoring of PSL targets at *quarterly* frequency (from Q1FY17) from annual frequency. This will ultimately reduce the 'seasonality' of business and securitization transactions. However, CARE is of the view that the RBI's quarterly monitoring of the achievement of PSL sub-targets for small and marginal farmers, micro enterprises and weaker section target will bring incremental challenges for banks.

Other possible ways that may gain prominence for achieving the PSL targets:

- IBPCs have been used for achieving PSL shortfall by SCBs. The IBPC issuing banks have been SCBs and RRBs. In IBPCs the participation can be 40% of outstanding balance of the issuing bank. The stipulated minimum period of such a Participation remains 91 days, while the maximum period can go up to 180 days.
- **<u>IWG recommendations on PSL Certificates</u>: promoting specialization**
  PSL certificate has been in existence in Indian market but limited to co-operative banks. The volumes of trades have been very minimal between banks and co-operative banks. The introduction of PSL certificate for SCBs has been recommended by many committees in the past in order to enable banks to achieve the PSL targets. IWG guidelines have broadened the coverage by including SCBs, RRBs, LABs, and Urban Co-operative Banks. Some of the key observations are:

a) Considering that direct credit origination may not be the most efficient method of credit delivery as it does not leverage the strengths of different banks in their respective areas of specialization, IWG proposed the concept of PSL certificates enabling banks to buy them from other banking participants (for a fees).

b) While the PSLCs will be sold, the loans would continue to be on the books of the originator. The *deficient* bank would only be buying a right to undershoot its priority sector-lending requirement by the amount of the certificate. For examples, if the loans default no loss would be borne by the certificate buyer.

c) We believe the merit of this concept is that it would allow the most efficient lender to provide access to the poor, while finding a way for other banks to fulfill their norms at lower cost. Also, the market driven pricing of these certificate will fetch credit at optimal cost as it would remove pricing arbitrage and inefficiencies of bilateral transaction (in case of IBPCs transactions).

d) At this stage, issuance/trading of PSLCs would be limited to banking participants. However, NBFCs would be a key beneficiary if they are allowed to issue certificates in future.

e) PSLCs cannot be carried forward to the next year. Thus, the benefit for PSLCs would be given only in the year of origination.

- **Business correspondence Model**

  RBI allowed non-deposit taking NBFCs to become BC for banks in June 2014. CARE is of the view that after the introduction of revised guidelines, BC model may become the route to achieve banks' PSL segment and sub-segment targets. CARE observed that recently some banks have started appointing NBFC MFI as BCs in order to have the access of Microfinance portfolio and rural presence, since banks still have low penetration in these segments. Banks may be keen to explore this as the BC model enables banks to function as per its own specifications with regards to credit policy, customer profile and target asset class.

Outlook

Ability of the banks to meet various sub-segments of PSL targets, emergence of clarity taxation-related issues, PSU banks' continued thrust towards acquisition of retail assets and the pace of growth in the loan books of Originators and Banks are expected to be the driving forces behind the total market volume in FY16. In the light of revised PSL guidelines and its elevated sub-segment targets, CARE is of the view that securitization market would witness relatively higher volume in FY16 (vis-à-vis FY15) primarily on account of transactions in Small & Marginal Farmers and Micro Enterprise sub-segments. The asset classes like Commercial Vehicle, Tractor and Microfinance loans are expected to witness higher PTC transaction in FY16.

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