Healthy revival in the retail securitisation market

March 2023

Introduction:

The retail securitisation market has witnessed a healthy recovery after the Covid pandemic. Acuité Ratings estimates the aggregate volumes in FY23 at Rs 1.8 lakh Cr, which is almost at the pre-pandemic levels. An uptick in consumer sentiments, better credit underwriting, and a significant recovery in collection efficiency have led to the revival in securitisation volumes. The resilient performance of past pools particularly during the pandemic period has been a key factor in enhancing comfort levels of the investors. A sharp rise in credit offtake over the last one year has also helped in the volume uptick.

Industry wise trends in securitisation:

Securitisation volumes has witnessed a sharp jump in H2FY23 and estimated to have touched Rs 1.2 Lakh Cr in Apr-Dec'23. Bankers and investors have started to regain confidence in asset classes such as microfinance and unsecured business loans after the disruptions during the pandemic. New originators in the NBFC sector have also tapped the market. However, as in the past, CV and LAP continue to be the key asset classes that find greater acceptance among the investors.

Direct assignment (DA) transactions continue to account for 60% of the retail transactions in the market largely due to the preference of the public sector banks for direct loan buyouts that support growth in advances. Clearly, the latter account for the majority share in DA transactions. Larger NBFCs have also been purchasing pools from the smaller NBFCs to enhance their loan growth and also capitalize on their origination capabilities. Usually, such transactions are a prelude to business correspondence or a co-lending arrangement if the underwriting and the servicing standards meet the buyer's expectations.

PTC transactions which account for the balance, are usually favoured by foreign banks who seek priority sector loans but also want to hedge the credit risks through the available credit enhancements in the structure. Mutual funds continue to have limited exposures to securitisation transactions in their debt schemes although the yields are relatively attractive at a given rating level.

India's retail securitisation continues to be driven by ABS transactions which is estimated to have a share of over 60%. The share of MBS transactions have varied within a narrow range of 35%-40% comprising both home loans and loan against property. Given the long tenure of the loans and the inherent interest risks in such tenures, the appetite for such pools is typically low among PTC investors and most of these transactions take place through DAs.

Some of the intermediaries are playing an important role in developing the securitisation market. They help some of the smaller originators in structuring the PTC transactions efficiently, take partial exposure particularly in subordinate tranches and sell down the senior tranches to new classes of investors such as HNIs and family offices.

The takeaways for three key asset classes where ratings are outstanding on PTC transactions are as follows:

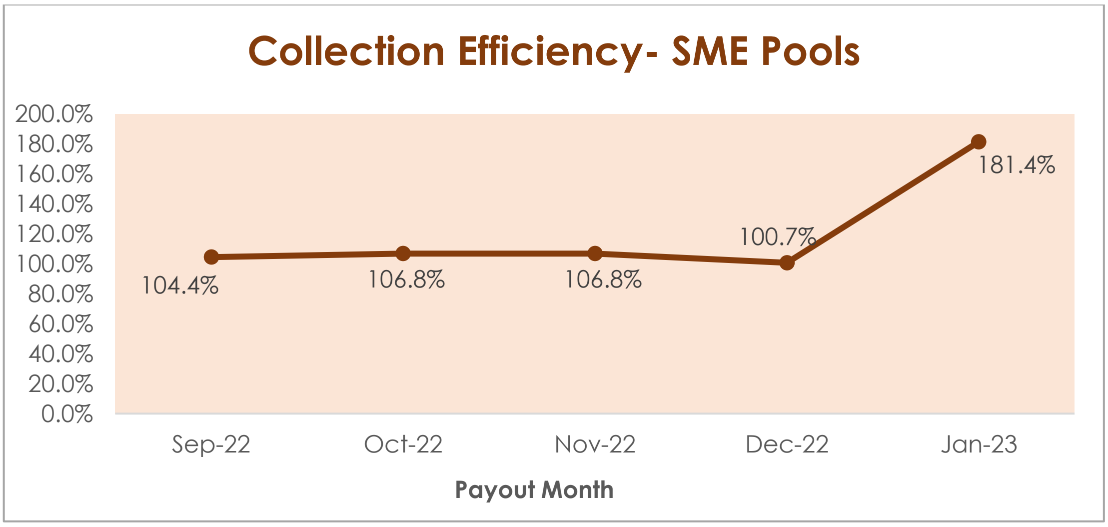
I. MSME Segment:

Credit offtake for MSME sector has grown by 15.6% YoY in Jan-23 (as per RBI data: Sectoral Deployment of Credit). A significant part is driven by the Emergency Credit Line Guarantee Scheme (ECLGS) which provided huge liquidity relief to MSMEs during and after the Covid pandemic. Also, growth in credit to MSME was bolstered by the recovery in demand, particularly in the services sector. Additionally, the banks' exposure to NBFCs has significantly grown by 31% in the last one year and a large part of it has flown to MSME segment.

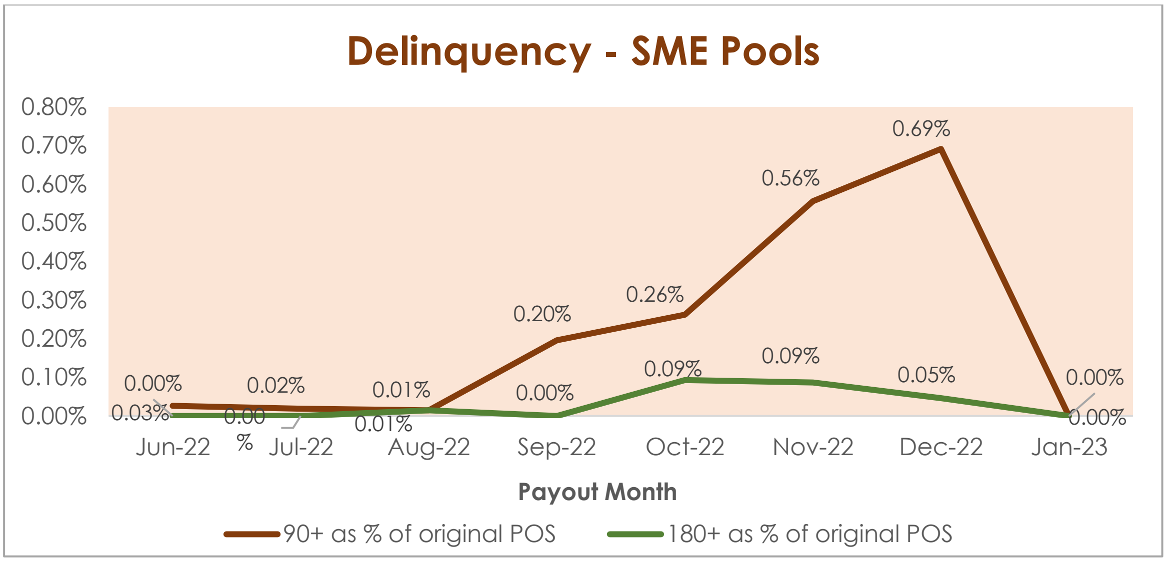
In the Union Budget 2023, Government has proposed to revamp the CGTMSE scheme and support it further through a Rs 9,000 Cr capital infusion. This will facilitate a higher quantum of particularly collateral free lending to the MSME segment and also enable a reduction in the borrowing costs.

While there were concerns on higher delinquencies in the MSME segment after the prolonged Covid pandemic, the extent of reported delinquencies has been moderate and on a gradual decline, both in banks and NBFCs. There is a portfolio of restructured loans of about 5% under the past dispensation given by the regulator but their performance has been largely satisfactory.

Pool Performance: SME Transactions Rated by Acuité Ratings



The collection efficiency chart highlights that significant progress has been made in recovering the past dues for SME pools.



The delinquencies in the PTCs rated by Acuite has remained well within the initial assumptions despite the significant stress in small businesses, reflecting thereby the quality of pool selection. Also, a sharp improvement can be seen in the delinquency levels in Jan-23 as compared to that in December 2022 which is likely to be sustained in the last quarter of the fiscal, given the typical focus on collections.

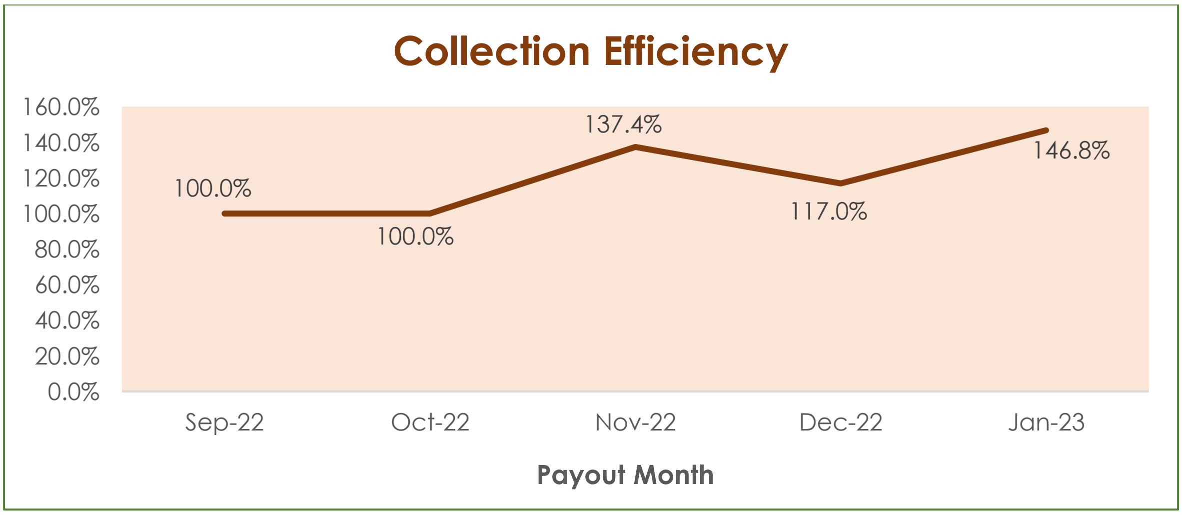
It can be noted that none of the PTC transactions rated by Acuité Ratings have shown any utilisation of credit enhancement over the last two years despite the challenging operating environment.

II. Microfinance Segment:

The volumes of MFI securitisation saw a significant impact during the pandemic period. However, it has witnessed a recovery, constituting 16% of the overall securitisation volume in 9MFY2023. This segment has historically displayed healthy growths in the last quarter of the financial year.

Around 25% of non-equity funds raised by NBFC-MFIs in FY2022 and 9MFY2023 was through securitisation, with a majority through direct assignments.

Pool Performance: MFI Transactions Rated by Acuité Ratings



The outstanding MFI PTC transactions rated by reported robust levels of collection efficiencies since November 2022; the higher than 100% levels reflects steady recoveries from the overdues of the underlying MFI loans and partly, prepayments from the borrowers.

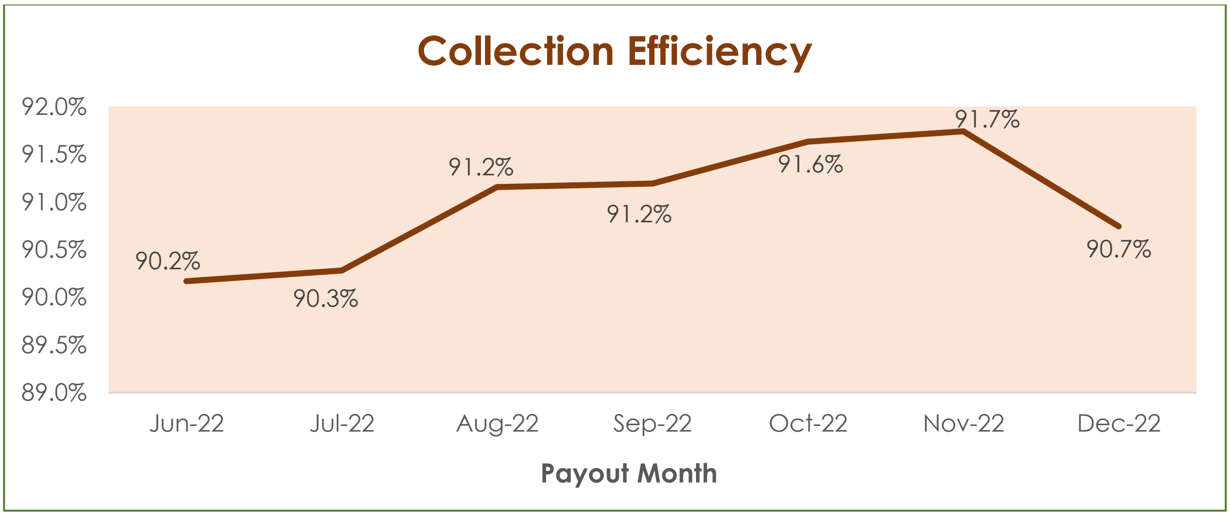
Further, the MFI PTCs rated by Acuite has not shown any delinquencies beyond 90dpd since their inceptions, implying superior pool selection and the presence of high grade borrowers who have been largely regular in repayments. The credit enhancement for all these transactions remained fully intact.

III. Two Wheeler Segment:

The two-wheeler segment had witnessed a slump not only due to the pandemic but also due to the sustained rise in fuel prices and the inflationary pressures subsequently. While a moderate recovery is visible, the segment continues to face challenges due to the continuing weakness in the rural economy. Gross two wheeler sales which peaked at 21.2 million units in FY19 had dropped to 13.5 million units in FY22 and is expected to see a volume growth of 10% in FY23. However, the segment may not see a full-fledged recovery unless there is broad based recovery in the rural markets.

Nevertheless, there has been an increase in the securitisation volumes for two-wheelers in the current year and is expected to increase further in the upcoming quarters.

Pool Performance: 2W Transactions Rated by Acuité Ratings



While the collection efficiency in the two-wheeler PTC pools rated by Acuite have been stable in the current year, there is no discernible uptrend from the 90% levels. With the expected recovery in the rural economy due to a healthy rabi crop output, the collections levels are likely to improve going forward.

There was no dip in the credit enhancement available for any of these transactions. However, two wheeler pools will continue to be subject to relatively higher delinquency risks given the higher vulnerability of the borrower segment to any economic stress.

Impact of revised Securitisation Guidelines

The Reserve Bank of India's (RBI) revised guidelines on securitisation in Dec-22 may dampen the securitisation market for personal, consumer and other short-term loans. The revised guidelines does not permit securitisation, through the pass-through certificate (PTC) route, of loans with residual maturity of less than 365 days. Secondly, the minimum holding period (MHP) will be considered from the date of full disbursement of the loan, or registration of security interest with the Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI), whichever is later. While these norms will reduce the PTC transaction volumes of fintech and gold loan NBFCs, the latter may get partly diverted to direct assignments.

Overall, the new norms are unlikely to disrupt the securitisation market as these short-tenured loans constituted only 5 per cent of the total securitisation volume in H1FY23. Acuite believes that the latest guidelines in securitisation will lead to the availability of more seasoned pools and therefore, will provide additional comfort to the investors.

Conclusion

Says Suman Chowdhury, Chief Analytical Officer, Acuité Ratings & Research "The recovery of the retail securitisation market in FY23 confirms the normalisation of business operations for NBFCs and the steady recovery in asset quality for almost all asset classes consequent to the revival in domestic demand. The market continues to be dominated by bilateral transactions given the need of the scheduled commercial banks to grow their priority sector loan book. The latest securitisation guidelines may further increase the share of direct assignments given the tightened regulatory norms on pool residual maturity. In the longer run, however, direct assignments may give way to structured and regular arrangements between banks and NBFCs through co-lending or business correspondence. On the other side, the risk profile of the PTC transactions are likely to strengthen further with increased requirements of seasoned contracts and can provide higher comfort to potential investors. Clearly, the key to a sustainable development of the securitisation market is the participation of a diverse base of investors including mutual funds, financial institutions as well as HNIs and increased trading of PTCs in the secondary market."

About Acuité Ratings & Research Limited:

Acuité Ratings & Research Limited is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 9,500 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Kanjurmarg, Mumbai.

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