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Securitisation in India

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ABSTRACT

Securitisation as a financial instrument has been in existence in India from the early 1990s. Despite being in existence for over two decades securitisation market in India continues to be in its nascent stages. The securitisation market in India has had several regulatory and taxation concerns in the past which have impacted the securitisation volumes and have had lesser impact from external shocks or opportunities. It has been observed that securitisation in India is in several ways very different from the rest of the economies. By means of this paper, the aspect of securitisation in India is described.

KEYWORDS Securitisation, Non Banking Finance Companies, Housing Finance Companies.

INTRODUCTION

The term securitisation, in India, has reference to the SARFAESI Act (Securitisation and Asset Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002). The SARFAESI Act came into existence with the intent of facilitating securitisation in India and also addressing the rising problem of non-performing assets. However, the law did not create any facilitating provisions of securitisation. In India, there is no overarching regulation pertaining to securitisation transactions in India. In other words, transactions of securitisation are covered by common law. There are, however, regulations on securitisation activities of banks and NBFCs.

Another distinctive feature of securitisation in India versus the rest of the world is that while securitisation is seen as a financial instrument for capital market access in India, barring one most of the securitised paper is unlisted and therefore not facilitating any capital market access.

Globally securitisation is seen as a tool for off balance sheet funding facilitating capital relief, however in India the key drivers for securitisation have been allowing banks to meet the priority

sector lending targets. Therefore, securitisation in India is driven by several factors that are unique to India and do not have global relevance.

OBJECTIVES OF THE STUDY

1. To study the securitization structures in India.
2. To study the typical originators and investors and Drivers for securitisation in India.
3. To study the regulatory scenario of securitization in India.

RESEARCH METHODOLOGY

This study is descriptive in nature. Here, we have explained the securitization structures prevalent in India. For this secondary data has been collected through different articles, research papers and reports published about securitization in India.

SECURITISATION STRUCTURES PREVALENT IN INDIA

Speaking of distinctive features of securitisation in India, another departure from global practices is that in India there are two models/ structures of securitisation transactions.

Securitisation for large part of its existence in India has been used as a device for bilateral acquisition of assets by banks/ financial institutions. Bilateral assignments have dominated the securitisation market in India, where around 80% of the securitisation in India is in the form of bilateral sales. Apart from bilateral assignments (also called direct assignment) deals, securitisation transactions have also used SPV structures, more popular and known to the rest of the world. In India, some quasi-securitisation structures have also been used where creation of any form of security was rare and the portfolios ended from balance sheet of originator to another. In India, assignment of receivables carried out bilaterally between banks and financial institutions without the use of an SPV as a conduit is referred to as bilateral assignment and where an SPV is used for converting the receivables to securities it is called securitisation.

A special purpose vehicle, typically a trust is created to cordon off the receivables of the originator into a bankruptcy remote entity which in turn will issue asset backed securities to investors. It is worthwhile to mention here, that while asset-backed securities in the rest of the world are denoted

based on the underlying assets they represent (for instance, residential mortgage backed securities, commercial asset backed securities, asset backed commercial paper and so on), in India, the securitised paper was called pass-through certificates or PTCs as they represented beneficial interest in the receivables. Therefore, the securitisation structure is often referred to as PTCs route in India as well. The first set of guidelines for securitisation of standard assets was issued by RBI in February 20061. The issuance of these guidelines was subsequent to the market witnessing some seasoning on securitisation transactions. The guidelines were the first attempt to regulate the securitisation transactions. The regulations focused largely on securitisation transactions using the special purpose vehicle, however direct assignments were not regulated by RBI then. The regulatory arbitrage prompted market to have an inclination towards doing more of bilateral assignments than securitisation.

TYPICAL ORIGINATORS AND INVESTORS

The typical originators in securitization are banks, NBFCs, housing finance companies, microfinance companies etc.

In India, the key motivations to invest in securitized paper have been meeting the priority sector lending requirements, capital relief and liquidity. However, the motivation to invest in securitized paper for various investor classes is myriad. The investors in the market are currently very centric and there is a need for broad basing the investors so that the motivation for securitisation is not restricted to meeting the priority sector lending requirements for banks alone. The investors to PTCs in India are limited to banks, NBFCs and mutual funds. Mutual funds in the last few years have faced some litigations where investments in PTCs was considered to be an alleged revenue leakage by the income tax department. This caused the mutual funds to stay away from the securitization market. The Finance Act, 2013 resolved the then ongoing issues pertaining to investments by mutual funds, but the mutual funds are yet to return to the market as investors.

DRIVERS FOR SECURITISATION IN INDIA

One of the major drives for securitisation in India is PSL (Priority Sector Lending) targets of the banks. Banks are mandated by RBI to have minimum exposure in identified sectors like

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agriculture, MSME (micro small and medium enterprises), education, etc. The shortfall in PSL targets of banks is being met by purchasing portfolios from NBFCs. Securitisation as a tool is also being used for diversification of the portfolio to manage credit exposures under various categories of assets. This helps in re-balancing and re-distributing risks such as credit, market or liquidity risk or risk of concentrations on the balance sheet as the risks can be bundled or hived off and distributed between various assets as per their risk appetite.

Securitisation structures come handy for inorganic growth for various entities. It provides alternate debt instruments by which funding can be arranged over and above the balance sheet.

Securitisation reduces the total cost of financing as assets are transferred to a separate SPV. To that extent FIs need not maintain capital to maintain their capital adequacy norms. Also, entities with a riskier credit profile can benefit from lowered borrowing costs.

Securitisation also comes handy for Asset-Liability Management (ALM). Securitisation offers the flexibility in structuring and timing cash flows to each security tranche. It provides a means whereby customized securities can be created which helps in matching the tenure of the liabilities and assets.

REGULATORY SCENARIO: SECURITISATION

Securitisation Regulations by RBI

As mentioned earlier, India has specific guidelines on securitisation issued for banks and NBFCs by RBI. The first set of guidelines were issued in 2006 (2006 Guidelines) and these guidelines were revised in 2012. RBI issued the revised guidelines for banks in May 20124 and for NBFCs in August, 20125 (2012 Guidelines).

The 2012 Guidelines were in addition to the existing 2006 Guidelines, this is to say, both the guidelines were to be read in consonance. The 2012 Guidelines was divided into 3 parts.

- Part A contained provision on PTCs route securitisation,
- Part B contained provisions on DA and
- Part C contains provisions on securitisation exposures that are not permitted under law.

Brief highlights on the 2012 Guidelines is as below:

a. Homogenous assets: The 2012 Guidelines make a reference to homogenous assets and though not defined, the expression homogenous assets would mean all such assets that share similar risk attributes would be called homogenous assets.

b. Assets eligible for securitisation: The 2012 Guidelines talk about securitisation of performing loans. Securitisation of non-performing loans is covered by separate guidelines. The pool of loans securitised should be homogenous in nature.

- MHP Requirements

The 2012 Guidelines require the loans to be seasoned in the books of the originator for some minimum time before they can be securitized. The intent is to ensure that the entire risk is not passed to the investors and during the seasoning period the portfolio would have demonstrated repayment performance to ensure better
underwriting standards. MHP shall be counted from the date of full disbursement of loans for an activity/ purpose; acquisition of asset by the borrower or the date of completion of a project. MHP requirements apply to individual loans, neither to borrower nor to the pool and runs from the date of disbursement to the purchase of the assets

- MRR Requirements

Minimum Retention requirement to be maintained in the securitized assets to ensure that the originating organization has a stake in the performance of the securitized assets

Loans with a maturity of 24 months or less have a MRR requirement of 5% of the book value of the loans being securitized

Loans with maturity of more than 24 months have a MRR requirement of 10% of the book value

The total investment by the originator in the securities issued by SPV through underwriting is limited to 20% of the total securitized instruments issued

- Total Retained Exposure: The 2012 Guidelines make reference to the Basel II norms to state that the total investment by the originator in the securities issued cannot exceed 20%

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of the total securitized instruments issued. If the banks exceed the limit, the risk weight of 1111% shall be applicable on the excess amount of exposure

DRIVERS FOR SECURITISATION IN INDIA

One of the major drives for securitisation in India is PSL (Priority Sector Lending) targets of the banks. Banks are mandated by RBI to have minimum exposure in identified sectors like agriculture, MSME (micro small and medium enterprises), education, etc. The shortfall in PSL targets of banks is being met by purchasing portfolios from NBFCs. Securitisation as a tool is also being used for diversification of the portfolio to manage credit exposures under various categories of assets. This helps in re-balancing and re-distributing risks such as credit, market or liquidity risk or risk of concentrations on the balance sheet as the risks can be bundled or hived off and distributed between various assets as per their risk appetite.

Securitisation structures come handy for inorganic growth for various entities. It provides alternate debt instruments by which funding can be arranged over and above the balance sheet. It frees up an originator's capital by removing the assets from the balance sheet and improves the liquidity position as the future receivables are replaced by cash. Securitisation reduces the total cost of financing as assets are transferred to a separate SPV. To that extent FIs need not maintain capital to maintain their capital adequacy norms. Also, entities with a riskier credit profile can benefit from lowered borrowing costs.

Securitisation also comes handy for Asset-Liability Management (ALM). Securitisation offers the flexibility in structuring and timing cash flows to each security tranche. It provides a means whereby customized securities can be created which helps in matching the tenure of the liabilities and assets.

CONCLUSION

The recent changes on the taxation side is sure to have a positive impact on the securitisation market coupled with the FPIs permissibility in investing in securitised debt instruments will propel the growth of the securitisation transactions in India.

- Distribution tax being replaced by pass-through status for securitization trusts will allow tax neutrality to prevail.

- The permissibility for FPIs to invest in securitized debt instruments will broaden base for the investors in PTCs.
- The current trends in securitization are indicating that the market is trying to grow beyond the priority sector requirements. There are several public sector banks that are purchasing loan portfolios for inorganic growth in the loan books. Also the regulations allowing priority sector lending certificates may have an impact on the demand for securitization.
- The NBFCs, be they Asset Finance Companies specialising in SME financing or transport financing, or be they MFIs or Housing Finance Companies (HFC), their USP is their capacity to originate loans and advances in sectors where the main stream banks have least penetration. They have comparative advantage and to leverage that they will have good opportunities in resorting to securitisation.
- The new set of differentiated banks, the Small Finance Banks, whose major portfolio will be small loans, will resort to securitisation for diversifying their balance sheet. In all likelihood, they are unlikely to build capacity in large sized lending and will resort to build diversified portfolio of large credit through securitisation.

In essence with the regulatory and taxation issues being ironed out, the future outlook of securitisation in India looks positive.

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