

# Securitisation Market Overview 2016-17

## Securitisation market hits a trillion, propelled by PTCs

*However, PSLCs cast a long shadow*



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## A trillion-rupee market

In fiscal 2017, securitisation transactions in India hit a lifetime high of Rs 102,500 crore, recording a growth of ~47% over fiscal 2016. The sharp rise in volume was driven by changes in underlying market dynamics, such as:

- 1) Clarity on distribution tax, which meant pass-through certificates (PTCs) were back in vogue, even as volume in the direct assignment (DA) route continued to be robust.
- 2) Increased participation by the treasuries of private sector banks and non-banking finance companies (NBFCs), and the re-entry of mutual funds. That meant investments by public sector banks (PSBs) shrank to a third of securitisation market volume from ~45% a year ago.
- 3) Healthy demand for non-priority-sector loans (NPSL) from NBFCs and bank treasuries because of higher yields, till demonetisation affected sentiment. Such transactions constituted a third of overall volume.
- 4) Mortgage-backed securities (MBS), the largest asset class, became even bigger with ~45% share

of retail securitisation volume, up from ~25% in fiscal 2013.

- 5) For the first time in five years, a transaction was originated by a bank in a marketplace where NBFCs have been the sole originators.
- 6) Non-retail securitisation volume scaled a new peak of Rs 12,000 crore with a few large-ticket future-flow and commercial mortgage-backed securities (CMBS) transactions.

### Cruising past twin headwinds

Securitisation transactions rose despite a couple of hiccups:

- 1) Demonetisation, which halted deals as investors worried about asset-quality, especially in microfinance
- 2) Introduction of priority sector lending certificates (PSLCs), which rapidly gained traction and provided a direct substitute to securitisation to meet priority sector lending (PSL) requirements.

Retail asset securitisation volume	PTC and DA volume across asset classes				
	Mortgage	Vehicle	Microfinance	Others*	Total
FY 17 (Total Volume) (Rs. Crore)	41,000	36,100	10,600	2,900	90,600
FY 17 – DA proportion	83%	28%	30%	8%	53%
FY 17- PTC proportion	17%	72%	70%	92%	47%
FY 16 (Total volume) (Rs. Crore)	29,400	20,500	11,500	7,800	69,200
FY 16 – DA proportion	99.7%	40%	19%	55%	63%
FY 16 – PTC proportion	0.3%	60%	81%	45%	37%

Source: CRISIL estimates

\*Others include SME and tractor

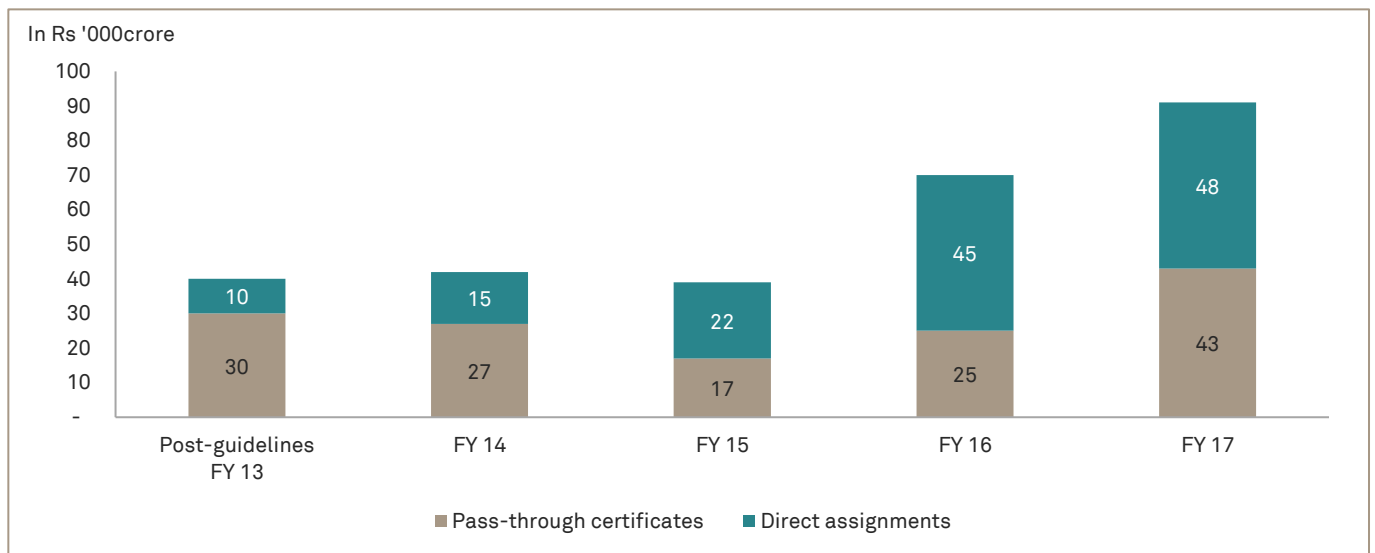
## PTC volume continues to soar...

The scrapping of dividend distribution tax in the Union Budget of February 2016 provided a strong impetus to PTC securitisation transactions, which galloped ~74% to a decadal high of Rs 42,800 crore from ~Rs 24,500 crore in fiscal 2016. The rise was across asset classes barring microfinance, where volumes shrunk marginally.

## ...even as DA volume remains robust

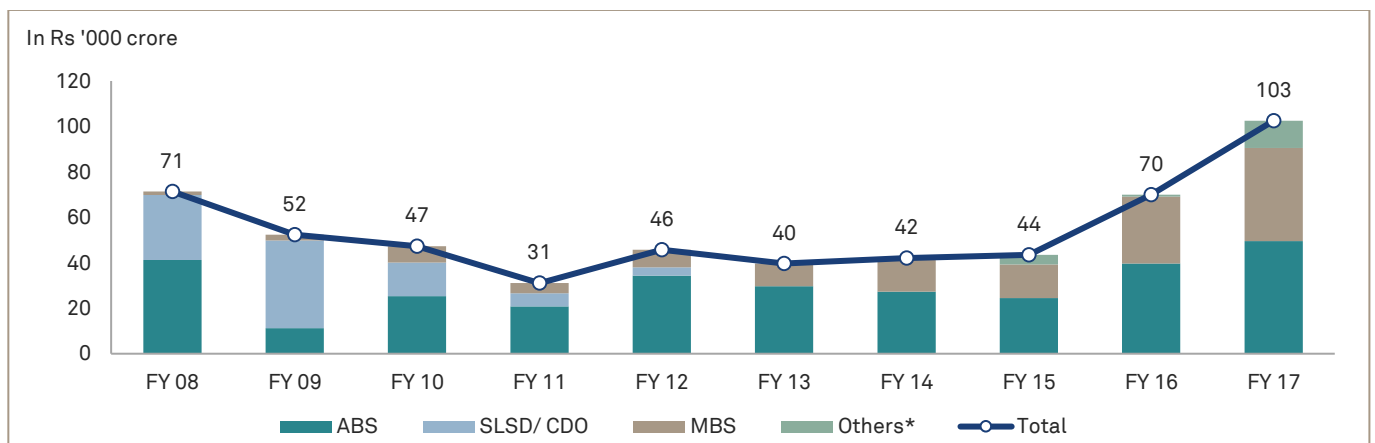
Securitisation transactions through the DA route remained healthy, growing 6.8% to Rs 47,700 crore. With bank credit growth tottering in single digits, banks focused on the DA route. So much so, 21% of incremental retail credit growth for fiscal 2017 was through DAs.

**Chart 1: Retail asset securitisation – PTC & DA mix**



Source: CRISIL estimates

**Chart 2: 10 year trend in securitisation volume**



Source: CRISIL estimates

\*Others include CMBS/Future flow

**Priority-sector lending demand from private banks lifts PTCs...**

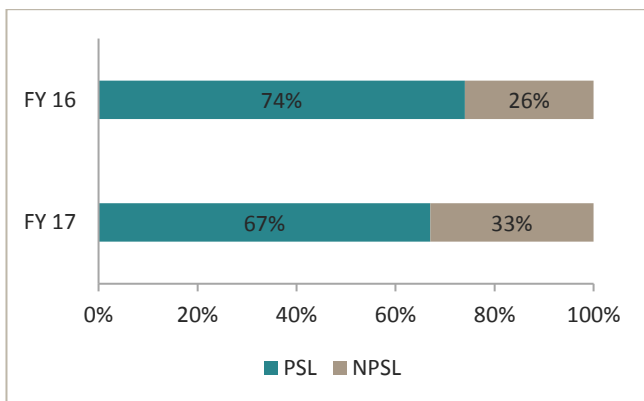
Growth in PTC securitisation was largely driven by private sector banks (including foreign ones), who prefer it over alternative DA route - because of higher regulatory due-diligence and also because absence of credit enhancement in DAs. Also, the removal of dividend distribution tax meant yields on PTCs became more attractive. Consequently, private sector banks went for PTC transactions to meet their priority-sector lending requirements.

**...along with non-priority sector loan (NPSL) demand from non-banks and banks alike**

For mutual funds, and treasuries of banks and NBFCs interested in selling down securities, PTCs remain the only securitisation route available. Not surprisingly, and given attractive yields, they made a beeline.

Banks' continued focus on expanding the retail loan book through securitisation route, given the corporate credit growth challenges, also raised NPSL securitisation demand - primarily MBS securitisation.

**Chart 3: Retail securitisation volume by priority sector status - FY 16 & FY 17**

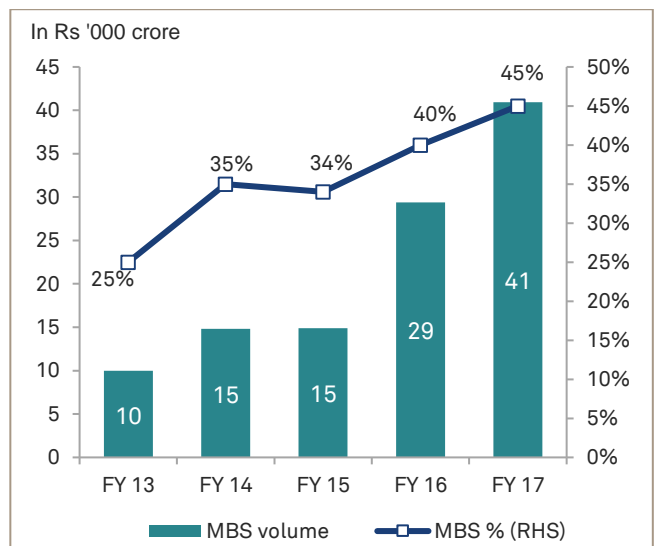


Source: CRISIL estimates

**MBS remains the most-preferred asset-class**

The mortgage sector continued to provide offset to weak credit growth at banks. While PSBs led the way in MBS investments in fiscal 2016, private banks invested ~70 per cent of such transactions in fiscal 2017. Not surprisingly, MBS volume surged 39 per cent to Rs 41,000 crore, with 17 per cent of transactions being through the PTC route, compared to just ~1 per cent in fiscal 2016.

**Chart 4: MBS securitisation volume & share in retail securitisation**



Source: CRISIL estimates

**ABS had a decent outing, too**

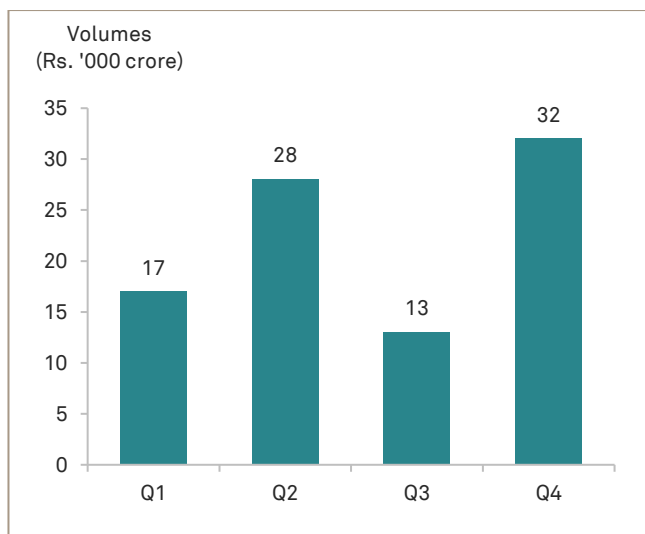
Volume in asset-backed securities (ABS) grew 24% to Rs 49,600 crore, largely backed by vehicle loans that piggybacked on demand for priority-sector lending assets. ABS volume was also supported by addition of newer asset classes such as trade receivables and two-wheeler loans (re-entering the market after fiscal 2013).

## The demonetisation drag

Most asset classes witnessed a sharp decline in collection efficiencies after demonetisation, and an increase in overdues in the immediate aftermath. Asset quality challenges kept investors away for rest of the third quarter and the beginning of the fourth quarter. However, collections in securitised pools of vehicle loan receivables rated by CRISIL saw a V-shaped recovery in January 2017, which helped investors regain confidence and significantly crank up investments in March.

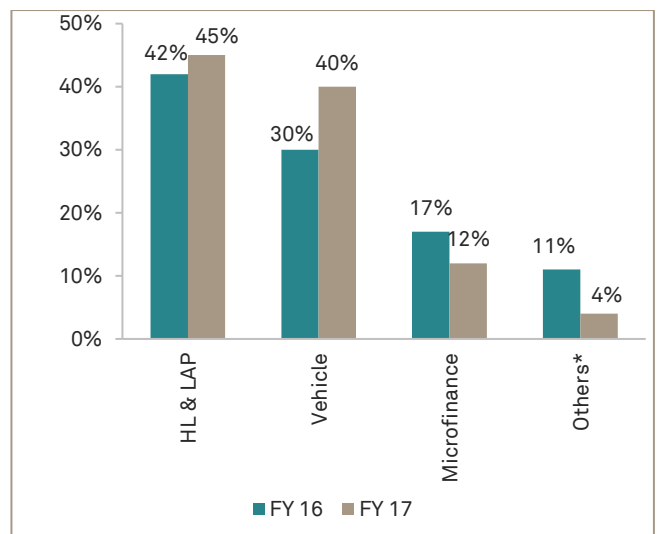
While volume in most asset classes rebounded in February and March, in microfinance, socio-political issues triggered by demonetisation kept delinquencies elevated. Consequently, securitisation volume in microfinance was estimated at Rs 10,600 crore, marginally lower than in fiscal 2016.

**Chart 5: Quarter-wise break-up of FY 17 retail securitisation volume**



Source: CRISIL estimates

**Chart 6: Retail asset securitisation volume by asset class - FY 16 & FY 17**



Source: CRISIL estimates

\*Others include SME and tractor

### The PSLC dampener

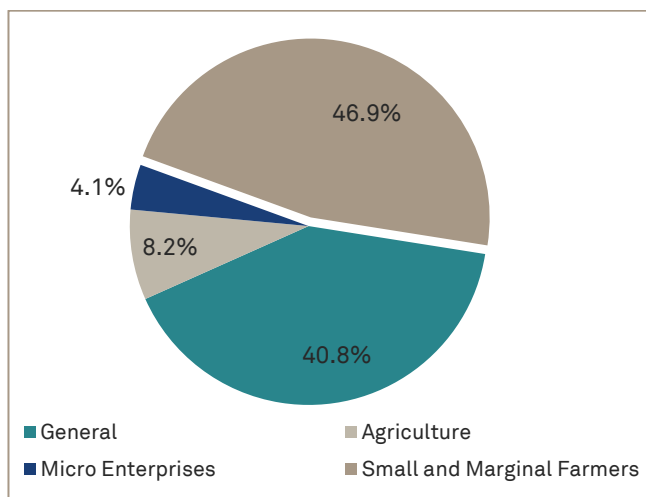
The introduction of PSLCs in the early part of fiscal 2017 is estimated to have had a negative impact on both securitisation and inter-bank participation certificate (IBPC) volumes. Given their ease of purchase and absence of risk transfer, PSLCs quickly gained currency. Around Rs 49,800 crore of PSLCs were traded between banks – bypassing the securitisation and IBPC routes – to meet their priority-sector lending mandate.

Around 55% of the PSLCs traded are from the PSLC Small and Marginal Farmer, and PSLC Agriculture categories. Given that over 60 per cent of Regional Rural Banks' (RRBs') clients are small and marginal farmers, CRISIL believes that RRBs, which are major participants in the IBPC market, are active in PSLC space too. A small finance bank and a few scheduled commercial banks (especially from the private sector) with excess priority sector lending assets also supplied PSLCs.

As for demand, foreign and private-sector banks short on advances under the agriculture category, and PSBs short on priority sector lending dominated PSLC deals.

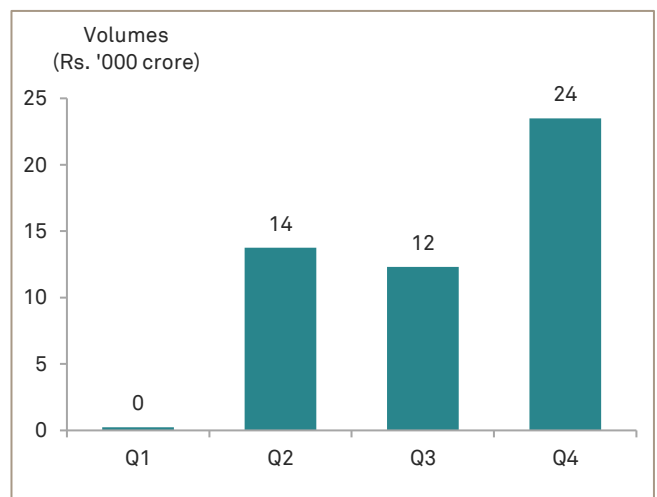
The full-year impact of PSLC introduction will be evident only this fiscal and therefore, the impact of PSLCs on securitisation and IBPC volumes would be more pronounced only at the end of it. On the supply side, NBFC-MFIs that converted themselves to small finance banks, or are expected to do so this fiscal, would further boost PSLC supplies, while priority-sector lending demand from banks – especially foreign ones which have to increase their PSL proportion by 2% annually till 2020 – would continue to be healthy.

**Chart 7: PSLC volume by category traded**



Source: CRISIL estimates

**Chart 8: Quarter-wise break-up of PSLC volume in FY17**



Source: CRISIL estimates

## What's in store in fiscal 2018?

Even under the looming shadow of PSLCs, the securitisation market, especially NPSL securitisation, would benefit from the following favourable trends:

### 1) Expanding investor base

- a. **Mutual funds and treasuries:** Demonetisation had dented sentiment in the mutual funds industry for most of the second half of fiscal 2017. Asset quality fears have now subsided. Consequently, appetite for PTCs from mutual funds and NBFC treasuries should rebound sharply this fiscal, especially because of higher yields offered by NPSL-backed PTCs.
- b. **Foreign portfolio investors:** The Reserve Bank of India (RBI) amended regulations permitting foreign portfolio investors into securitised debt instruments in October 2016. In February 2017, the Securities and Exchange Board of India (SEBI) followed suit. Additionally, SEBI excluded investments in securitised debt from the minimum 3-year residual maturity requirement. That means the investor base for NPSL transactions could expand further.
- c. **Scheduled commercial banks:** Spurred by declining asset quality of corporate credit, banks remain focused on growing their retail book. The DA route would continue to find favour with banks, which would further lift NPSL transactions.

### 2) Broadening originator base

- a. **Banks as originators:** Banks are set to become active originators of securitised assets from this fiscal, focusing on corporate loans, infrastructure assets, and trade receivables as underlying assets.

### 3) Rising demand for priority sector loans

- a. **PSBs and private sector banks:** Demand for priority sector loans from PSBs and private sector banks is expected to stay high. Data from the RBI show several top PSBs and private sector banks are short on overall targets and/or many sub-targets.
- b. **Foreign banks:** Demand for priority sector loans would get a further push as foreign banks with 20 branches or more are required to achieve their targets and sub-targets by this fiscal, and those with less than 20 branches have to achieve a target of 36 per cent, up from 34 per cent in fiscal 2017.

**Nevertheless, the key roadblock to market growth will be...**

### 4) PSLCs

The full year impact of the introduction of PSLCs will be visible this fiscal. The ease of purchase and absence of risk transfer make PSLCs an attractive alternative to securitisation for meeting PSL targets. Foreign Banks with less than 20 branches, who have incremental PSL targets, are more likely to embrace PSLC option.

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