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Moratorium extension announced by the RBI to hurt securitisation volumes; Revised guidelines for partial credit guarantee to the NBFC sector may not have an immediate impact on liquidity

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Securitisation volumes to be hurt by the moratorium extension announced by the RBI

The Reserve Bank of India (RBI) extended the existing loan moratorium policy, earlier announced under its 'Covid-19 Regulatory Package', by another three months upto August 31, 2020, thus making it a six-month moratorium starting from March 1, 2020. While the extension would provide relief to many retail borrowers, if incorporated by the lending institutions, it would be detrimental to the securitisation market which has been a key funding source for the non-bank financial institutions (NBFCs, HFCs and MFIs). The securitisation volumes had already come to a grinding halt in April and May as the investors chose to stay away from purchasing pooled loans that are under moratorium and are not going to result in any immediate cash flows.

ICRA is of the view that securitisation volumes are expected to be significantly lower in H1 FY2021, as against Rs. 1.1 lakh crore raised in H1 FY2020, as investors will be more cautious on the performance of retail loan pools for the near term. Also, with no cash flows expected until August from loans under moratorium, purchase of such loans will dry up. Investors may also take time to rebuild their confidence in the collection efficiencies of originators as the consumer behaviour towards loan repayments may also be impacted due to the long moratorium period. With the prevalent economic stress, the ability of the borrowers to meet their obligations in a timely manner even post the moratorium ends remains to be seen.

Liquidity pressures on NBFCs, MFIs and HFCs would also grow as securitisation has been one of the key funding sources in recent years with certain originators having an off-balance sheet portfolio of as high as 30% of their total assets under management. Loans eligible for securitisation have already reduced due to the dip in incremental disbursements by non-bank finance sector across major asset classes (vehicle loans, home loans, microfinance loans etc.) seen in recent months due to the nationwide lockdown arising from the Covid-19 pandemic. If the funding situation for NBFCs remains challenging in the coming months, fresh disbursals could remain muted which would have a bearing on the securitisation volumes even in H2 FY2021. Nonetheless, if lesser NBFCs were to offer moratorium this time or the economic revival was to be sharper with businesses resuming operations and the lockdown ending effectively, lesser borrowers would be expected to opt for the moratorium (or could opt out mid-way) which would then support the securitisation market.

ICRA has observed that the moratorium extension allowed by the RBI in its earlier announcement in March had been adopted by almost all the NBFCs. For the ICRA-rated securitisation transactions, the moratorium had been approved by the investors with very few exceptions. If the NBFCs opt for the second round of moratorium, a similar approval would be required for the securitisation transactions from the investors. ICRA expects that investors would largely proceed with the moratorium in line with the policy being adopted by the respective NBFC that is acting as a servicer for the pooled loans. In the event that such a moratorium is not provided, it could result in pressure on the ratings of the pass-through certificates (PTCs) as the collections may still be weak during the moratorium period leading to utilisation of the cash collateral to meet the scheduled investor payouts.

Revisions in the Partial Credit Guarantee Scheme (PCGS) may not have an immediate impact on the liquidity profile of the NBFCs

The Union Cabinet's recent approval on the revisions in the existing partial credit guarantee (PCG) offered by the Government of India (GoI) to Public Sector Banks (PSBs) increases the coverage by introducing guarantees for on-balance sheet debt on the books of NBFCs, HFCs and MFIs other than pooled assets which are sold to the banks. As per ICRA, widening the coverage under the PCG scheme is in line with the Government's intent to support the non-banking finance sector which is going through a difficult period due to the ongoing Covid-19 pandemic. PSBs have been one of the key investors in the securitisation market in recent years and direct buy-out of retail loan pools from NBFCs/HFCs by PSBs has gained prominence, as it is seen as a viable route for loan book growth, especially in the absence of lending opportunities in the corporate loan segment[1]. The Rs. 10,000 crore of guarantee amount available under the scheme (including the amounts already committed) is expected to provide additional comfort to the PSBs in this regard.

The initial detailed press releases on 'Partial Credit Guarantee (PCG) Scheme', issued by the Ministry of Finance in the month of August 2019, was modified in the month of December 2019. A table below provides a snapshot of changes since initial press release on PCG guidelines by the government:

EXHIBIT 1. Salient modifications in the GoI's PCG scheme

Parameter	Initial guidelines - August 2019	Previous guidelines – December 2019	Revised guidelines – May 2020
SMA-1 category entities	The NBFCs/HFCs should not have been reported under SMA category by any bank for their borrowings during last one year prior to 1.8.2018.	The scheme would cover NBFCs / HFCs that may have slipped into SMA-0 category during the one-year period prior to 1.8.2018	The scheme would cover NBFCs / HFCs that may have slipped into SMA-1 category on technical reasons during the one year period prior to 1.8.2018
Net profit criteria	NBFC/HFC should have made a net profit in at least one of the financial years of FY2017-18 And FY2018-19.	No change	NBFC/HFC should have made a net profit in at least one of the financial years of FY2017-18, FY2018-19 and FY2019-20.
Criteria for eligible contracts	Assets originated up to March 31, 2019	No change	Eligible contracts would include assets originated up to at least six months prior to the date of initial pool rating
Validity of the scheme	Six months from the date of issuance of the Scheme	June 30, 2020	March 31, 2021

[1] PSBs had 43% participation in securitisation/DA in FY2019-20

Parameter	Initial guidelines - August 2019	Previous guidelines – December 2019	Revised guidelines – May 2020
Minimum eligible rating for pool of assets	AA	BBB+	No change (BBB+)

The relaxation pertaining to making SMA-1 category (due to technical delay) NBFCs/HFCs eligible and addition of one more financial year to the net profit criteria would increase the number of eligible entities seeking the PCGs for their pooled assets. Additionally, allowing new assets originated up to at least six months prior to the date of initial pool rating (as against originated up to March 31, 2019 previously) is in line with the RBI's existing Minimum Holding Period (MHP) of 6 months criteria for securitisation transactions. The previous loan origination date being prior to March 31, 2019 was proving to be a roadblock as quantum of eligible loans were reducing. This modification considerably increases the pool of assets available for sell-down under the PCG scheme.

ICRA, however, believes that the revised PCG scheme does not support the immediate liquidity requirement of the NBFCs as investors may be cautious of certain asset classes given majority of the retail loans are under moratorium and the trend in collections after the moratorium remains unclear. The possible extension of the moratorium by another three months, as allowed by the RBI, would further reduce the cash flows that would be earned by the investors during this period making the purchase of pooled loan assets at this juncture less lucrative. The credit enhancements that the entities may have to maintain in the transactions could also be higher in the current environment. In light of this, the extension of effective period for the scheme by nine months i.e. from June 30, 2020 to March 31, 2021, is a positive development. In ICRA's view, majority of transactions and resultant volume growth would be skewed towards H2 FY2021 on the expectation of easing lockdown situation and gradual economic recovery from the impact of the pandemic.

ICRA also believes that the continuity of guarantee coverage for the first 24 months only from the date of purchase of the assets would still limit the utility of PCG scheme as majority of the underlying loans typically have a tenure anywhere between 3 -5 years (for car loans, truck loans, business loans) to 15 - 20 years (for home loans, Home Equity loans). Since the loan tenure is typically higher than the guarantee period, any loan slipping into delinquency after 2 years would not be covered by the PCG. Also, even within 2 years, if the intent is to cover only the overdue portion (and not the entire unbilled amount outstanding on a 90+ delinquent loan), the utility of the PCG would be considerably reduced.

Along with the modifications in the PCG for pooled assets, the extended scheme increases the coverage by introducing guarantees for on-balance sheet debt on the books of NBFCs, HFCs and MFIs. The support for on balance sheet lending will be available for MFIs which are not eligible for coverage under the pooled assets. The key points of these guidelines are as follows:

- Guarantee would be in the nature of first loss for purchase of Bonds or commercial paper (CPs);
- Guarantee would be capped at 20% of the crystalised portfolio;
- AA and AA- investment sub-portfolio should not exceed 25% of the total portfolio of the PSBs under this scheme;
- The portfolio should be built up within three months of the announcement of the scheme; Guarantee shall come into effect at the end of three months based on the actual amount disbursed;
- The bonds/CPs purchased by PSBs under this scheme shall be primary issuance only;
- The original tenure of Bonds/CPs shall be between 9 to 18 months, except of unrated papers whose maturity should not exceed one year;
- Guarantee fee shall be 0.25% of the fair value of the crystalised portfolio and shall be payable by the PSB.

As per ICRA, the partial guarantee on bonds/CPs would benefit the investors as it would reduce the expected loss on the instruments. However, it may not necessarily lead to any enhancement in the credit rating. While evaluating the benefits of a partial guarantee from a rating perspective, ICRA analyses various parameters including the number of payment instalments of the instrument being covered by the guarantee and the payment mechanism in the transaction to ensure timely payments. However, if the partial guarantee does not completely cover a few instalments (such as in the case of CPs that have a bullet repayment), it would not reduce the probability of default and thus would not enhance credit rating of the instrument. Also, the investor preference may still continue to remain in favour of higher rated entities which would lead to lower support extended to entities with weaker credit profiles which are in a greater need of funds today. The limit introduced on the proportion of funding to AA- and AA rated entities to a maximum of 25% partly alleviates this concern.

ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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