Non-bank funding Update

Maintaining liquidity key for weathering near-term headwinds

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Executive Summary

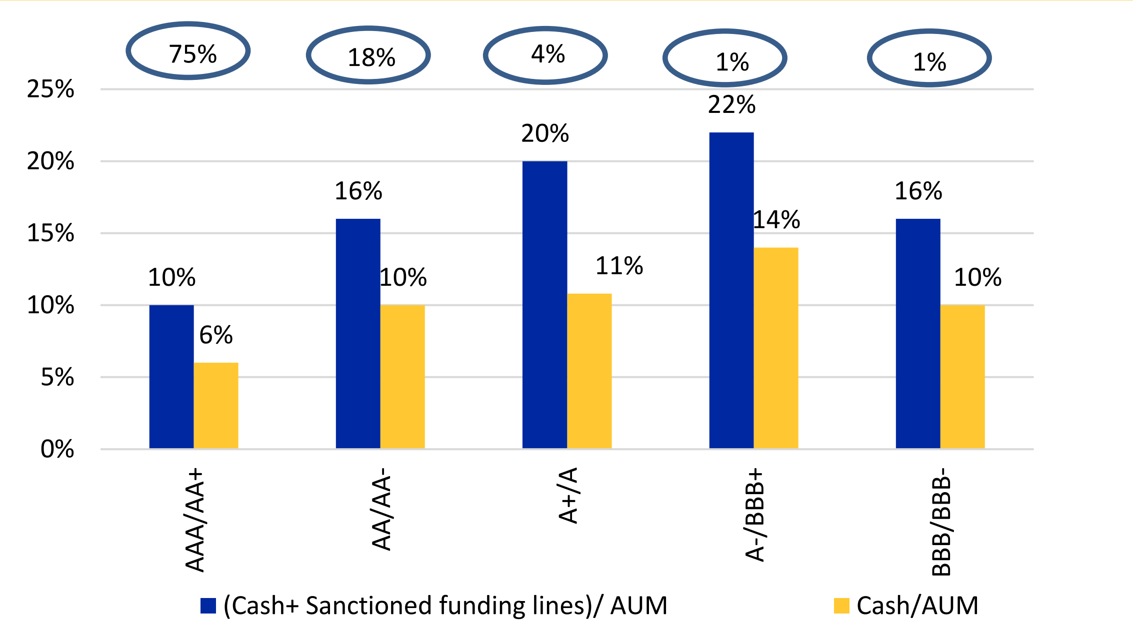
- Non-banks[1] are estimated to have close to Rs. 6.0-6.5 trillion of long-term debt/borrowing maturities in the current fiscal. Thus, assuming stable asset under management (AUM) vis-à-vis the March 2020 levels, the entities would have to refinance the same.
- Most non-banks carried adequate on-balance sheet (on-B/S) liquidity as of March 2020, which, along with access to funding lines, would be sufficient to meet the near-term requirements. However, the extension of moratorium, the consequent impact on collections and any delay in the disbursement of sanctioned lines or fresh sanctions could impact the entities, especially in the lower (A+ and below) rating categories. These entities are expected to have limited financial flexibility.
- Of the total Non-convertible debenture (NCD) maturities of Non-banks of about Rs.2.6 trillion in the current fiscal, maturities in the lower rating categories are not substantial. Targeted funding to these entities would help them weather the near-term headwinds. Commercial Paper (CP) maturities is about 1.2 trillion between May 2020-March 2021; AAA/AA+ entities account for about 85-90%.
- Private (PVT) banks are exhibiting risk aversion to the sector and exposures remained stable between March 2019 and March 2020. Public sector banks (PSBs) are expected to meet much of the incremental sectoral requirements as the Government of India (GoI) and the Reserve Bank of India (RBI) have announced various measures to augment sectoral liquidity and funding.
- The securitisation volumes are to be impacted significantly with the extension of the moratorium and with the asset quality pressure expected to mount in the sector.
- The recently announced special liquidity and partial guarantee schemes are likely to see a subdued response as the tenor is quite short, which may affect offtakes. Further, asset quality and performance-related concerns would weigh on investor decisions.
- External commercial borrowing (ECB) issuances would be muted vis-à-vis the levels achieved in the last fiscal, considering the global nature of the Covid-19 pandemic, while the sharp equity price correction would hamper fresh capital raise.

[1] *Non-banking financial companies (NBFCs) and housing finance companies (HFCs)*

Non-banks are estimated to have close to Rs. 6.0-6.5 trillion of long-term debt/borrowing maturities in the current fiscal. Thus, assuming stable AUM vis-à-vis the March 2020 levels, the entities would have to refinance the same. Further, non-banks augmenting their on-B/S liquidity profile or growing their AUM would warrant further funding. For every 1% growth in the sectoral AUM, the additional funding requirement is about Rs. 380-400 billion.

Lower rated and smaller entities would face liquidity-related headwinds because of moratorium extension

EXHIBIT 1: Non-bank liquidity profile (ICRA rated) – March 2020



Source: Company data, ICRA research; Data for ICRA rated entities are on a weighted average basis in relation to their AUM; this is about 80% of the overall non-bank AUM

% AUM of ICRA rated entities in each rating category

The on-B/S liquidity of non-banks improved in the past few quarters, especially post September 2018. The entities have steadily beefed up their liquidity as market sentiments towards non-banks turned bearish. Based on the ICRA rated entities, which account for close to 80-85% of the sectoral AUM, the weighted average on-B/S cash and liquid investments stood at about 7% of the AUM as of March 2020. Including the sanctioned funding lines, the same improved to 12% (March 2020).

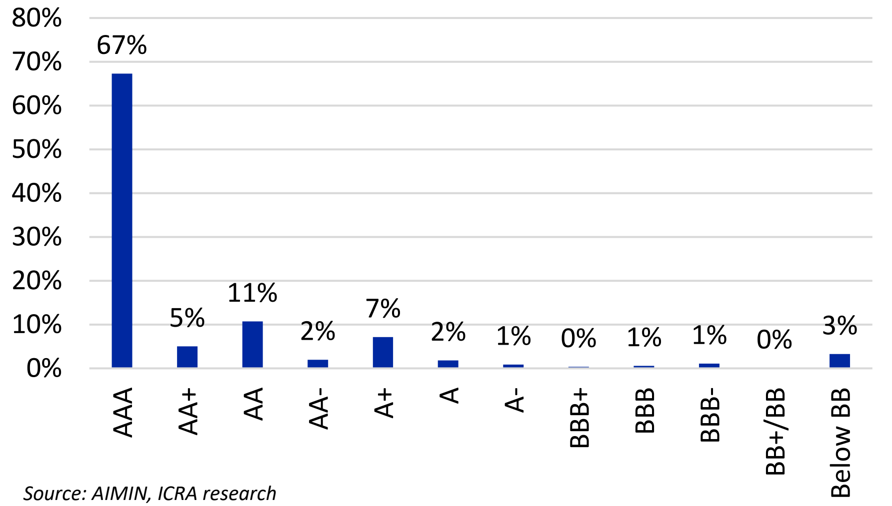
The on-B/s cash & liquid investments in March 2020 is sufficient to cover about 2-3 months of the debt repayments (excluding securitisation/direct assignment (DA) outflows) of most non-banks while access to the sanctioned funding lines could enhance the cover by an additional 1-2 months.

The entities in the AAA/AA+ rating category have lower on-B/S liquidity compared to their peers in the lower rating levels as they enjoy high financial flexibility. The AAA category includes a few large public sector NBFCs, large HFCs and entities backed by strong parent/group, which have a demonstrated fund-raising track record. Most entities in the AAA/AA+ category, therefore, have not sought a moratorium from their lenders while they have offered a moratorium to their borrowers.

About 30-75% non-bank AUM (depending on the entity under consideration) is under moratorium though not all lenders have extended a moratorium to non-banks. Also, the moratorium is not applicable for market instruments [NCDs/commercial papers (CPs]), which account for about 35-40% of the outstanding borrowings. While fresh sanctions from lenders including financial institutions (SIDBI, NABARD, NHB) are in various stages of approval, the liquidity profile of non-banks, especially lower rated and small entities, could witness headwinds in the event of any delays in securing the same and as the RBI permits them to offer a further 3-month moratorium period to their borrowers.

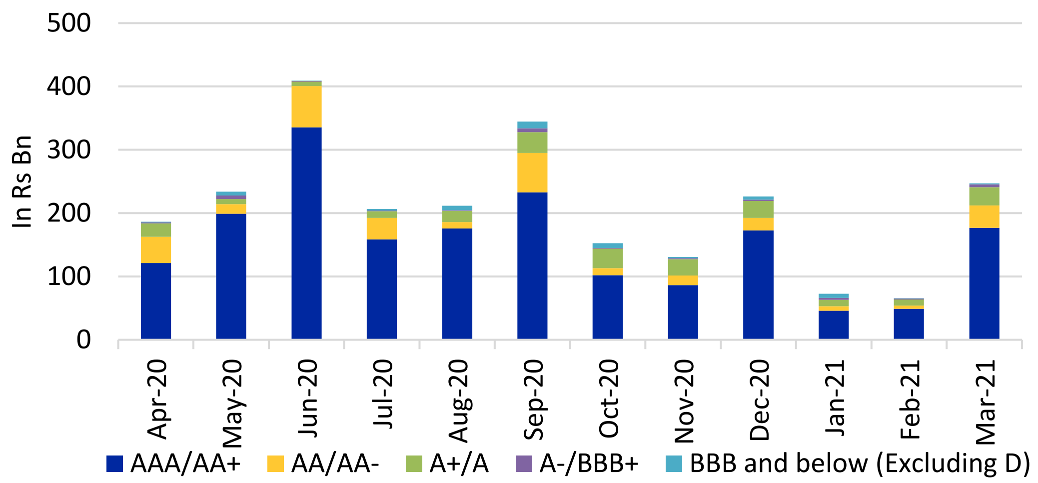
NCD maturities for current fiscal estimated at Rs. 2.6 trillion

EXHIBIT 2: Non-banks NCD Maturities in FY2021- Rating wise break-up



Source: AIMIN, ICRA research

EXHIBIT 3: Monthly NCD Maturities of Non-banks in FY2021



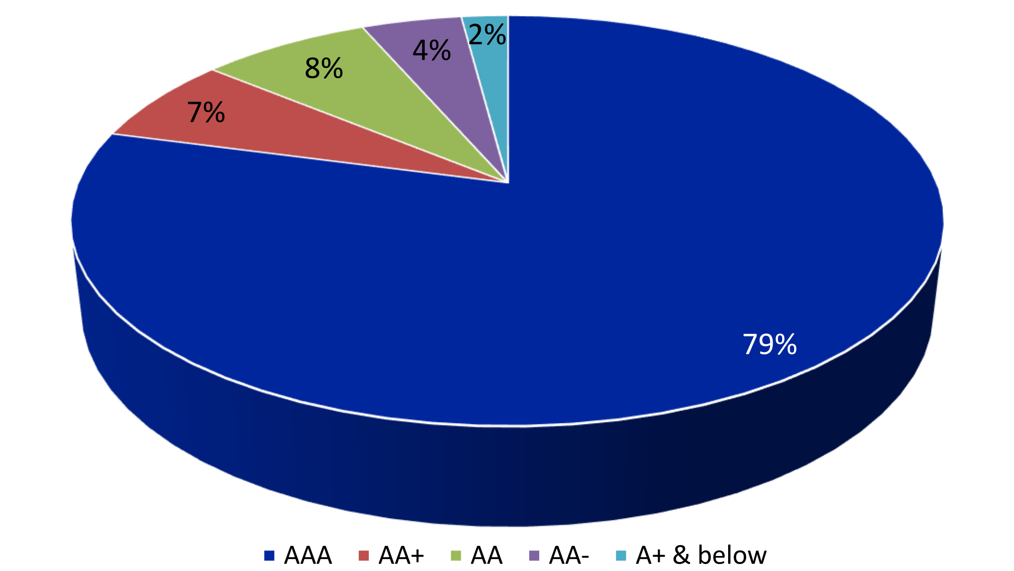
Source: AIMIN, ICRA research

In line with the exposure trends, AAA rated entities account for the bulk of the NCD maturities in the current fiscal. About 30% of the AAA rated maturities are accounted by large public sector NBFCs and about 33% by two large HFCs. Most of the other entities in this rating category are a part of a larger group and have a track record of refinancing and securing fresh-funding.

The maturities of A+ and below rated entities (Excluding entities in default) stood at about Rs. 300 billion and mostly (~80%) is in the A rating level. Targeted funding could support the liquidity/refinancing needs of these entities as securing funds via conventional sources is expected to be challenging in the current fiscal.

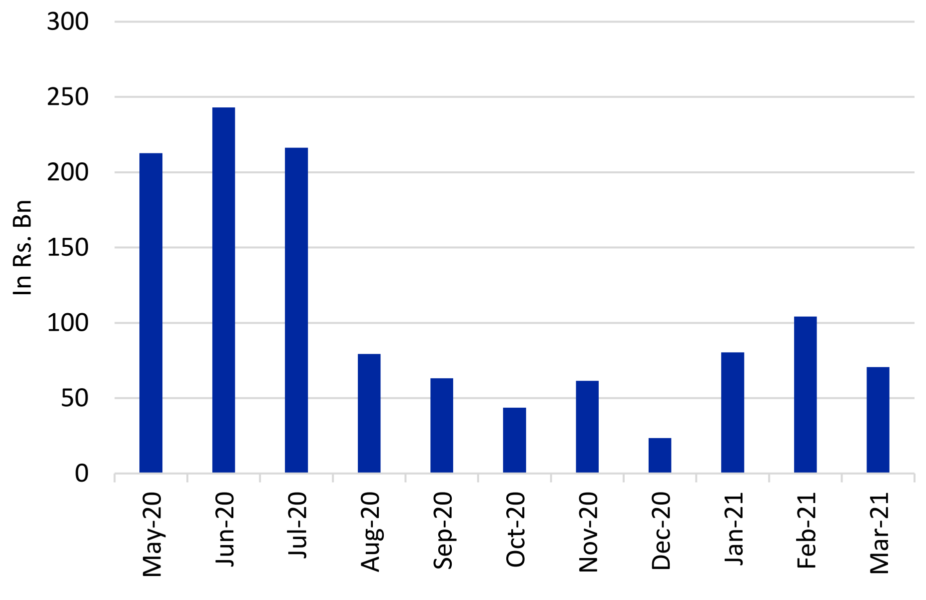
The targeted long-term repo operation (TLTRO) 2.0, announced in April 2020 and specifically focussed on non-banks, received a subdued response. While the recently announced Rs. 300-billion Special Liquidity Scheme (SLS) for NBFCs/HFCs/microfinance institutions (MFIs) with 100% guarantee from the GoI for investments in the debt instruments of investment grade entities, was seen as a welcome move, the short-term nature (3 month) of this facility is likely to have dampened investor/issuer sentiment. The proposed Rs. 450-billion Partial Credit Guarantee Scheme (PCGS), with a sovereign portfolio guarantee of up to 20% of the first loss for the purchase of the bonds or CPs of NBFCs/HFCs/MFIs with a rating of AA and below, is also a relatively short-term (9-18 months) measure. The details of this scheme are covered further below in the report.

EXHIBIT 4: Non-bank CP Rating wise break-up



Source: F trac, ICRA research

EXHIBIT 5: Monthly CP maturities of Non bank (O/s as on April 30, 2020)

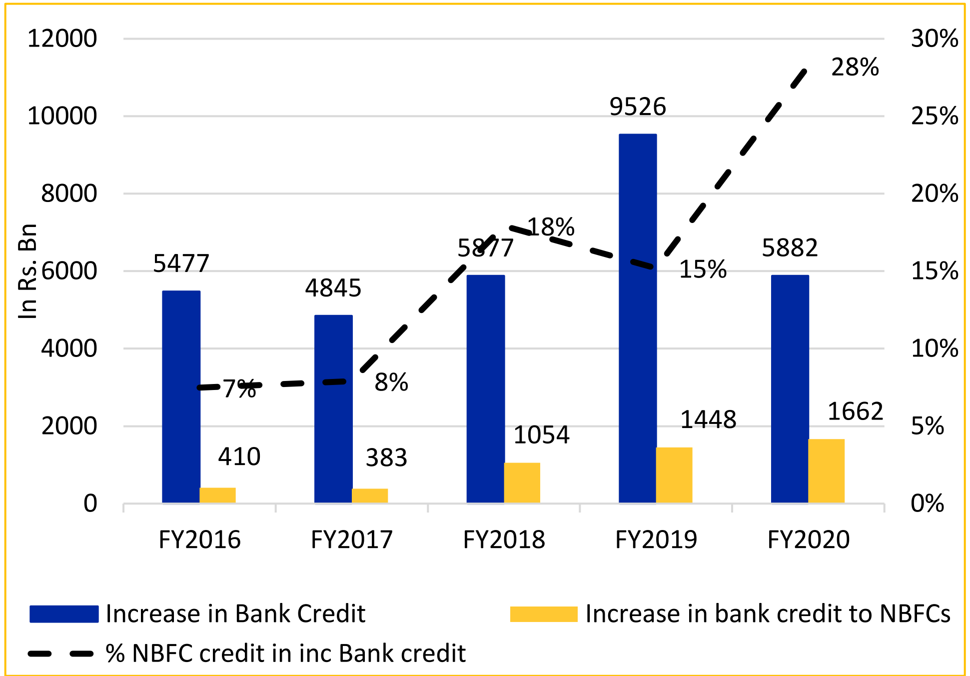


Source: F trac, ICRA research

CP maturities is about 1.2 trillion between May 2020-March 2021; AAA/AA+ entities account for about 85-90% of the CP outstanding (As on April 30,2020). While AAA/AA+CPs are more likely to be rolled-over, some AA/AA- rated and other lower rated CP may have to be refinanced by other forms of debt, most likely bank funding.

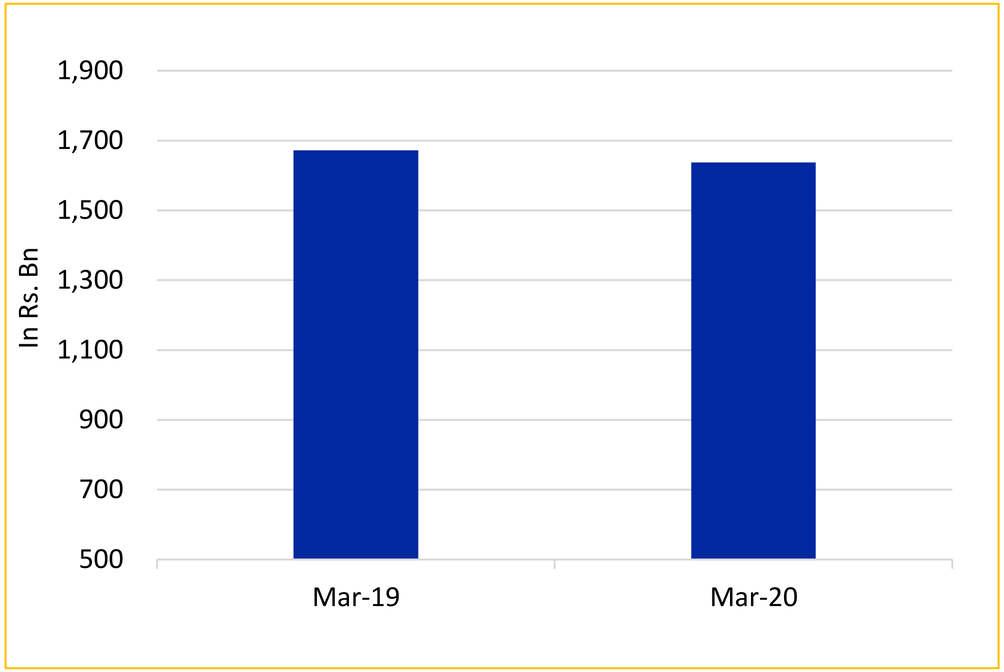
Bank loan maturities estimated at about Rs. 3.0 trillion for current fiscal

EXHIBIT 6: Incremental bank credit and share of credit to non-banks



Source: RBI, ICRA research

EXHIBIT 7: Exposure of 6 leading PVT banks



Source: Basel III disclosures, ICRA research

Bank credit to non-banks was close to Rs. 8.0 trillion as of March 2020, registering a YoY growth of 26% and a 3-year CAGR of 27% compared to the overall YoY credit growth of 7% and 3-year CAGR of 9%. This resulted in an increase in the share of NBFCs in the overall bank credit to 8.8% in March 2020 from 5.5% in March 2017.

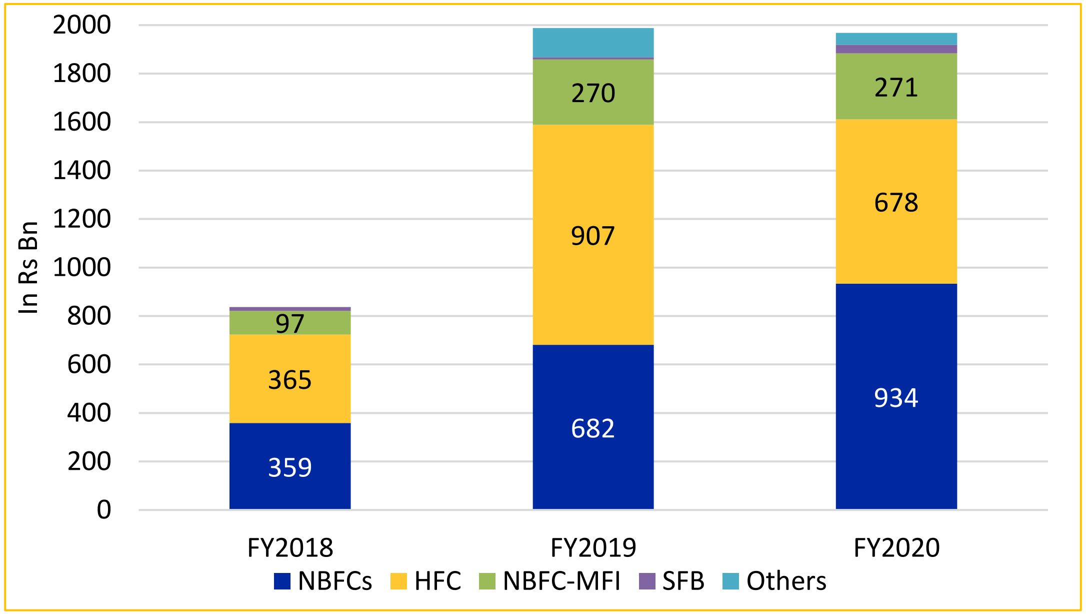
While the overall bank credit to NBFCs has grown at a good pace, PVT banks have remained somewhat averse to the sector. Their overall exposure to the sector *(based on Basel III disclosures)* has remained largely stable between March 2019 and March 2020. Therefore, PSBs did most of the heavy lifting needed to support non-banks. The overall bank loan maturities in the current fiscal is estimated at around Rs. 3.0 trillion[2]; PVT bank maturities in this estimated to be about 25-30%. PSBs may have to partly fund a portion of these maturities if PVT banks remain averse to the sector.

[2] ICRA estimates based on the o/s bank credit to the sector as in March 2020

The credit growth outlook for PSBs is expected to remain muted. Therefore, PSBs would have to increase their internal exposure norms to accommodate incremental credit to non-banks as other lenders are likely to show muted interest.

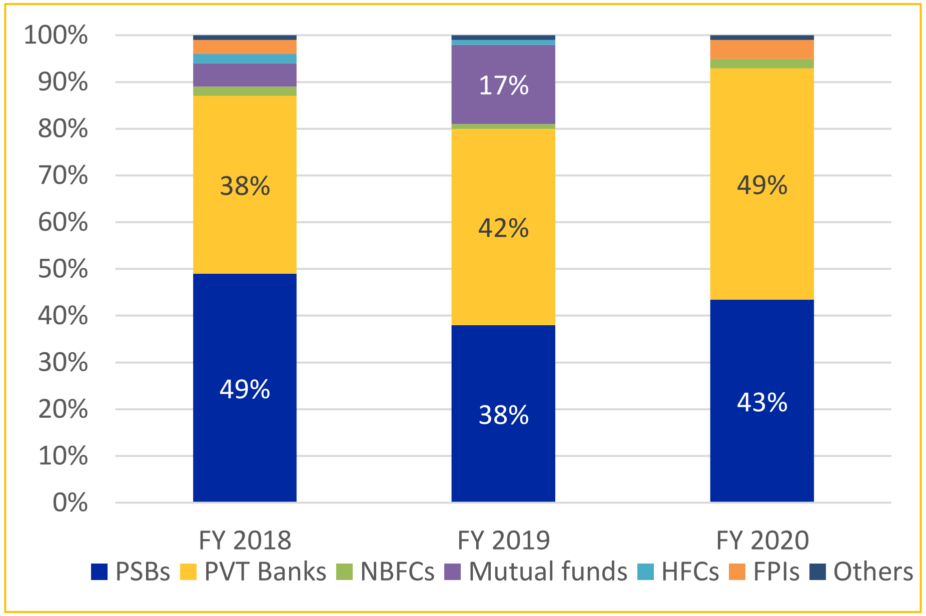
Securitisation volumes to be impacted by extension of moratorium

EXHIBIT 8: Loan sell-down volumes



Source: ICRA research

EXHIBIT 9: Investor profile of ICRA rated pools



Source: ICRA research and Estimates

The loan sell-down volumes in FY2020, which were set to surpass Rs. 2.0 trillion, were impacted by the Covid-19 related lockdown as many deals that were in various stages of approval could not be sanctioned. The loan sell-downs had supported the liquidity of e-retail focussed players over the last two fiscals as funding via conventional means was difficult to come by, thereby supporting their liquidity and enabling AUM growth.

Based on the ICRA rated transactions, banks have been the largest investors in sell-down transactions, accounting for 80-90% of the volumes. Banks take these exposures as investments in case of securitisation or on-B/S loans in case of DAs. Some banks also factor in the DA exposures while evaluating their sectoral exposure caps. With bank's own credit growth expected to be lower at about 6% in the current fiscal, many PSBs may have to revise their internal sectoral caps to accommodate the funding requirements of non-banks. ICRA expects banks to be the key investors for loan sell-downs from established non-banks and entities with lower asset quality pressure. ICRA expects the loan sell-down volumes to contract by about 50% in the current fiscal as the moratorium has been extended by 3 more months.

Extended PCGS may also see muted response

The original PCGS announced in FY2020 involved an offer for a sovereign guarantee on the first loss of up to 10% to PSBs investing in the BBB+ or higher rated pooled assets of non-banks. The total funding to non-banks via this route was envisaged at Rs. 1 trillion with an overall GoI guarantee commitment of Rs. 100 billion.

In May 2020, the GoI extended this scheme to cover the purchase of the fresh NCD/CP issuances of non-banks (including MFIs) with a rating of AA and below (including unrated instruments with a tenor of up to one year). The rated instruments could have tenors ranging from 9 months to 18 months. The GoI would extend a first loss guarantee of 20% (at an investment portfolio level, which needs to be built over the next 3 months) to PSBs undertaking the above transaction. Other key terms of the transaction are provided below.

- Cap of 25% at portfolio level for investment in AA/AA- instruments
- Individual PSBs can purchase up to 20% of their non-SLR book and would hold this as a held-to-maturity investment
- Single entity exposure capped at 1.25 times of the total maturing liability over the next 6 months from the date of the issue of CPs/NCDs

The GoI also extended the original PCGS-backed pooled asset scheme and increased the scope

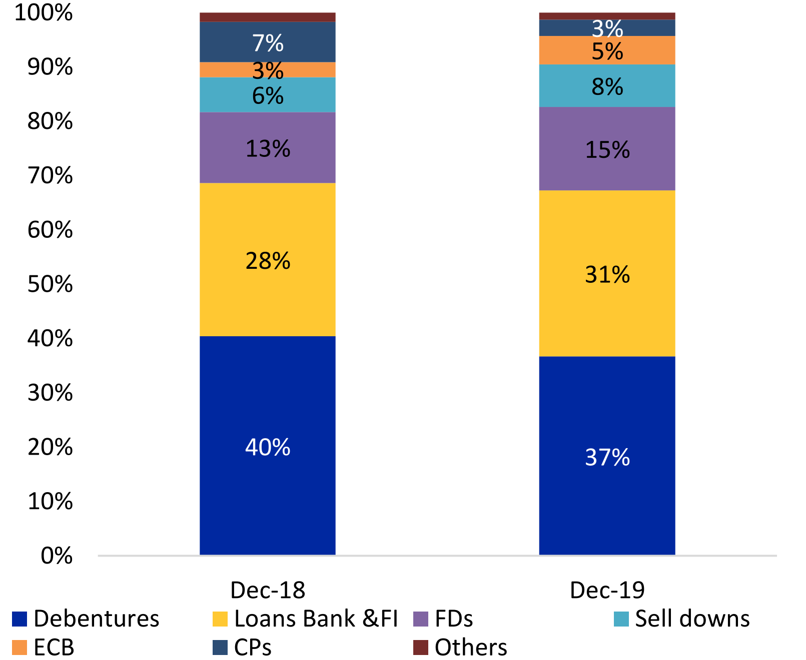
- By extending the scheme till March 2021 for the purchase of pooled assets; originally, the scheme was available only till June 2020
- By making entities reported under SMA-1 only for technical reasons, eligible to offer their loan pools
- By relaxing the net profit criteria of the selling entity
- By relaxing the criteria for the date of origination of assets to include new assets originating up to at least 6 months prior to the date of initial pool rating; earlier, only assets originated up to March 2019 were eligible under the scheme

Observations and Views

- Rs. 450-billion PCGS 2.0 announced in May 2020 seems to have been carved out of PCGS of FY2020. Anecdotal evidence suggests that a sizeable portion of the original scheme of FY2020 (~85%) remain unutilised. The extended PCGS is thus expected to consist of 1) Rs. 450 billion towards funding investments in CPs/NCDs and 2) ~ Rs. 400-450 billion for investments in pooled assets.

- Considering the muted response in the past along with the expected increase in the asset quality stress for these entities, investor interest, especially for pooled asset purchases, remains to be seen
- Identification of good quality assets may be challenging as the operating environment weakened
- Only assets originated at least 6 months prior to the initial pool rating, provided they have a clear 6-month repayment history, excluding any moratorium are eligible; with 50-70% of AUM for most NBFCs under moratorium, free assets meeting this criteria and other investor requirements may be difficult
- Guarantee for pool loan assets can be invoked if the interest/instalment is overdue for more than 90 days(i.e when the liability is crystallised for the underlying borrower) ; Guarantee for NCDs/CPs can be invoked at at maturity and coverage would be 20% of the crystallised portfolio value

EXHIBIT 10: Borrowing profile of 15 leading Private Non-banks



Source: Company data, ICRA research

ECB to dry up in current fiscal and equity-raising plans could get delayed, given market uncertainties

ICRA estimates ECB issuance at Rs. 800-1,000 billion by Non-banks in FY2020, which supported their liquidity and funding diversity. However, considering the global nature of the pandemic, the ability to raise fresh overseas funds is expected to be constrained. Also, with equity prices crashing by about 30-60% for most players, funding via this route, considering the dilution the existing shareholders would have to face, also seems less likely.

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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