

Chapter 4 Scope of Securitisation and Indian Experience

4.1 Introduction

The major players in the asset securitisation market in India are expected to be commercial FIs, PSUs, Corporates, Government bodies, Mutual Funds, Pension Funds, etc. Securitisation generally pre-supposes that the Originator has a bulk of its assets in the form of self-amortising financial assets, either with or without underlying security. It is also imperative that these assets should have a clearly established repayment schedule. Moreover, since capital market instruments have a minimum marketable tenure, the receivables underlying the securities should themselves have a sufficiently long tenure, so as not to frustrate the securitisation exercise.

While securitisation started off in the housing loan sector, the development of the securitisation market as a standard funding option across most industries has been the result of a constantly expanding universe of securitisable non-mortgage asset types. This chapter lays emphasis on three potential areas of securitisation in India - MBS, ABS and Infrastructure Sector.

4.2 Mortgage Backed Securities (MBS)

4.2.1 The securitisation of assets historically began with, and in sheer volume remains dominated by residential mortgages. The receivables are generally secured by way of mortgage over the property being financed, thereby enhancing the comfort for investors. This is because mortgaged property does not normally suffer erosion in its value like other physical assets through depreciation. Rather, it is more likely that real estate appreciates in value over time. Further,

- the receivables are medium to long-term, thus catering to the needs of different categories of investors;
- the receivables consist of a large number of individual homogenous loans that have been underwritten using standardised procedures. It is hence suitable for securitisation;
- in the US where it originated, these mortgages were also secured by guarantees from the Government;
- the receivables also satisfy investor preference for diversification of risk, as the geographical spread and diversity of receivable profile is very large.

More details are given in Para 6.1.

4.2.2 In the Indian context, the funds requirement in the housing sector is immense, estimated at Rs. 150,000 crore during the current five-year plan. Of this, it is envisaged that about Rs 52,000 crore would be financed by the formal sector. It is unlikely that this gap can be filled out of budgetary allocation or regular bank credit. Securitisation allows this gap to be bridged by directly accessing the capital markets without intermediation. Securitisation tends to lower the cost at which the housing sector accesses funds. It also facilitates a sufficiently deep long term debt market. It is estimated that about Rs 2,500 crore would be mobilised through the securitisation route during the current five-year plan.

4.3 Asset Backed Securities (ABS) – Existing assets

(a) Auto loans:

Though securitisation was made popular by housing finance companies, it has found wide application in other areas of retail financing, particularly financing of cars and commercial vehicles. In India, the auto sector has been thrown open to international participation, greatly

expanding the scope of the market. Auto loans (including instalment and hire purchase finance) broadly fulfil the features necessary in securitisation. The security in this case is also considered good, because of title over a utility asset. The development of a second hand market for cars in India has also meant that foreclosure is an effective tool in the hands of auto loan financiers in delinquent cases.

Originators are NBFCs and auto finance divisions of commercial banks.

(b) Investments:

Investments in long dated securities as also the periodical interest instruments on these securities can also be pooled and securitised. This is considered relevant particularly for Indian situation wherein the FIs are carrying huge portfolios in Government securities and other debt instruments, which are creating huge asset-liability mismatches for the institutions.

Government securities issued domestically in Indian Rupee can be bundled and used to back foreign currency denominated bonds issues. It would more be of the nature of derivative. The subordinated Government securities are intended to absorb depreciation in the value of the rupee thereby protecting to certain extent the senior securities that the Government securities back. The senior securities are directed at the international capital markets and are structured using offshore SPVs by countries like Mexico.

Similarly, under the STRIPs mechanism, the interest coupons on the Government dated securities are separated and traded in the secondary markets. Such interest instruments can also be bundled and securitised in the normal asset securitisation method.

(c) *Others:*

Financiers of consumer durable, Corporates whose deferred trade receivables are not funded by working capital finance, etc are Originators of other asset classes amenable to securitisation. Corporate loans, in a homogeneous pool of assets, are also subject to securitisation

There is virtually no known instance so far in the United States or in other countries of an ABS transaction having failed. This is despite the fact that the markets for ABS are exceptionally large. Industry experts attribute this to three main factors. ABS transactions are always planned, prepared and carried out with great care. Second reason is the intrinsic value of the paper and in particular the high level of transparency on the quality of the underlying assets. Third, ABS transactions are sponsored generally by large and well known institutions which can't afford to jeopardise their reputation with investors, the majority of which are institutional investors.

4.4 Securitisation of infrastructure receivables

4.4.1 Securitisation of wholesale assets refers mainly to the use of securitisation as a technique for infrastructure funding. The availability of an efficient infrastructure framework is vital to the economic growth and prosperity of any country. Traditionally, infrastructure facilities have been developed and provided by Governments and are looked upon as basic privileges of a citizen and have thus been accorded priority for Government investment. The Central Government has envisaged that more than 40% of the annual central plan outlay would be for the development of infrastructure.ⁱⁱ In the context of India's size, population, and economic growth, the present infrastructure continues to be inadequate and will require massive incremental investment to sustain economic growth. Hence, the participation of private capital in the development of infrastructure (over and above the Government's direct involvement) is essential. The India Infrastructure Report submitted by the Rakesh Mohan Committee in 1995 estimated that a total outlay of Rs 400,000 – 450,000 crore would be

required for infrastructure financing in the period of 1996-2001. Some of the broad observations outlined in the report in respect of various infrastructure segments are detailed in the table hereunder.

Table 3: Criticality of Requirements and Outlay for Infrastructure

Segment	Criticality of Requirements – Status in 1995	Outlay estimated (Rs. crore)
Urban Infrastructure	Water Supply – Covering 20% of total population Toilet facilities covering 23.55% of households Sanitation – Covering 52% of households	94,000
Power	Peak Shortage of 19% and energy shortage of 8%. Addition of upto 111,500 MW from 1996-2006	500,000
Telecom	Penetration of 1.3 telephones for every 100 people	60,000
Roads	Of the total 165,000 km of highway (State and National) – 2% are four lane highways, 34% in the form of two lane highways and 64% single lane highways	95,000
Ports	Operating at optimal capacity utilisation and marred by lower efficiencies and delays because of using second and third generation equipment	25,000

4.4.2 Along with the Government's earnest attempt at attracting private investment into infrastructure funding, the role of innovative funding techniques such as securitisation is vital. The suitability of securitisation for infrastructure funding stems from the fact that cash flows are stable and concession driven, and also because ultimate credit risk (which is central to the concept of securitisation) is partly guaranteed by Government. Securitisation is particularly appropriate at the post-commissioning stage when the project begins to generate cash, with overall project risk being largely replaced by credit risk.

4.4.3 Some of the typical characteristics of infrastructure projects that set them apart from other financing needs are:

Multiple level project risks: Infrastructure financing involves risk participation at multiple levels and is complex to understand for individual investors. The nature of project risk in various stages is volatile, it is highest in the pre-commissioning stage and is sought to be mitigated through contractual framework, which is concession driven or provides guaranteed returns. These guarantees and concessions are typically extended by Government and quasi Government organisations and thus minimise financial risk.

Unconventional asset cover: Infrastructure projects are typified by the creation of unconventional assets. The assets of an infrastructure project could comprise roads or bridges, jetties and quays in a port infrastructure project, drills and rigs pertaining to an oil

well, water treatment plants. These assets are not amenable to resale or reapplication and hence are unacceptable as security cover to conventional lenders. Furthermore, the step-in rights to lenders are non-existent since such projects are awarded on the basis of concession and are on a Build Operate and Transfer (BOT) basis with the “ownership” of such assets resting with the State or Central Government.

4.4.4 Tenure and size of funds required: Infrastructure projects are typically long gestation projects involving high capital outlay and back-ended project returns. The sources of funds would hence have to be long term and provide for a sufficient moratorium.

4.4.5 Securitisation will benefit infrastructure financing because it:

- permits funding agencies whose sector exposures are choked, to continue funding to those sectors.
- permits the participation of a much larger number of investors by issue of marketable securities.
- lowers the cost of funding infrastructure projects; long term funding (a *sine quo non* for most infrastructure projects) is more feasible in securitised structures than conventional lending.
- facilitates risk participation amongst intermediaries that specialise in handling each of the component risks associated with infrastructure funding (while these may initially be borne by regular financial intermediaries and insurance companies, it is expected that specialised institutions would develop over time).
- shifts the focus of funding agencies to evaluation of credit risk of the transaction structure rather than overall project risk. This is because the other components of project risk (as mentioned above) would be borne by specialised intermediaries, at a fee.

4.4. 6 *Relevance of securitisation in some infrastructure sectors*

(a) Power

Various public sector units (PSUs) have a high financial exposure to state electricity boards (SEBs), some of which are sub-standard loans since several SEBs have inadequate solvency for meeting obligations on the due date. Securitisation in the power sector can be divided into the following segments:

- Receivables of PSUs such as National Thermal Power Corporation, Coal India Ltd., Power Finance Corporation, Rural Electrification Corporation, National Hydel Power Corporation, etc. from various SEBs can be securitised to reduce/rebalance financial exposure of these PSUs.
- Securitisation of SEB revenues for resource raising.

(b) Roads

Private sector road projects are expected to earn revenues from toll collections and concessions. However these projects carry multiple level of risks which could be summarised as under:

Construction risk – In event of inordinate delays in procuring land and completing implementation.

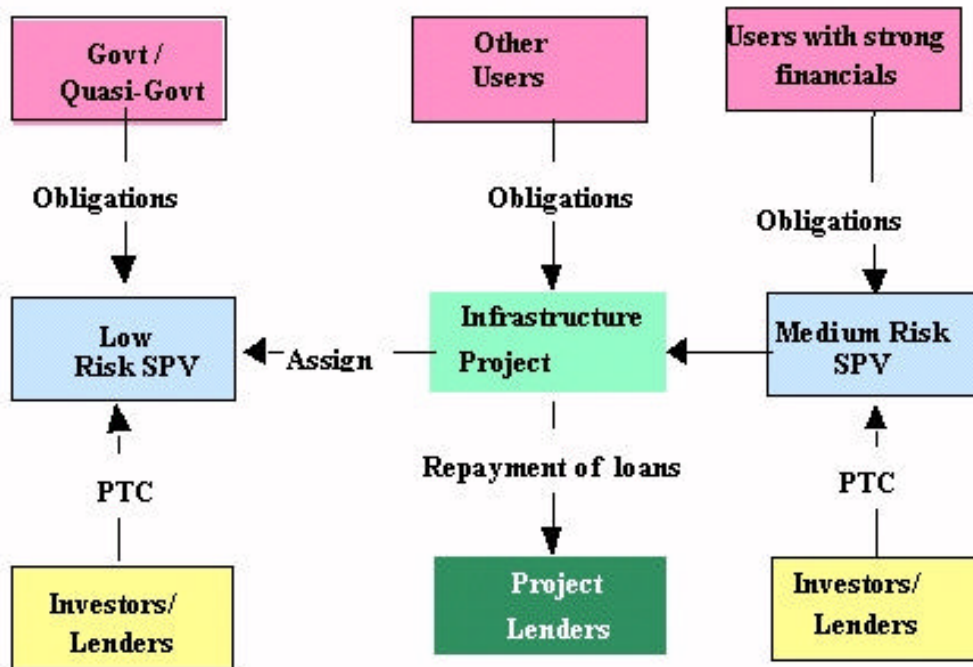
Traffic Estimation risk – Accuracy of estimating traffic in various segments i.e. commercial vehicles, buses, passenger cars, two wheelers and achieving desired traffic estimates

Toll collection risk – Intent and willingness of users to pay requisite tolls for usage.

Considering the multiple levels of risk, securitisation could be used to splice various levels of risks and thereby facilitate financial closure at an optimal cost of capital.

Following is an illustrative securitisation structure :

Figure 3 : Infrastructure Securitisation



In a typical road project, the Project Company could expect receivables from three broad categories of constituents. This could be classified under various "risk" categories as under:

- i) Low Risk Users - Government/Quasi Government agencies which may have provided concessions or awarded the project on a BOT basis. The Government or its agency would guarantee a minimum toll/traffic or would provide concession in the form of a fixed return. The guarantee element would carry the same risk as that of the Government agency providing such assurance. Receivables from this nature could be securitised to low risk investors.
- ii) Medium Risk Users - A road or a bridge to be constructed by the Project Company could be used in a large measure by industrial or corporate users, who would pay lump-sum tolls for usage of the road. The receivables from such entities could be securitised to users with a medium risk appetite.
- iii) Other Users - A road would be used by passengers, one-time users and others. The toll receivables from small users would continue to be received by the Project Company.

(c) Ports

The revenues of typical port projects would be in the nature of stowage and loading revenues levied on ships, which stop at the port of call. In addition, ports tend to provide storage facilities for chemicals, cargo, petroleum products, etc. to several large companies. The port authority/operator contract such storage facilities for a long tenure. The port revenues of this nature are suitable to securitisation.

(d) Urban Infrastructure

Primarily, the opportunity in urban infrastructure is in the areas of housing loans (the same has been covered under the section pertaining to mortgage securitisation). The other areas under urban infrastructure are water supply, sewage facilities, garbage disposal, etc

4.4.7 Further, the above list is illustrative and not exhaustive. Wherever a reasonably certain sum of money will be received over a certain time, not very short, securitisation possibility exists. In short, the scope of securitisation is vast; ultimately being limited only by the consideration that assets proposed to be securitised must fundamentally be income bearing.

4.5 Future receivables:

4.5.1 Providers of utilities such as electricity and telephone services have an excellent opportunity of securitising electricity meter rentals and telephone rentals. The receivables in these cases are very widely spread, and delinquency record very favourable. A specific case can be that of VSNL. Being the sole gateway for inward traffic of international calls, the company gets a large and steady inflow of foreign exchange, that is ideal for securitisation. Suggested accounting treatment for future flow receivables is given in Annexure – II (Para 15).

Export Receivables:

Securitisation of export receivables can be considered by (i) the financing FIs or (ii) exporters themselves. The basic requirement for securitisation would be that the receivables have a reasonable span of life so that they can be segregated and covered by a market instrument. The securitisation of export receivables over a medium to long term period could thus be securitised by any of the above entities. Among the Institutional lenders, EXIM Bank may be able to undertake securitisation since they are involved in financing exporters on deferred terms. Among the exporters, those engaged in export of capital goods may be able to do securitisation if the relevant mechanism is in place.

The export receivables are offshore dollar cash flow transactions as secured financing backed by future dollar receivables that can be isolated outside of India. In these transactions, the rights to receive future dollar cash flows can be transferred to an SPV outside India. The offshore vehicle issues the securities. As a result, the cash flows are first received outside India for payment to investors. Thus, it is possible to receive a rating on the securities higher than the India sovereign ceiling.

Because the primary goal in these transactions is to isolate the India sovereign risk, offshore dollar receivable transactions should be structured using special purpose vehicles outside of India. The securities that would be issued, moreover, would be dollar denominated and directed to investors outside of India. Consequently, these transactions are not affected by the legal issues in the Indian scenario. Such transactions are reported to have been done in Mexico. Exchange Control Department, RBI may examine the issue.

Forfeiture of concessional finance on exports:

Currently the RBI regulations state that export receivables must first be used to liquidate the packing credit facility or any other form of concessional export finance, if availed.

The concerned department/s of RBI may re-examine the issue keeping in view the international practice and the huge potential to securitise export receivables. RBI may consider issuing a clarification that exporters would continue to be eligible for concessional export finance in the event of a securitisation transaction being carried out as long as upfront purchase consideration is paid in foreign currency.

Credit card receivables:

Securitisation of credit card receivables is an innovation that has found wide acceptance. Although the average tenure of credit available to a credit card holder is generally very short

(less than two months), it is revolving in nature. The lacuna of short tenor of the receivables is hence overcome by 'substitution', whereby collections are used for fresh purchases of receivables. Thus a securitisable asset of marketable tenure comes into being. The structure in this case is generally pay-through, since it is impossible to match the payment made by the cardholder with the payment to the investor.

Originators are credit card divisions/subsidiaries of commercial banks, including a number of foreign banks.

Airline ticket receivables:

Future sales of airline tickets can be securitised considering the predictability of the cashflows from the same.

Future oil sales:

Oil sales from confirmed oilfields can form a large pool of assets that are suitable for securitisation, especially considering that the Obligors would normally be high quality corporates

Lease rentals:

Equipment and real estate leases exhibit characteristics that are amenable to securitisation, particularly in respect of a fixed payment schedule for the lease rentals. In the Indian context, there is ample scope for securitisation of these future flows in this asset class in view of the impressive growth of hire purchase and leasing finance companies, especially after the issue of guidelines by the RBI regulating their functioning. While portfolios of lease/hire purchase receivables are obvious choices, securitisation can also be attempted for lease rentals from individual commercial properties, provided they are sufficiently big and backed by an agreement. Structuring securitisation transactions in this asset class would have to take into consideration the payment schedule of the underlying receivables, i.e. balloon, bullet, front-ended, back-ended and so on. Incorporation of international risks is necessary in the case of import leasing and cross-border leasing.

Originators are NBFCs and leasing divisions of commercial banks.

4.6 The Indian Experience

4.6.1 Securitisation is a relatively new concept in India but is gaining ground quite rapidly. CRISIL rated the first securitisation program in India in 1991 when Citibank securitised a pool from its auto loan portfolio and placed the paper with GIC Mutual Fund (a case study of one of Citibank's subsequent deals is discussed later in detail). Since then, securitisation of assets has begun to emerge as a clear option of fund raising by corporates and a few transactions of well-rated companies have taken place in the country. While some of the securitisation transactions which took place earlier involved sale of hire purchase or loan receivables of non-banking financial companies (NBFCs), arising out of auto-finance activity, many manufacturing companies and service industries are now increasingly looking towards securitising their deferred receivables and future flows also. Information on past deals is not readily available, as most of them have been bilateral one-to-one and unrated transactions. In the context of rated transactions, CRISIL has rated about 50 transactions till date, with volume aggregating to well over Rs 4,500 crore. Other rating agencies in India, viz., ICRA, DCR and CARE have also been actively involved in the process. The majority of these being in the nature of outright sales of auto loan portfolios without subsequent issue of securities and do not amount to securitisation in the real sense. There has till date been no instance of downgrading of the rating assigned to any of these transactions. As per an estimate, out of the total asset securitisation attempted between 1992 and 1998, as much as

35 % relates to hire purchase receivables of truck and auto loan segment. The car loan segment of the auto loans market has been more successful than the commercial vehicle loan segment mainly because of factors such as perceived credit risk, higher volumes and homogeneous nature of receivables. Other types of receivables for which securitisation has been attempted include property rental receivables, power receivables, telecom receivables, lease receivables etc.

However, while several ABS transactions may have assumed a form similar to that of securitisation, the absence of marketable securities available for distribution to several investors would imply that in substance all these transactions partake of the essential characteristics of a structured loan deal rather than of a securitisation transaction. So far, 'Securitisation' in India was meant to imply any of the following distinct activities:

- Structured obligations against receivables (whether loans or debentures/bonds)
- Outright sale of financial/trade receivables without issue of securities
- Securitisation transactions involving assignment of receivables to an SPV and issue of securities backed by these receivables

In the first type, there is no legal true sale of receivables. The lenders/investors rely on a structured payment mechanism for timely servicing of their dues and not on the performance of the assets. Further, the receivables do not go off the balance sheet of the Originator and the lenders/investors continue to have full recourse to the Originator. In the second type, while the Originator would get the benefit of off-balance sheet funding, it fails to satisfy a basic requirement of securitisation i.e. issue of securities backed by these receivables. Securitisation is incomplete unless it involves an issue of (marketable) securities whereby the risks and rewards are channeled into the capital market (at least into the wholesale segment). Thus, only the third type of activity falls under the category of true securitisation as understood internationally.

The first two types are already witnessing some activity from certain lending institutions. Other players in the reckoning are multinationals like GE Capital and Citibank who have been acquiring asset portfolios generated by local NBFCs like Ashok Leyland Finance, 20th Century Finance and other companies like TELCO.

The third type of activity, which would involve issue of tradable securities either in the form of PTCs or structured debentures, is the one that is expected to see larger volumes in the long run. This segment would comprise within it, both corporates willing to raise funds against their assets as also FIs wanting to securitise their loan portfolios. In fact, organisations like HUDCO and Rural Electrification Corporation have already evinced interest in creating a securitisation structure for their future investments in the infrastructure area.

4.6.2 Some of the pioneering transactions that have either been concluded or are being structured in this regard are described in the following sections.

(a) Housing Loans

Housing loan portfolios are considered to be high quality assets with diversified risk and attractive returns. They are by their nature amenable to securitisation. In India however, in spite of outstanding to the tune of Rs 12,000ⁱⁱⁱ crore in the organised sector, no transaction has yet achieved successful completion. This needs to be analysed in light of the experience in the US markets, where the overwhelming majority of securitisation deals have been of housing loans or MBS.

However, of late there has been a perceptible positive orientation of Government policies towards securitisation for the housing sector. The five-year Plan documents have repeatedly

emphasised the need for developing a secondary mortgage market (SMM) for bridging the resource constraint confronting the housing sector. The Ninth Five-Year Plan has strongly recommended securitisation as an important source of funds for the housing sector and has envisaged Rs. 2500 crore to come by way of securitisation. The National Housing Policy (1992) of the Government of India also identified securitisation as an essential measure for generating resources for housing. In particular, it has emphasised the development of a SMM in the country in order to channelise funds from wide range of investors and help integrate the housing finance system with overall finance system, especially the capital market. That securitisation has come to represent a major policy plank of the Government, is further manifested in the recently announced National Habitat and Housing Policy (1998), which lays emphasis on the National Housing Bank (NHB) playing a lead role in mortgage securitisation and development of a SMM in the country. NHB has taken up the issue of securitisation with state Governments through the Ministry of Urban Development.

NHB is now proposing a pilot issue of MBS, as a prelude to the development of a SMM in the country. The pilot project involves securitising a pool of housing loans originated by four Housing Finance Companies. The pool would include unencumbered loans given to individuals for residential houses, in the states of Maharashtra, Tamil Nadu, Gujarat and Karnataka, with maximum loan to value ratio (LTV) of 80%. NHB would act as the SPV and facilitate the transaction. The issue is proposed to be launched in FY 1999 – 2000 and is expected to be a path-breaking issue for MBS transactions in the country. All the major procedural, legal, and taxation issues are in the process of being resolved in this transaction, thus paving the way for classical securitisation transactions to take off in the country.

As with the rest of the world, the potential for mortgage securitisation is enormous. In the case of mortgage securitisation there are specific issues that stymie the process. These are the long tenure of loans, low spreads, cumbersome foreclosure procedures, prepayment risks etc., all of which have led to its tardy progress. A major hurdle in India is simplified foreclosure norms. Once this happens, housing finance institutions (HFIs) will be able to tackle delinquencies effectively and will be willing to lend with less stringent credit evaluation. This is expected to enlarge volumes in the formal sector, helping a wider section of society (who would otherwise have approached the unorganised sector) to borrow at lower rates.

(b) Auto loans – Citibank Case

Citibank assigned a cherry-picked auto loan portfolio to People's Financial Services Ltd. (PFSL), an SPV floated for the purpose of securitisation by paying the required amount of stamp duty (0.1%) to ensure true sale. This is a limited company and can act only as SPV for asset securitisation. This SPV is owned and managed by a group of distinguished legal counsels. PFSL then proceeded to issue 'Pass Through Certificates' to investors. These certificates were rated by CRISIL and listed on the wholesale debt market of the National Stock Exchange (NSE), with HG Asia and Birla Marlin as the market makers. Global Trust Bank acted as the Investors' Representative. Citibank played the role of servicer. The certificates are freely transferable and each of the transfer will have a stamp cost of 0.10%.

The coupon of the security was high in spite of good quality of the underlying asset portfolio, because investors expected a premium to compensate for their unfamiliarity with the certificates. The investor base was limited mostly to MFs. FIs were hesitant because of the unsecured nature of the instrument and the absence of clarity on whether the certificates could be treated on par with other debt securities in their investment policy. Although the certificates were listed on the NSE, there was very little secondary market activity because there was absence of adequate amount of alternative security of similar risk profile.

Besides Citibank, NBFCs like Ashok Leyland Finance, 20th Century Finance etc. have securitised their auto loan portfolio, though, of course, these transactions involved assignment of receivables only and not issuance of securities. The asset portfolios were bought by one or two large institutions. TELCO has also reportedly sold over Rs 550 crore of its auto loan portfolio in multiple tranches through this route.

(c) SEB receivables – KEB case

Another important asset class for the purpose of securitisation pertains to the power sector. The Government is keen to securitise the outstanding dues of various State Electricity Boards (SEBs) and the total market of such receivables is estimated at around Rs.10, 000 crore^{iv}. However, securitisation of these receivables is feasible provided they are sufficiently credit enhanced, preferably with Government guarantee.

The initiative in this regard has been taken by Karnataka Electricity Board (KEB) who, in a recent transaction, are securitising around Rs 210 crore of their outstanding dues from various State owned public enterprises. The outstanding dues of KEB are being assigned to another State owned subsidiary, Karnataka Renewable Energy Development Ltd. (KREDL) which is acting as the SPV and in turn issuing securities. The securities are being credit enhanced by way of a guarantee from the Karnataka Government with a structured payment mechanism. HUDCO has agreed to be the investor and subscribe to the securities in full.

(d) Future Flows

Traditionally, existing receivables, where receivables are not contingent upon the performance of the Originator were securitised. The asset classes mentioned above viz. housing mortgage, auto loans, industrial loan receivables, etc. belong to the category of existing assets. As mentioned earlier, of late, 'future flow securitisation', is gaining momentum. Remittances from overseas workers, international telephone settlements, export receivables, future sale of oil and gas and other commodities, project cashflows and toll receivables are finding favour with investors. Some illustrations are given below:

(i) Future receivables - L&T case

The recent case of a power plant construction being financed through the capital markets is an example of future flow securitisation. Although Larsen & Toubro bagged the Build, Lease and Operate contract for a 90-MW captive power plant for Indian Petrochemical Corporation Ltd. (IPCL), it preferred to transfer it to an SPV – India Infrastructure Developers Ltd. (IIDL) which issued debentures in the private placement market. The debentures would be serviced out of the lease rentals due to IIDL from IPCL. L&T's guarantee was also available to a limited extent. The novelty of this transaction is that instead of a plain loan with say, 3:1 debt equity ratio, the project was financed in the form of a securitisation like structure through the capital market with a much higher gearing ratio.

(ii) RIICO case

This was the first attempt at issue of structured debt paper backed by the cash flows arising out of future receivables of a utility. Rajasthan State Electricity Board (RSEB) proposed to raise resources to the tune of Rs.250 crore, but, on account of its weak balance sheet, was not able to access the market directly. A structure was, therefore, devised whereby a pool of receivables comprising RSEB's high value customers was selected based on their payment history. The pool was then rated and credit enhancements were built. While no SPV was set up specifically for the purpose of the transaction, an existing profit-making Government Company, viz. Rajasthan State Industrial Development and Investment Corporation Ltd. (RIICO), was selected as the borrowing entity and the future cash flows and underlying receivables were charged to RIICO. The bonds backed by cash flows were issued by RIICO

to various investors by means of a privately placed issue. The investors continued to have recourse to the issuer i.e. RIICO in the event of shortfall in cash flows. The high stamp duties then prevalent, as also certain legal and market-related hurdles, delayed the introduction of full-fledged securitisation at that juncture.

Since the first issuance in 1991, the ABS have been very popular with the NBFCs in India. Over Rs.2000 crore of debt has been raised through this route^v. The repayment history of all the issues has been extremely satisfactory. The level of cash collateral to support 'AAA' rating has come down (from a peak of 16% to an average of 8%). While the investors enjoyed a higher yield, the cost to NBFCs was lower than the traditional sources such as bank loans and public deposits. The primary market size of commercial loans and auto loans is expected to be about Rs.11, 000 crore and grows annually by 6% - 8%.

4.7 General

4.7.1 EMs have high cost of raising funds and look for alternative sources for raising funds at cheaper sources. FIs in Asia have large illiquid debt to get rid off. These countries have the potential to benefit from securitisation as soon as the situation improves in South East Asia. Some of the countries in EMs have introduced specific securitisation laws. Eastern Europe offers good scope with the growth of consumer assets; export credit for traditional markets is growing in countries like Poland, Czech republic, Hungary, Slovakia. After the success of securitisation of credit cards and workers remittances in Turkey, other markets in the region like Israel, Lebanon, Egypt are ready for consumer type securitisation. Latin America is already on the path of active securitisation and is well ahead of the other EMs.

4.7.2 There is a huge potential for infrastructure finance in EMs. FIs can securitise their loans for infrastructure projects and the same can be sold to potential local or foreign investors. This presupposes a well-developed secondary debt market.

4.7.3 Government guaranteed loans may remain excluded from securitisation, as they are less efficient.

4.7.4 Privatisation is revolutionising the economic practices in the EMs. Banks are going to the markets for raising equity in the wake of reducing State funding. Their shares are being quoted in the stock markets. They are being forced to improve ROE and the efficiencies of the capital deployed. This gives them the opportunity to consider securitisation in an aggressive way.

4.7.5 Market penetration of FIs in the area of origination of loans will be determined more by the volume of loans originated during a period than by the amount of loans owned at a particular point of time.

4.7.6 Certain potentials for securitisation especially in the mortgage sector in India and elsewhere are as under:

Increasing share of tertiary sector, urbanisation and demand for houses

Reduction of poverty and fast development of enlightened middle/upper middle classes in India and elsewhere

Disappearance of joint family system and demand for new houses

Housing initiatives

The increasing size of the middle class and the resultant continuous increase in the demand for new houses as well as loans for renovation will increase the demand for mortgage finance in the EMs in future. Mortgages retain the major share of securitisation so far.

4.7.7 Presently, investors include FIs, special funds raised for the purpose of investment in ABS, pension funds, insurance companies, mainly from USA or Europe. Local investors from Asia look forward for higher returns, as their cost of raising funds is high. Saving rates in Southeast Asia have been 32 percent of GDP versus 21 percent in Latin America, according to ING Baring estimates. Although the local investors' appetite from these EMs is dependent upon the deepening of the markets, the huge savings may provide potential as the process for widening and deepening of these financial markets is taken up.

4.8 Future Prospects

4.8.1 In brief, securitisation will grow in future for two significant reasons:

a) securitised paper is rated more creditworthy than the FI itself

b) strict capital requirements are imposed on the FIs

4.8.2 Future trends in securitisation of assets will not only be influenced by those FIs who are knowledgeable about this process, and therefore, aware of its potential but will also be affected by the level of knowledge in the financial community as a whole as well as the perception of the regulators. While the benefits that securitisation brings in its wake are well documented, it may however, be worthwhile to examine whether the domestic financial markets are sufficiently developed to accept the product and utilise it efficiently.

4.8.3 The debt market has deepened and widened in recent years in India after the introduction of financial sector reforms. The recent recommendation of the committee on financial sector reforms (Narasimhan Committee Phase II) stipulates that the minimum shareholding by Government /Reserve Bank of India in the equity of the nationalised banks should be brought down to 33%. The same report also emphasises financial restructuring with the objective of, inter alia, hiving off non-performing-asset portfolio from the books of the FIs through securitisation. According to an estimate, Indian banks may be able to raise funds at 200 BP above US Treasury rate for an issue of US\$ 150 mn. with a maturity of five years, giving them a gain of 200 to 400 BP. over the domestic rates after taking care of related expenses. The securitised paper can be raised in a period of 16 weeks after signing the mandate with advisors/lead manager. The costs involved are advisors' fee to the tune of 1.5% of issue size, rating agency fee US \$ 300,000, legal expenses US\$ 500,000 and road shows US\$ 100,000. The guidelines of RBI restricting the quantum of the public deposits that can be raised by an NBFC have given them further incentive to look for alternative sources of funds. The opening of the insurance sector for privatisation can create demand for the securitised paper.

4.8.4 The Indian financial system is sound and very well developed. A number of new financial products have arrived and been tested in the market during the brief period since the reforms began. The past few years have also witnessed a healthy trend towards computerisation of transaction and information management systems. The availability of computer technology would thus permit the capture and manipulation of large databases, which are a basic requisite in structuring, securitised products.

The debt market is poised for substantial growth with the development of the sovereign yield curve across different maturities and the active participation of primary dealers.

The Indian market has existing well-developed institutions, specialised regulators in Banking, Capital Markets, Rating Agencies and also a well-developed regime of controls and supervision.

The infrastructure sector has already started witnessing contracting of debt in a tradable form by most lending institutions. This has been concurrent with the advent of Structured Debt Obligations which has in turn familiarised Rating Agencies to 'SO' ratings.

The existence of specialised financing institutions like Housing Finance Companies, Urban / Infrastructure development Bodies like Housing and Urban Development Corporation (HUDCO), Rural Electrification Corporation (REC) etc. who not only have existing securitisable portfolios but also have the capacity to keep creating such assets with a view to securitising them. Since most such institutions are facing resource constraints, securitisation will enable them to focus on their core competency of supporting infrastructure products through the gestation stage and securitising them later, rather than funding them till maturity. The domestic financial institutions are fast reaching their prudential limits in various sectors. Further lending by them to these sectors is thus dependent upon their being able to securitise their existing portfolios.

4.8.5 The investors with long term funds have traditionally favoured equity and Government securities portfolio and have stayed out of debt. Also the present illiquidity of the loan portfolios does not allow FIs to actively manage or manipulate the related sector, interest rate or maturity risks. This places a restriction on further asset expansion, as assets once taken on the books necessarily need to be carried till maturity. Securitisation will provide solution for their requirements.

4.8.6 The market is thus at a stage where debt is increasingly going to be offered in a tradable form, whether or not secondary market trades take place in individual cases. Securitisation, by converting debt into tradable financial instruments, provides an opportunity for more efficient reallocation of sector specific risks among a more diversified set of players. By offering an exit option, it channelises surpluses that have so far remained untapped, to capital-deficient sectors of the economy.

ⁱ National Housing Bank

ⁱⁱ Infrastructure Leasing and Financial Services (ILFS)

ⁱⁱⁱ National Housing Bank

^{iv} SBI Capital Markets Ltd.

^v Citibank, Mumbai