CRISIL Ratings

Securitisation

Bridging a funding gap

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Executive summary

The securitisation[1] market, a key funding avenue for non-banking financial companies (NBFCs), witnessed a rise in activity in fiscal 2024, taking the annual volume to a peak of Rs 1.9 lakh crore. The growth momentum was driven by enhanced market participation, with securitisation attracting more originators, including banks, as well as investors, a bouquet of asset classes, and innovative structures.

The step-up in market activity more than compensated for the loss of volume due to the exit of a large housing finance company (HFC) originator following its merger with a bank in the second quarter of fiscal 2024. The HFC had accounted for 23% of the volume in fiscal 2023. While the overall market grew 5%, adjusted for the large HFC's volume, growth was 27%.

In terms of asset classes, vehicle loans displaced mortgages[2] at the top, cornering a share of over 40% in fiscal 2024. While microfinance and personal loans improved their share in the securitisation pie to 16% and 5%, respectively, the share of business loan securitisation more than doubled vis-à-vis fiscal 2023, to 11%.

The volume mix is expected to gravitate towards these asset classes in fiscal 2025, given the high expectations of credit growth and recent regulatory/corporate actions affecting gold loan and mortgage securitisation. The share of mortgage-backed securitisation fell to 17% in fiscal 2024 from 33% in fiscal 2023, while the gold loan securitisation share dipped to 6% from 7%.

The split between pass-through certificates (PTCs) and direct assignments (DAs) also saw significant changes last fiscal. PTC pools, where the underlying loans are sold to special purpose vehicles (SPVs) that issue instruments to investors, increased their share to 55% from 42% in fiscal 2023, hitting record volume of over Rs 1 lakh crore. DAs, where loan assets are sold directly to acquiring banks or NBFCs, accounted for the rest.

PTCs are expected to increase their share further in fiscal 2025 as they offer better investor protection through credit enhancements and transaction structures ensuring timely payouts. The share of DAs will decline due to the expected reduction in gold (due to regulatory action on one originator) and mortgage (due to merger of the largest HFC originator with a bank) securitisations, as well as rise in co-lending arrangements.

The securitisation momentum should sustain in fiscal 2025, and volume could reach a new peak as NBFCs[3] look to diversify their funding avenues to meet increasing retail credit demand following recent regulations that increased the risk weights for banks lending to them.

On the demand side, banks are the dominant investor class, accounting for 90% of securitisation investments as they look to increase exposure to retail assets with robust performance track record. Participation by other investors, such as mutual funds, insurance companies and alternative investment funds, has been rising, too, as securitisation transactions offer scope for customisation as per investor requirements.

With banks also exploring securitisation as an alternative channel for fund-raising, given the lagging deposit growth vis-à-vis credit growth, the market is set to be a critical, reliable and efficient source of funds for financiers looking to diversify their resource profile.

[1] *Refers to structured finance transactions including pass-through certificates and direct assignment transactions*
[2] *Mortgages refer to housing loans and loans against property, typically originated by HFCs*
[3] *NBFCs include HFCs and microfinance institutions (NBFC-MFIs)*

Securitisation volume scales peak of Rs 1.9 lakh crore

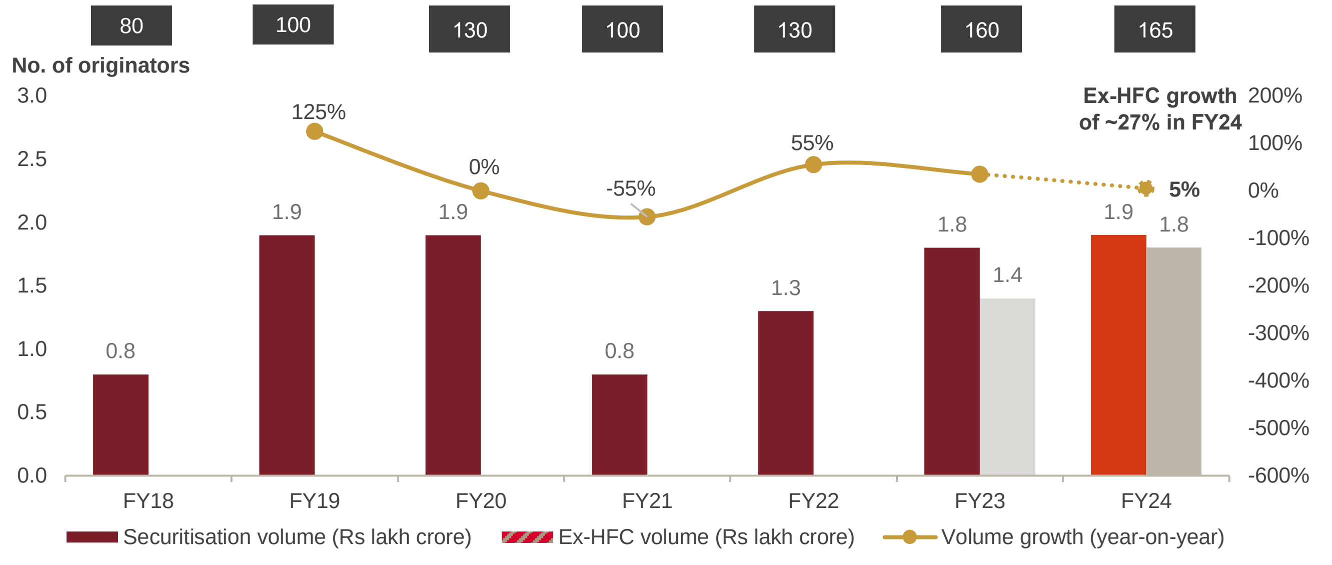
Securitisation volume reached the all-time high of Rs 1.9 lakh crore in fiscal 2024, previously scaled in fiscals 2019 and 2020. Back then, securitisation had emerged as a key funding avenue in the aftermath of liquidity and funding access challenges faced by many NBFCs from fiscal 2019. Plus, there was policy support in the form of partial credit guarantee schemes offered by the Government of India to NBFCs.

While fiscal 2021 saw volume drop as the pandemic curtailed disbursements and impacted loan collections, the market has made remarkable recovery with the revival in retail credit growth post-pandemic and in loan collections. Plus, the market is now more broad-based, with the number of originators rising from 100 in fiscal 2019 to 165 in fiscal 2024.

While the volume growth in fiscal 2024 was lower at 5% (vis-à-vis 35% and 55% in fiscals 2023 and 2022, respectively), it is important to note that this growth was despite the exit of the largest HFC originator from the market post its merger with bank. If one were to exclude the HFC volume from the market, the volume growth was 27%, signifying the continued relevance of securitisation as a fund-raising avenue for non-banks.

While large NBFC originators continue to drive volume, the participation of mid-size NBFCs has also increased with time. Cherry-picked pools have exhibited stable performance across business cycles, even in adverse market conditions, which has boosted investor confidence in the segment. This has helped even mid-size NBFCs tap the securitisation market.

Chart 1: Securitisation volume (Rs lakh crore) and originator base (including both DAs and PTCs)



Source: CRISIL Ratings estimates

Note: Numbers in boxes represent the number of originators that undertook securitisation during the year

The volume is also supported by the continuing retailisation agenda of banks that are dominant investors. Historically, bank investments were driven by priority sector lending (PSL) requirements, which were being met through investments in PSL-compliant loan pools. However, of late, banks have increased their exposure to non-PSL pools as well, which allows them to enhance exposure to retail assets as well as generate higher yields.

Changes underway in asset classes, securitisation routes

Regulatory/corporate actions in the NBFC space are leading to changes in the market composition in terms of asset classes and the split between DA and PTC routes of securitisation. The emergence of co-lending will also play a role in how securitisation shapes up going forward.

Mortgages, gold loans cede market share to other asset classes

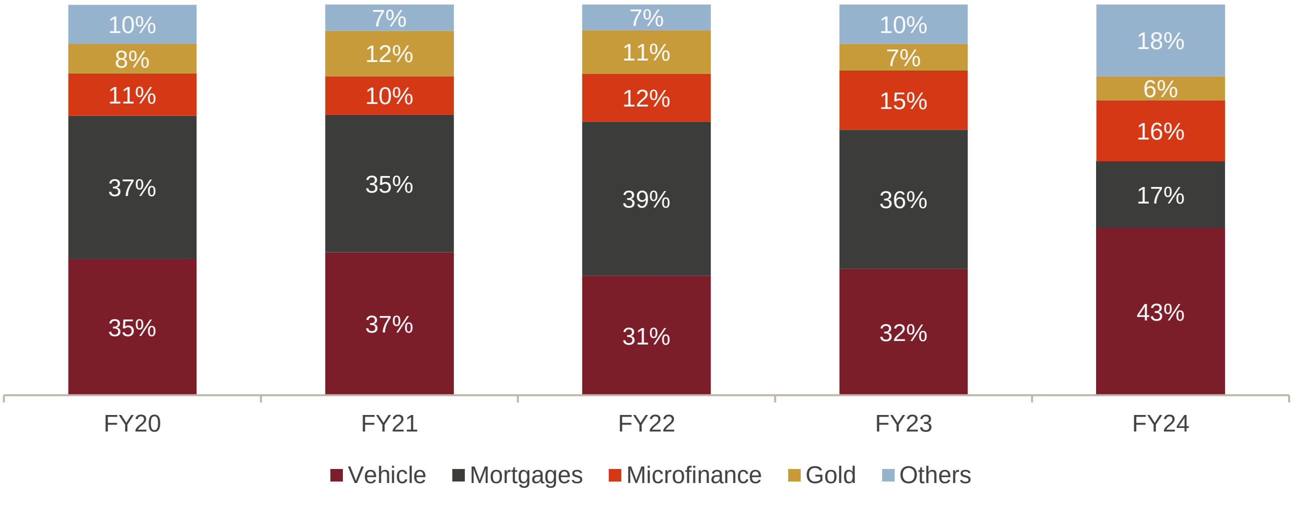
In terms of asset classes, traditionally, investors preferred mortgage, vehicle and microfinance loan pools. However, the landscape is evolving rapidly, with a broad array of asset classes being securitised now. For instance, apart from the rise in the volume of securitisation of business and personal loan pools, last fiscal saw a pickup in asset classes such as education loans and supply chain financing, too.

Mortgages lost its position as the largest asset class in securitisation. The share of mortgage-backed pools fell to 17% in fiscal 2024 from 33% in fiscal 2023 on account of the exit of the largest HFC originator post its merger with the bank in the second quarter of last fiscal. Gold loan securitisation share also declined to 6% from 7% in fiscal 2023. Regulatory actions on gold loans are expected to lead to a further drop in gold loan securitisations.

The volume mix is expected to gravitate towards vehicle loans, microfinance, business and personal loans in fiscal 2025, given high expectations of credit growth in these segments. The share of these asset classes in the securitisation mix is already on the rise.

Vehicle loans are the largest asset class in the securitisation market now, cornering the highest market share in fiscal 2024 (43% versus 31% in fiscal 2023). Microfinance accounted for 16% against 15%, share of business loan securitisation more than doubled to 11% from 5% and personal loan securitisation inched up to 5% from 4%.

Chart 2: Asset class mix in the securitisation market



Source: CRISIL Ratings estimates; Vehicle loans include two-wheeler transactions, which formed ~2.5% of overall volume in FY24; Others comprise business (11%), personal (5%), education loans and lease-backed transactions

PTCs gaining ground over DAs

PTC pools volume crossed Rs 1 lakh crore for the first time in fiscal 2024, growing ~40% on-year, while DA volume dropped ~15% to Rs 0.85 lakh crore, mainly on account of the exit of the large HFC and impact of regulatory actions on gold loan DAs in the last quarter of the fiscal. The share of PTCs in securitisation overtook DAs for the first time in 10 years to reach 55% in fiscal 2024 (42% in fiscal 2023).

Among asset classes, PTCs accounted for 82% of vehicle loan securitisation volume (the largest asset class in the market), 71% in personal loans, and 44% in the business loan segment. Among mortgages and microfinance, while DAs accounted for the majority, PTCs accounted for over 35% of volume. PTCs made a re-entry in gold loans last fiscal after a gap of two years, accounting for 3% of the gold loan securitisation volume.

Chart 3: Share of DAs, PTCs

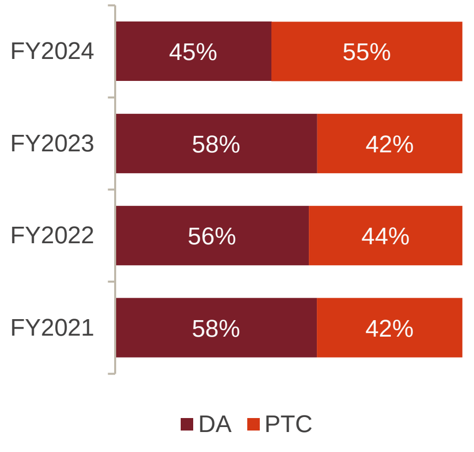
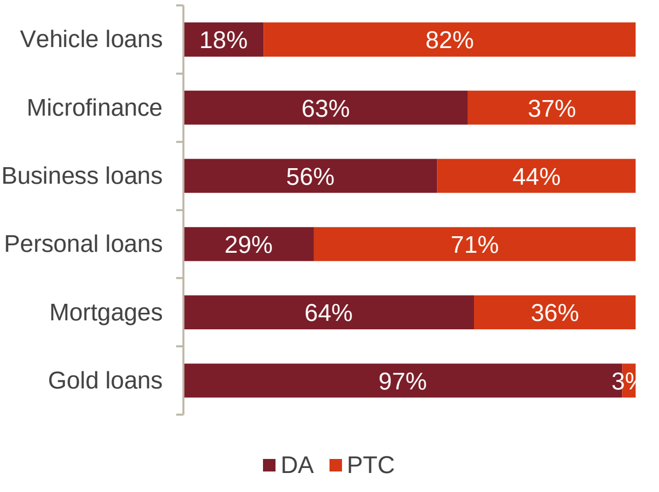


Chart 4: DAs vs PTCs across asset classes in fiscal 2024



Source: CRISIL Ratings estimates

DAs are expected to decline further, especially in mortgages and gold loans. Personal loan DAs also face headwinds due to the recent increase in risk weights for unsecured consumer credit by 25%. However, given the healthy credit growth in the segment, PTCs should continue gathering pace.

DAs are also likely to be affected by the pick-up in co-lending arrangements. Co-lending assets under management (AUM) of NBFCs are nearing ~Rs 1 lakh crore after more than five years since the model came into being and are expected to grow 35-40% annually over the medium term[4]. The growth in co-lending, supported by the controlled asset quality seen so far in the co-lending portfolio of banks and NBFCs, could eat into DA volume.

PTCs, on the other hand, are expected to remain a key funding source, enabling access to different sets of investors, including capital market players. PTCs offer better investor protection through the presence of credit enhancements to cover for shortfalls in pool collections and meet investor payouts. The performance track record of pools backing PTC transactions has been healthy post pandemic, enhancing investor comfort.

PTCs also offer structuring flexibility to customise issuances to meet investor requirements. Innovative structures, such as replenishing structures and transactions with trigger-based turbo amortisation, are seeing increased popularity among stakeholders across various asset classes. Such innovations could deepen the PTC market by enabling better alignment of originator and investor interests.

[4] *https://www.crisilratings.com/en/home/newsroom/press-releases/2024/04/nbfc-co-lending-aum-closing-in-on-Rs-1-lakh-crore-mark.html*

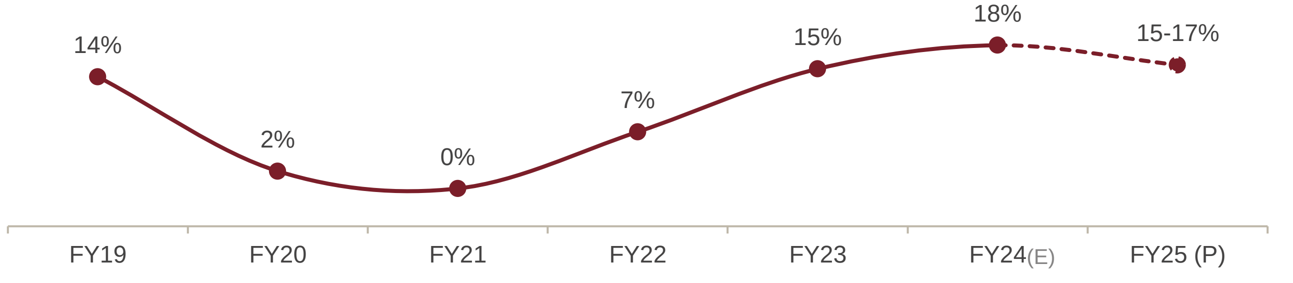
Factors aligning to create environment for growth

The securitisation momentum is expected to continue with both supply and demand-side factors aligning to create a favourable environment for growth. The key factors that are expected to drive growth are as follows:

1. Resource diversification by originating NBFCs amid risk weight increase on bank funding

On the supply side, NBFCs, which are the largest originators of securitised pools, have seen double-digit growth in AUM in the previous two fiscals, riding on rising demand for retail credit. Strong credit demand across retail segments, a resilient economy, stronger balance sheets with healthy liquidity, capital and provisioning buffers, and better asset quality are seen driving AUM growth of 15-17% in fiscal 2025.

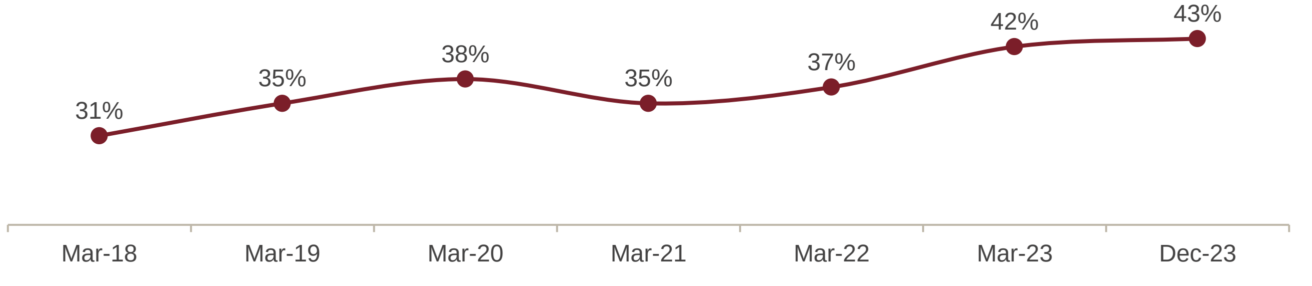
Chart 5: AUM growth of NBFCs



Source: Company data, RBI publications, CRISIL Ratings estimates; NBFC AUM growth data excludes HDFC Ltd

To fund growth, NBFCs relied largely on bank loans over the last few years. The share of bank borrowings in the NBFC resource mix increased from 31% in March 2019 to 43% in December 2023.

Chart 6: Share of bank borrowings in NBFC resource mix



Source: Company data, RBI publications, CRISIL Ratings estimates

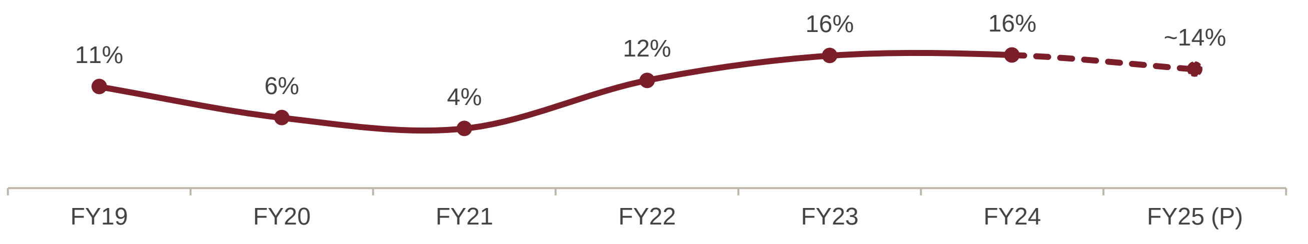
However, given the increase in risk weights for bank lending to NBFCs (excluding HFCs and NBFC-MFIs) by 25% as per the regulatory guidelines issued in November 2023, availability of bank funding this fiscal at optimal cost will be a key monitorable for NBFCs as banks factor in the enhanced risk weights while deciding their exposure limits and lending rates to NBFCs.

Bank credit to NBFCs saw signs of moderation in the latter half of fiscal 2024 with annual growth as of March 2024 at 13.3% compared with 30.2% as of March 2023. Ergo, funding diversification will be imperative for NBFCs. Herein, securitisation is expected to be an important fund-raising tool to support the growing credit demand.

2. Retail loan appetite, risk weight considerations of investing banks

On the demand side, banking credit growth is expected to be healthy, albeit a tad lower, at ~14% this fiscal. Healthy credit growth, along with appetite for retail loans and PSL requirements, will drive acquisitions of retail loan pools by banks from NBFCs.

Chart 7: Banking credit growth



Source: Company data, RBI publications, CRISIL Ratings estimates

Moreover, securitisation offers potential for banks to fund the retail credit growth of NBFCs without a direct exposure to NBFC balance sheets, which now attract higher risk weights. It also allows banks to earn better risk-adjusted returns, given the typically higher yields offered by PTCs and lower risk weights compared with direct lending to NBFCs in the 'A' and above rating categories.

Chart 8: Risk weights for bank exposures – lending to NBFCs vs investments in PTCs

Rating category	Risk weights - Loans to NBFCs	Risk weights - Investments in PTCs
AAA	45%	20%
AA	55%	30-45%
A	75%	50-70%

Risk weights for NBFCs (excluding HFCs and NBFC-MFIs) rated in 'A' category and above have been increased by 25% as per regulatory guidelines issued in November 2023

Risk weights for PTCs pertain to senior tranches with five-year maturity; ranges represent potential changes in risk weights based on rating modifiers. Risk weights could also vary based on the tranche maturity

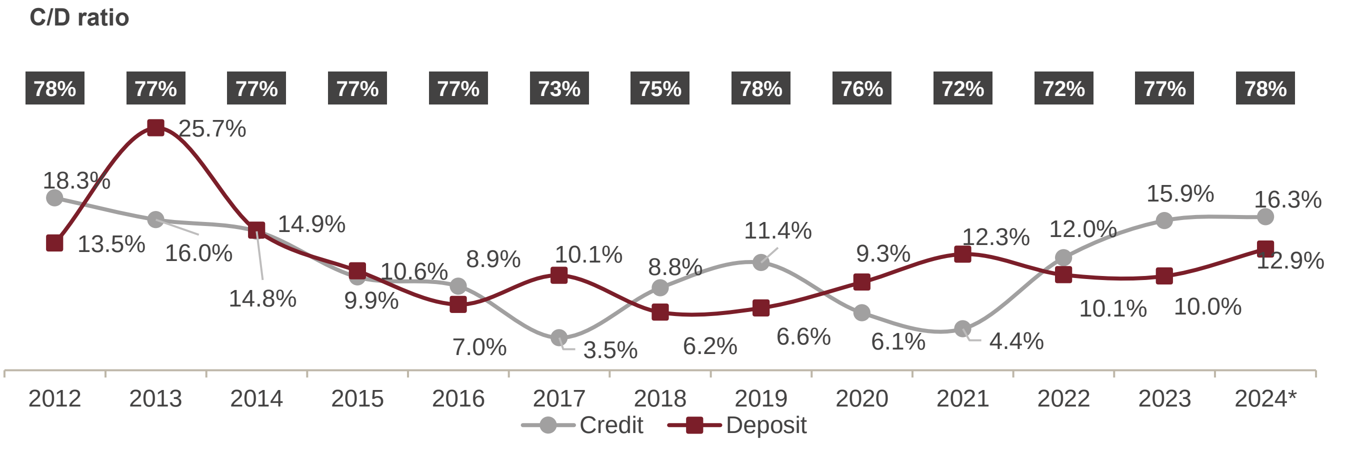
3. Entry of banks as originators

Banks are gradually making a footprint as originators in the securitisation market. Bank-originated volume rose ~50% to Rs 10,000 crore in fiscal 2024 from Rs 6,600 crore in fiscal 2023. While originators were primarily small finance banks, recent quarters saw the entry of a private sector bank too.

With deposit growth continuing to lag credit growth, banks are scouting for alternative avenues for raising funding to fuel their credit growth. The overall banking system credit-deposit ratio was 78% as of March 2024, which is a decadal high, and deposit rates are on the rise. More banks, especially those with higher credit-deposit ratios, are therefore expected to evaluate securitisation in the near to medium term to diversify their fund-raising avenues.

Securitisation can be an efficient funding avenue for banks, without attracting incremental cash reserve ratio (CRR) and statutory liquidity ratio (SLR) requirements. It also allows banks to better manage the asset class mix in their loan book, PSL requirements and asset liability maturity mismatches.

Chart 9: Trend in credit vs deposit growth of banks



Source: RBI

**As on/for the year ended March 22, 2024*

Note: Adjusted for merger of HDFC Ltd with HDFC Bank; numbers in boxes depict credit-deposit ratio

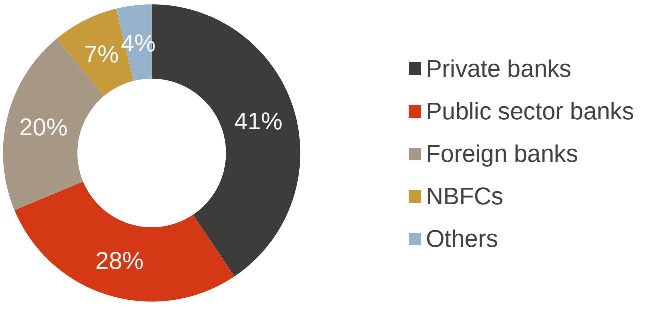
4. Entry of new investors

Among investors, our estimates indicate that banks account for ~90% of the market volume. While investments by private sector banks account for ~41% of volume, public sector and foreign banks account for ~28% and ~21%, respectively. Private sector and foreign banks prefer the PTC route for securitisation, whereas public sector banks predominantly acquire retail loan pools via the DA route.

While banks continue to be the dominant investor class, participation by other investors has been on the rise in recent years. NBFCs now account for ~7% of the investments in the market, diversifying their loan books through DAs and funding smaller NBFC customers through PTCs.

Capital market investors such as mutual funds, private credit funds and insurance companies are also eyeing investments in PTCs, accounting for 4% of the securitisation volume in fiscal 2024. While mutual funds are gradually raising investments in highly rated PTCs backed by secured asset classes such as vehicle and small business loans, alternative investment funds are targeting the mid-rated PTC segment across asset classes. Insurance companies are also warming up to investments in highly rated, long-dated residential mortgage-backed securities in the market.

Chart 10: Investor mix in the securitisation market (fiscal 2024)



Source: CRISIL Ratings estimates; Others include mutual funds, private credit funds, insurance companies, etc.

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Conclusion:
Securitisation will remain an important funding source

Securitisation is set to reach new peaks in fiscal 2025, as NBFCs and banks look to diversify their funding avenues to meet increasing credit demand amid tighter liquidity and regulatory environment. Wider stakeholder participation, including entry of new originators and investors, innovative transaction structures and new asset classes are all indicators that securitisation will remain a critical, reliable and efficient source of funds.

PTCs, which offer credit enhancements for investor protection and structuring flexibility, are emerging as the preferred route while DAs are facing a natural de-growth due to the impact of regulatory/corporate actions and growth in co-lending. The sustenance of healthy collection performance in securitised pools and interest rate movements will bear watching, given their potential to impact the attractiveness of securitisation.

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