Critical Success Factors in Asset Securitisation in Indian Banks

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Abstract. Asset securitization is the structured business process whereby Banks' loan assets and other receivables are packaged and sold in the form of 'as-set-backed securities' (ABS), thereby loan originators transfer some of their loan-risks to third parties. Asset securitization considers a pool of performing/non-performing retail loan assets and through financial engineering models, transforms them to tradable security by involving a Special Purpose Vehicle (SPV) that issues Negotiable Instruments (like Bonds/Promissory Notes/CPs) called Pass Through Certificates (PTCs) to Investors. In Indian context, most asset securitization deals are done on Direct Assignment (DA) basis through retail loans-asset pool transfer to pool-buyer Bank with no SPV in between and hence no tradable security. This Research study analysed 'Critical Success Factors (CSFs)' in Indian model of asset securitisation and in the process also analysed its associated business-processes, systematic-risks, Issues & challenges. This study sourced its primary data from hands-on deal-practitioners and Subject Matter Experts (SMEs) associated with deal-participating entities and through qualitative data analysis technique of Narrative analysis and Applied Conversation analysis, the research-findings are concluded. Towards future prospects and challenges, this study suggests for setting up 'Centre of Excellence (CoE) for Assets Securitisation' in each bank, for 'building product-expertise and evolve appropriate asset-pricing-models for deals and PTC securities. The study also suggests for an 'Enabling IT systems' that support automated deal-processes, risk-monitoring and compliance tracking'. These two aspects would facilitate for better deal-transparency and for making informed decisions by deal stakeholders.

Keywords: Asset Securitisation · Bank · Systematic Risks · Direct Assignment

1 Introduction

Asset securitisation market has grown to become a prominent fixed income sector, and the securitised assets are backed by diverse and ever-expanding array of asset-pool receivables including Credit card receivables. Loan assets of Banks/FIs that are mostly non-transferable and non-tradable, gradually becoming disadvantageous and devoid of liquidity. Transforming loan-assets into securities in order to acquire characteristics of

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marketability is the crux of asset securitisation and it uses the revenue stream generated by the underlying assets to raise finance. Assets are transferred to SPV, that intermediates between primary market for the underlying assets and secondary market for issuing Negotiable Instruments (Bonds, Commercial papers), called Pass Through Certificates (PTCs) to Investors. These PTCs are issued without any recourse to deal-originator and Investors can hold SPV only liable for meeting the payment obligations.

As an established practice amongst Indian Banks & FIs, deal Originator identifies asset pool on the basis of asset type (ex. MFI loans, Vehicle loans, retail-housing loans, Gold loans etc.), and defines pooling-criterion based on: 'asset quality (AA rated & above), residual loan-tenure (12–36 months) and identical loan Interest rate'. Almost 90% of Banks/FIs included in this research executed its asset securitisation deals through Direct Assignment (DA) basis, wherein, the Originating Bank sells a part of their loan-book by creating an asset-pool, involving internally rated (AA & above) loan assets, and selling at a fixed interest rate to the buyer bank/FI, as an out-right sale without involving SPV. A small percent of asset securitisation deals exe-cuted involving SPV that also acted as Trustee and issued PTCs, which are like cou-pon-bearing Bonds/Commercial Papers for Standard Assets, and Security Receipts (SRs) for Stressed Assets/NPAs (Mandal, & Maiti, 2018) [2].

This research was conducted with the primary objective of anlaysing 'critical success factors in asset securitisation', and in tandem included the secondary objectives as 'analysing key business processes/deal types/deal execution model, associated Systematic risks, and Issues & challenges'. This research study was performed in Semi-structured & In-depth Interview method involving 25–30 leading Industry Practitioners (IPs)/Subject Matter Experts (SMEs) from a set of 8–10 leading Public & Private Sector Commercial Banks/FIs, through primary source of data collection method. It used the qualitative data analysis technique of 'Narrative analysis' that is its structural version combined with 'Applied Conversation analysis' method, for structuring the contents of conversations between researcher and respondents.

1.1 Asset Securitisation Deal Processes and Types

This study analysed the business process flows in asset securitisation deals, key characteristics of Direct Assignment & PTC types of deals. The research data confirms that all survey participating entities prefer executing DA type of deals as against PTC route, considering the immediate liquidity benefit available to deal Originators (Malik, 2008) [7]. The Fig. 1 provides an easy understanding of key business process involved DA & PTC types of asset securitisation deals. The CSFs include - key business benefits including achieving lending targets & compliance norms, supporting IT systems, immediate liquidity support (Chilukani, 2018) [3].

1.2 Characteristics of DA Type of Deals

- Mostly performing & internally-rated (AA & above) retail-asset pool having same loan type, Interest rate and residual maturity (say 12–24 months)
- Deals getting executed within 5–7 business days.

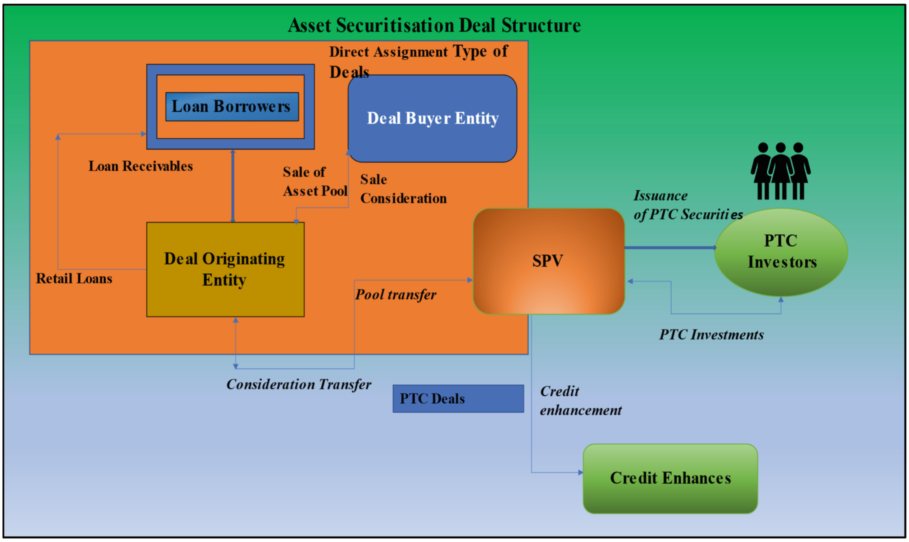


Fig. 1. Business processes in asset securitisation

- Asset replacement facility within 120 days for any default in pool account loan repayment or becoming non-performing asset (NPA).
- Post deal execution, assets are moved from On-balance sheet in the Seller's books and buyer bank includes the same as its on-balance sheet accounting.
- Deal Originator retains the pool accounts at their end (without transferring to buyer bank) and instead issues monthly 'Chartered Accountant Certificate' confirming its health and continuing as 'performing asset'.

1.3 Characteristics of PTC Type of Deals

- Either performing or non-performing (D'Souza A, 2018) [1], externally rated, having matching cash-flow loan accounts are pooled and sold/transferred to SPV for issuing PTC securities to retail/corporate investors and traded in OTC. Normal deal time execution spans to 30–45 business days.
- No asset replacement facility available instead discounted pricing is considered for NPA type of asset-pool.
- Post deal execution, assets are moved from on-balance sheet and off-balance sheet entries are created in Seller's books.

Asset securitisation deals amongst Banks/FIs are mostly on Direct Assignment (DA) basis comprising 60% of deal volume while remaining 40% of deals executed through PTC type, that is often executed between NBFCs & HFCs (Housing Finance Companies). Figure 2 provides deal-types executed in last 5 years by all market participants.

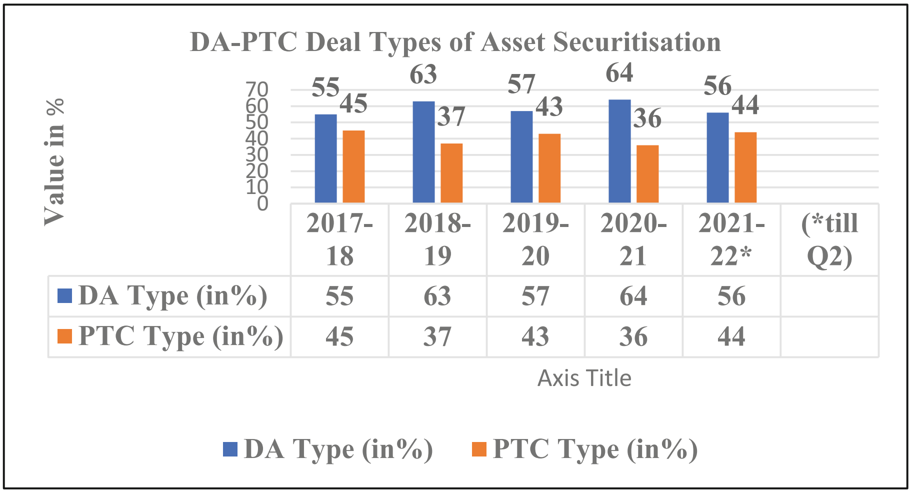


Fig. 2. DA & PTC type of deals in the last 5 years

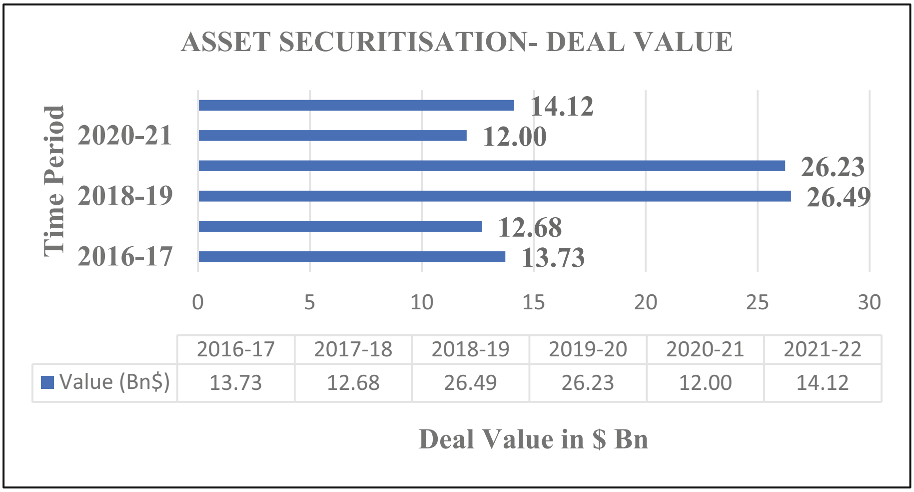
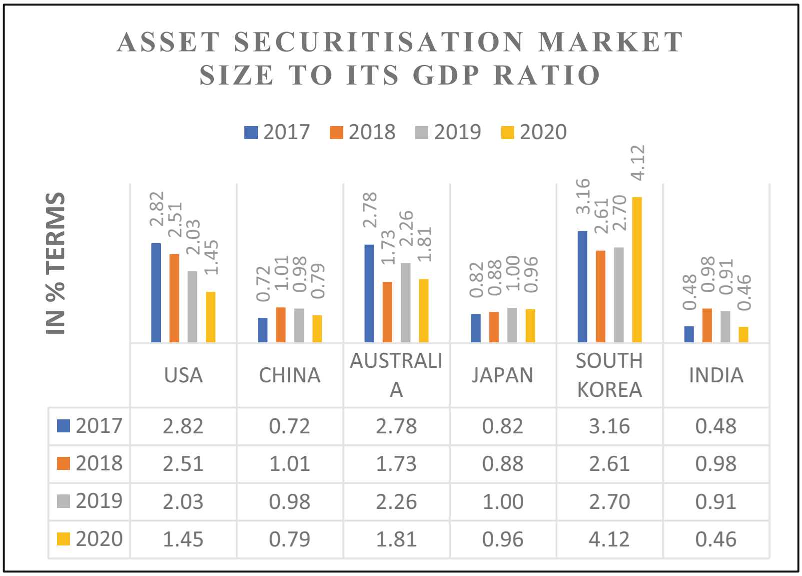


Fig. 3. Deal value in the last 5 years

1.4 Asset Securitisation Deal Value and Market Size

Asset securitisation recorded trade volume of Rs 1.26 lakh crore in FY22 and it is projected to go up to Rs 1.70 lakh crore for FY23, as per latest estimates of ICRA. Below diagram, provides a trend on asset-securitisation deal volume in last 5 years amongst all Banks/FIs in India (not pertaining to survey participating entities alone) (Fig. 3).

Figure 4 provides a comparative analysis of Asset Securitisation market size to its GDP of some leading financial markets. This data highlights the fact that there exists



	USA	CHINA	AUSTRALIA	JAPAN	SOUTH KOREA	INDIA
2017	2.82	0.72	2.78	0.82	3.16	0.48
2018	2.51	1.01	1.73	0.88	2.61	0.98
2019	2.03	0.98	2.26	1.00	2.70	0.91
2020	1.45	0.79	1.81	0.96	4.12	0.46

Fig. 4. Market size to tis GDP

significant opportunity in Indian financial markets for executing more asset securitization deals and for introducing more tradable securities through PTC structures in its secondary market operations.

Asset securitisation volume in Indian financial market remains at USD 14.12 billion comprising 0.32% of its GDP for FY 2021–22 as against its market size in US at USD 304 Bn, accounting for 1.45% of its GDP for FY 2021, supported by the fact that overall GDP of United States (USD 21 Trillion) is nearly 6 times the size of GDP of India and US asset securitisation market assumes 4.5 times the size of Indian market size.

2 Asset Securitisation - Critical Success Factors (CSFs)

Research survey participating Banks identified some of the key success factors in structuring & executing asset securitisation deals (Romero-Torres, Bhatia, Sural, 2017) [8]. These success factors are analysed - from the perspective of 3 key stake holders, namely, Deal-Originators, Deal-Buyers, Investors, the 'Three Pillers of Asset Securitisation market' and provided here under.

2.1 A CSFs from Deal Originator Perspective

The most critical success factor for deal originator being – 'Bouquet of business benefits' accruing out of asset securitisation deals as below:

- Optimisation of PSL loan book by removing excess holding with minimal credit enhancement, thereby giving high confidence on the asset pool based on internal

ratings (Kara, Marques-Ibanez, Ongena, 2019) [5]. Availability of Rated & Performing Assets constituting the asset pool along with Credit enhancement and asset substitution facility is a key CSF (Bothra, 2016) [6].
- Sell for profit – Originators able to sell at 150 to 300 basis points over & above the average holding-cost of asset-pool, resulting in immediate income booking with considerable spread.
- Immediate liquidity – on account of quick realisation of cash, through its future interest receivables and loan-repayments. This contributes for increased liquidity and banks can utilise these funds for expanding their Credit utilisation and Investment portfolio with alternate assets.
- Removing from on-balance sheet at one-stroke - thereby trimming-down Banks' Credit-portfolio to the extent of 5000 to 10000 Crores by executing a couple of asset securitisation deals.

2.2 Other Critical Success Factors

- Manage Asset-Liability mismatch - Asset securitisation is used as a tool for adjusting Banks' asset liability mismatches (ALM) in terms of matching maturities and interest rates buckets. Banks' Treasury function ensures the assets and liabilities are well balanced in its interest-rate and maturity-buckets with the execution of couple of Asset securitisation deals (Garg, 2017) [4].
- Availability of reliable IT systems – that supports for: easy identification of pool-asset accounts based on pooling-criterion, cash flow projection for loan-receivables.
- Tapping of low-cost funds for better liquidity through asset securitisation - considering increasing Repo rate & Interbank-borrowing costs
- Freeing up of Capital, as Originating Bank is not required to maintain capital against the transferred assets, hence managing Capital Adequacy Ratio (CAR) become easier.

2.3 CSFs from Deal Buyer Perspective

The most critical success factor for Deal buyer being 'Bouquet of business benefits' accruing out of asset securitisation deals as below:

- Comply with PSL, CDR norms - with ease of efforts & timeline by executing a couple of asset securitisation deals involving performing & rated retail asset-pool. If not for asset securitisation deals, buyer Bank would need to spend considerable human effort & time towards - borrower identification, loan sanction, loan disbursal and end-use tracking for a few thousand- retail loans through its multiple Branches. This single stroke transaction at Zonal office/Head office level richly contributes for meeting their PSL/CDR norms at shorter turn-around-time (TAT).
- High deal-transparency & quality asset-pool with asset-substitution facility ('True sale Criteria' document - that gets executed between Assignor/Originator & Assignee/deal buyer), confirms the quality of asset-pool, and the same is certified by Law Firms. Additionally, 'Credit Loss Estimation Report' can be obtained from Rating agencies for the asset-pool and this provides for any possible loss arising out of pool accounts.

Other Critical Support Factors:

- Reduced cost-of-acquisition - In the event of increasing interest rate scenario, buyer bank is able to acquire a pool of quality & rated assets at a relatively reduced-cost when compared to direct (cost-of-funds) & indirect costs (human efforts & time factor) involved in actual distribution of hundreds of retail loans through multiple branches.

2.4 CSFs from PTC Investor Perspective

The most critical success factor for PTC Investors, being 'Higher yield on securitised debt instruments' - by 50 to 150 bps above the conventional bonds.

- Higher ROI for high-rated instrument that implies better recovery rates. When the pool of assets securitised lead to improved collection performance, their yield be-comes higher with lower risks.
- Most of the securitised asset tranches are given AAA rating by the Rating agencies considering the quality of the underlying asset-pool. These high ratings are made possible through a combination of features, such as bond insurance, letters of credit and asset-substitution features.

Other Critical Support Factors:

- Flexibility to buy any asset-tranche with higher yield and meeting their risk-appetite & maturity timeline.
- Availability of flexible PTC type of securities such as - Credit Default Swaps (CDS), Asset Backed Credit Default Swaps (ABCDS), Asset Backed Commercial Papers (ABCP) type of hedging instruments for hedging against pool-account defaults and borrower delinquency.

3 Analysis of Past Deals and Its Challenges of Systematic Risks and Its Mitigation

Please It may be recalled that Systematic risk is the 'overall risk that is inherent to the financial market or for the whole sector and is not specific to individual Bank/FI'. Some of these systematic risks, as shared by survey-respondents mainly from Senior Management cadre, pertain to:

- Variations in bench-mark lending rate (pegged to Repo/Reverse Repo rates) by RBI
- Insolvency risk of Originator due to business uncertainties/financial scams
- Default-risk of pool-loan accounts' repayments
- Regulatory & Compliance risk on asset securitisation deals as stipulated by RBI, SEBI.

Some of the mitigation plan as narrated by survey-respondents of both Originating Bank and Buying Bank are:

- Securitisation agreement may include a clause to pass-on the benefit arising out of Lending Interest rate fluctuations to pool-buyers, as its mitigation.
- Recourse to pool-assets is not available for Originator and RBI SSA Directions prohibits buy back of pool-assets by the Originator. Deal agreement may address the Insolvency- risk and include the loan receivables too, as part of the Insolvency proceedings.
- Towards mitigating the default-risk, Deal agreement may reiterate upon adding a clause for asset substitution in case of repayment-default/becoming NPA including PTC type of securities
- Introducing online compliance Tracking mechanism through IT software applications, regular auditing and real time reports including system monitoring and raising alerts, will mitigate the regulatory & compliance risk aspect.

4 Analysis of Past Deals and Its Challenges

During primary data collection, the researcher focused to understand the volume of asset securitisation deals done by survey participating Banks/FIs in the last 5 years and the associated Issues & Challenges. This list is provided in Table 1.

5 Research Implications

This study opens up scope for other researchers to take up more detailed research focussing on evolving appropriate deal pricing models for asset securitisation deals & pricing of PTC securities. On the same note, the Banking Policy makers & Regulatory bodies may evolve business-policies for 'loans-trading' by Banks/FIs/NBFCs in addition to creating a framework & guidelines for banks to invest/participate in PTC securities and its secondary market trades. This leads to evolving and establishing a '2-2-2 business rule' that refers to "2 Critical aspects of Success Factors- supporting 2 Critical Functions - leading to 2 Critical Research Implications". This 2-2-2 business rule is explained below.

Critical Aspects Success Factors:

Critical Aspects Success Factors:

- Optimisation aspect (efficient way of Asset Liability Management & Liquidity Management)
- Compliance aspect (complying with PSL, CDR, CAR norms)

Two Critical Functions of every Bank/FI

- Credit function
- Treasury/Investment function

Critical Functions of every Bank/FI

- Credit function

Table 1. Deal size, business issues & challenges in the last 5 years

FY (Apr-Mar)	Deal Value (in Rs) & Deal Count (in Number)	Key Business Issues & Challenges
2021-Sep '22	24,000 Crs (10)	Non-availability of appropriate 'risk-management tool' to assess default-risk, pre-payment risk of pool-accounts. Lack of adequate IT-system support for deal structuring, repayment & pre-payment tracking.
2020–21	12200 Crs (8)	Post-covid impact led to low to deal-volume coupled with Banks' reluctance to part with performing retail asset-pool. Non-availability of established price discovery mechanism for deal-pricing, was another challenge.
2019–20	14000 Crs (12)	Impact of Covid towards low credit off-take for retail loans and re-adjustment of loan repayments (repayment holiday due to lock-downs)
2018–19	11500 Crs (8)	*Deals were value driven and not volume driven.* Lack of regulatory support from RBI and Deal Incentives in the form of Guarantee-support (Bothra, 2016) [6].
2017–18	6300 Crs (6)	Mostly NPA accounts were considered in the asset pool and Banks preferred for 'outright selling to Asset Reconstruction Companies (ARCs) with appropriate hair-cuts', instead of asset securitisation route.

- Treasury/Investment function

Critical Research Implications

- Research scope for research scholars and academic-Thinktanks for-
- Evolving Mathematical models for asset pricing' for deals & PTC Securities
- Risk management experts to evolve appropriate 'Risk-measurement tools' for quantifying and monitoring Pre-payment risk, Default-risk, Pool-borrower delinquency risk, Compliance risks.

– Design Scope for evolving Business Policy & Investment Guidelines – by Banking Policy makers and Regulatory bodies to evolve framework & guidelines for 'loan-trading' by Banks/FIs/NBFCs, and also appropriate Investment Guidelines to invest in PTC assets. In addition, scope for evolving Accounting standards & relevant Taxation methods for asset securitisation deal Originators/SPVs/Buyers/Investors.

6 Conclusion

In order to provide further impetus towards asset securitisation market operations and its stake-holders, the survey respondents recommended for 2 essential 'make-over-approaches'. First towards – 'Setting up Asset Securitisation - Centre of Excellence (CoE)' at every Bank level, for 'building product-expertise and evolve appropriate asset-pricing-models' for deal-pricing and pricing of PTC type of Securities & its derivative products such as Collateralised Debt Obligations (CDOs), Collateralised Loan Obligations (CLOs), Asset Backed Credit Default Swaps (ABCDS), Asset Backed Commercial Papers (ABCPs) etc., both from Credit product perspective as well Investment perspective for investing in PTC assets. The CoE may be assigned responsibility for cascading theoretical and practical knowledge on asset securitisation to middle and senior level managers of the Bank and build product competency for a wider section of banking professionals. Second suggestion towards 'Evolving relevant IT Systems' that supports automated-processes for deal-structuring/evaluation/execution/deal-pricing and risk assessment tools for evaluating pre-payment risk, default-risks, real-time cash flow projection details for pool-assets through its life-cycle. This would richly facilitate for 'making more-informed-decisions' by deal originator/deal buyer/PTC investors, besides enabling better deal-transparency & active stake holder participation.

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