CRISIL
An S&P Global Company

Treatment of securitisation in ratings of finance companies

February 2018

CRISIL
An S&P Global Company

Criteria contacts

Pawan Agrawal
Chief Analytical Officer – CRISIL Ratings
Email: pawan.agrawal@crisil.com

Somasekhar Vemuri
Senior Director – Rating Criteria and Product Development
Email: somasekhar.vemuri@crisil.com

Ramesh Karunakaran
Director – Rating Criteria and Product Development
Email: ramesh.karunakaran@crisil.com

Ajit Velonie
Director - CRISIL Ratings
Email: ajit.velonie@crisil.com

In case of any feedback or queries, you may write to us at Criteria.feedback@crisil.com

Executive summary

The effect of securitisation on the balance sheets of finance companies is a crucial credit quality consideration, given that securitisation is a key funding source for the country's non-banking finance companies (NBFCs) and housing finance companies (HFCs).

Securitisation essentially involves the legal transfer of assets (or receivables) by an originating institution to a third party, typically referred to as a special-purpose vehicle (SPV). The SPV then issues asset-backed securities (or pass-through certificates) that are claims against specific asset pools.

Securitisation benefits originators' resource profile primarily by increasing the diversity and flexibility of their funding sources, enhancing liquidity, and reducing funding costs. In addition, securitisation may prove beneficial to credit quality by positively influencing asset and data management in the long term, thus potentially enhancing the efficiency and profitability of originators.

Securitisation also improves the asset liability maturity profile of originators (especially HFCs) as long-term assets are replaced by cash. In addition, transferring the credit risks on the assets securitised frees the capital required to maintain those assets, which is termed as 'capital relief'.

CRISIL's rating methodology for finance companies factors in the rating process an evaluation of each securitization transaction on a case-by-case basis. The analysis includes an assessment of the securitization transaction's impact on the originator's capital, asset quality, earnings, and liquidity. This comprises assessment of the risks (both legal and practical) retained by the originator and how much capital would be economically appropriate against these risks, whether the assets are off-balance sheet or on-balance sheet.

Criteria for assessing the impact of securitisation

CRISIL evaluates the impact of securitisation[1] on the capital, earnings, funding, and liquidity of the originator on a case-to-case basis.

Impact on capital

In its evaluation of the adequacy of finance companies' capital, CRISIL employs a broad-based approach that goes beyond the regulatory capital adequacy ratio. As part of its analysis, CRISIL also evaluates the impact on the capital adequacy if the off-balance sheet securitised assets are brought back on the balance sheet. Similarly, CRISIL calculates adjusted gearing by factoring in off-balance sheet assets as part of total external debt. In the Indian context, the credit enhancement is typically provided by originators (unlike third-party credit enhancement providers in the international context).

[1] *For accessing previous published document on " Treatment of securitisation in CRISIL's ratings of finance companies", Kindly follow below mentioned link:*
https://www.crisil.com/content/dam/crisil/criteria_methodology/criteria-research/archive/CRISIL-Ratings-research-treatment-securitization-finance-cos_2007.pdf

While the capital treatment of credit enhancement provided is well-defined by the Reserve Bank of India, CRISIL evaluates the risks retained by the originator (in terms of credit enhancement provided, assumptions on credit losses, and the like) by reviewing the performance of the various securitisation transactions. Thus, CRISIL is able to determine the appropriate level of capital support required for the off-balance sheet assets.

Impact on asset quality

In a securitisation transaction, investors typically select loans with better origination characteristics. Moreover, securitised loans being standard till the minimum holding period, exhibit superior collection performance than the rest of the portfolio. Therefore, CRISIL's analysis of asset quality adequately factors in the relatively weaker performance of the residual assets. To analyse the overall asset quality, CRISIL also looks at a peer group comparison of the asset quality on a managed basis including securitised contracts.

Impact on earnings profile

Originators in a securitisation transaction typically retain residual benefits in the securitised loans in the form of upfront premium/profit or excess interest spread. As per the revised guidelines on securitisation issued in 2012, the profit/premium can be recognised based on amortisation of principal and losses incurred; as well as specific provision requirements on the securitisation exposures at the end of every financial year. The excess interest spread can be recognised in the profit and loss account only on cash basis. Additionally, a part of the risk is retained by the originator in the form of investment and credit enhancement. Originator needs to provide adequate provisioning against these risks. CRISIL factors in these aspects by evaluating return on managed assets for NBFCs and HFCs with an off-balance sheet loan portfolio as the metric for measurement of profitability. Apart from reported total assets, managed assets include the off-balance sheet portion of loan assets under management.

Impact on liquidity

In CRISIL's view, funding diversification is one of the important advantages of securitisation for finance companies. By using securitisation as an alternative funding source, finance companies get additional funding options. Moreover, securitisation also helps an originator manage its asset liability maturity profile by perfectly matching payouts with receivables from underlying loans. However, these benefits can be illusory if a company relies too heavily on securitisation or any other single funding source.

About CRISIL Limited

CRISIL is an agile and innovative, global analytics company driven by its mission of making markets function better. We are India's foremost provider of ratings, data, research, analytics and solutions. A strong track record of growth, culture of innovation and global footprint sets us apart. We have delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers.

We are majority owned by S&P Global Inc., a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

About CRISIL Ratings

CRISIL Ratings is part of CRISIL Limited ("CRISIL"). We pioneered the concept of credit rating in India in 1987. CRISIL is registered in India as a credit rating agency with the Securities and Exchange Board of India ("SEBI"). With a tradition of independence, analytical rigour and innovation, CRISIL sets the standards in the credit rating business. We rate the entire range of debt instruments, such as, bank loans, certificates of deposit, commercial paper, non-convertible / convertible / partially convertible bonds and debentures, perpetual bonds, bank hybrid capital instruments, asset-backed and mortgage-backed securities, partial guarantees and other structured debt instruments. We have rated over 24,500 large and mid-scale corporates and financial institutions. CRISIL has also instituted several innovations in India in the rating business, including rating municipal bonds, partially guaranteed instruments and microfinance institutions. We also pioneered a globally unique rating service for Micro, Small and Medium Enterprises (MSMEs) and significantly extended the accessibility to rating services to a wider market. Over 1,10,000 MSMEs have been rated by us.

CRISIL Privacy Notice

CRISIL respects your privacy. We use your contact information, such as your name, address, and email id, to fulfil your request and service your account and to provide you with additional information from CRISIL and other parts of S&P Global Inc. and its subsidiaries (collectively, the "Company") you may find of interest.

For further information, or to let us know your preferences with respect to receiving marketing materials, please visit www.crisil.com/privacy. You can view the Company's Customer Privacy at https://www.spglobal.com/privacy

Last updated: April 2016

Argentina | China | Hong Kong | **India** | Poland | Singapore | UK | USA
CRISIL Limited: CRISIL House, Central Avenue, Hiranandani Business Park, Powai, Mumbai – 400076. India
Phone: + 91 22 3342 3000 | Fax: + 91 22 3342 3001 | www.crisil.com
/company/crisil @CRISILLimited /CRISILLimited /user/CRISILLimited

CRISIL
An S&P Global Company