ICRA
A MOODY'S INVESTORS SERVICE COMPANY

STRUCTURED FINANCE

Delinquencies remain high in softer buckets; extent of slippages in harder buckets would be a key monitorable

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OUTLOOK

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While the total collections indicate a considerable recovery, the current collections including overdues (against current month billings) remain below the pre-lockdown levels

A spike was seen in softer bucket delinquencies (i.e. 0+dpd and 30+dpd) in October 2020 compared to the pre-moratorium period

The spike in softer bucket delinquencies was least in the MBS pools (i.e. HL and LAP) and highest in the CV pools (includes tractor and construction equipment sub-pools); nonetheless, the unsecured loans, i.e. microfinance and SME loans, also showed a considerable increase

ICRA expects stable credit quality of its rated securitisation transactions led by prospects of further recovery in collections as the economy and business activity rebound

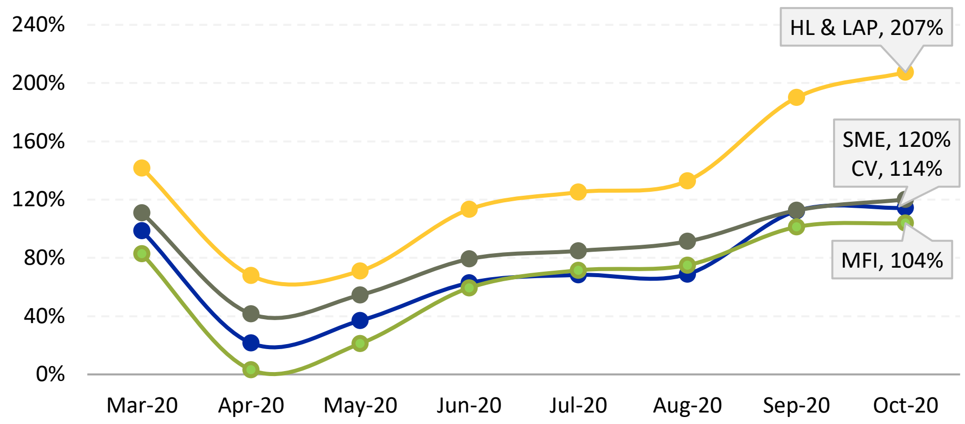
- The collection efficiency in ICRA-rated retail loan pools (originated largely by non-banking financial companies or NBFCs and housing finance companies or HFCs) remained steady in October 2020 for almost all the retail asset classes. While the total collections (including advances, overdues, prepayments) indicate a significant recovery, the current collections inclusive of overdues (against current month billings) remain below the pre-lockdown levels, i.e. in the range of 81% to 95% across asset classes in October 2020.
- The collections in the mortgage-backed securities or MBS segment [home loan (HL) and loan against property (LAP)] remained healthy on account of the prevailing online collection practices and the better repayment capacity of the salaried customers. Within MBS, affordable HL and LAP pools have shown a marginally lower but better recovery in collections compared to other asset classes. Within asset-backed securities or ABS (excluding microfinance), loan against gold (GL), two-wheeler (TW) loans and SME loan pools have shown higher collections compared to the vehicle loan pools.
- Compared to the pre-moratorium levels, the spike in delinquencies in the softer buckets was the least in the MBS pools (i.e. HL and LAP). However, the delinquencies in commercial vehicle (CV) pools (includes tractor and construction equipment sub-pools) have been the highest followed by unsecured loans i.e. microfinance (MFI) and SME loans, which have also shown a considerable rise in their 0+ days past due (dpd) and 30+dpd compared to their pre-moratorium levels (i.e. February 2020).
- ICRA had observed a rise in delinquencies in the 0+dpd bucket in September 2020. The delinquencies in the 0+dpd bucket in October 2020 remained largely at the same elevated levels, indicating no material improvement from the previous month. Across retail asset classes, ICRA notes that more than 1/3rd of the delinquent borrowers (in 0+dpd) slipped into the 30+dpd bucket in October 2020.
- During the moratorium period, there was no material cash collateral (CC) utilisation for most of the transactions despite the lower collections as investors had provided a moratorium on the pass-through certificate (PTC) payouts. On the basis of a sequential improvement in collections post the moratorium, the possibility of significant utilisation of CC in future remains low. Thus, ICRA expects stable credit quality of its rated securitisation transactions amid prospects of a further recovery in collections as the economy and business activity rebound.

Collection Efficiency[1] Remains Steady In October 2020 Across Retail Asset Classes In ICRA-Rated Securitised Pools

The collection efficiency in ICRA-rated retail loan pools (originated largely by NBFCs and HFCs) remained steady in October 2020 for almost all the retail asset classes. While the total collections (including advances, overdues, prepayments) indicate a significant recovery, the current collections including overdues (against current month billings) remain below the pre-lockdown levels, i.e. in the range of 81% to 95% across asset classes in October 2020. Consequently, delinquencies in the softer buckets (0+dpd) that had seen a spike in September 2020, following the end of the moratorium period, remained high in October 2020, though there has been no material increase in the slippages. The considerable improvement in total collections witnessed in the months following the end of the moratorium in August 2020 was supported by higher collections in the form of advances, overdues and prepayments. This was driven by heightened collection efforts, the adoption of advance digital platforms/payment gateways and the rebound in economic and business activity. Further, the lower-than-estimated impact of the Covid-19 pandemic in rural and semi-urban areas has provided a much-needed impetus to the recovery rates.

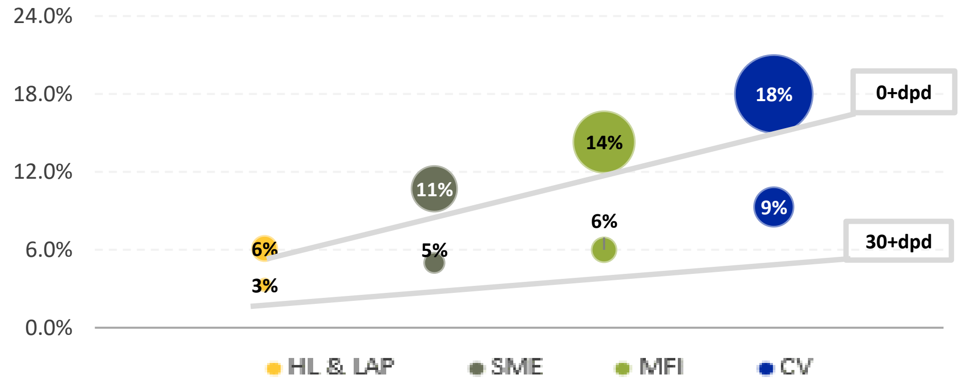
Despite the high job losses seen in certain sectors, the MBS segment (HL and LAP) remained the least impacted by lockdowns amid the pandemic and showed a substantial sequential recovery in collections after falling in April 2020. The collections in the MBS segment remained healthy till October 2020 on account of the prevailing online collection practices and the strengthening of borrowers' repayment capacity due to the restoration of their salaries to the pre-moratorium levels and the release of bonuses and increments by most of the firms. Within MBS, affordable HL and LAP pools have shown a marginally lower but better recovery in collections compared to other asset classes. Within ABS[#] (excluding microfinance), GL, TW loans and SME loan pools have shown higher collections compared to the vehicle loan pools. Despite the local political challenges and natural calamities in a few states, the collections in microfinance pools saw a substantial recovery by October 2020 after dipping to the lower single digits in April 2020.

Exhibit 1: Asset class-wise collection trend[1] in ICRA-rated pools



Source: *ICRA research, Industry*

Exhibit 2: Asset class-wise softer bucket delinquencies as of Oct-20 in ICRA-rated pools



Source: *ICRA research, Industry*

[1] *Collection efficiency = (current collections + advance collections + overdue collections + prepayments)/current billings as per pre-moratorium schedule;* [#] *Represents CV, construction equipment, tractor, TW, GL, personal loan (PL) & SME*

LOWER INCREMENTAL DETERIORATION IN OCTOBER THOUGH DELINQUENCIES REMAIN ABOVE PRE-MORATORIUM LEVEL

ICRA notes that robust collection infrastructure (i.e. systems, IT, and teams), better geographical spread, borrowers in rural/semi-urban areas and engaged in essential goods or business activities have been the key contributors to the strong recovery in the collections of the entities/pools. However, the current collections remain below the pre- moratorium level as of October 2020, leading to higher slippages in the softer buckets (i.e. 0+dpd and 30+dpd) post the end of the moratorium. Compared to the pre-moratorium levels, the spike in delinquencies in the softer buckets has been the least in the MBS pools (i.e. HL and LAP) vis-à-vis other asset classes due to the financially better borrower profiles and predominant digital collection methods. Nonetheless, the increase in delinquencies in the softer buckets in the HL and LAP pools was mainly on account of the relatively lower collections in the affordable HL and LAP pools. However, the delinquencies in the CV pools (includes tractor and construction equipment sub-pools) have been the highest in the aftermath of the localised restriction on inter-state transport movement following the lockdowns and lower economic activity, especially in areas like construction, real estate and mining. The unsecured loans, i.e. MFI and SME loans, have also shown a considerable increase in their 0+dpd and 30+dpd levels compared to their pre-moratorium levels (i.e. February 2020).

COMPARISON OF SOFTER BUCKET DELINQUENCIES WITH PRE-MORATORIUM PERFORMANCE IN ICRA-RATED POOLS

Exhibit 3: Asset class-wise 0+dpd

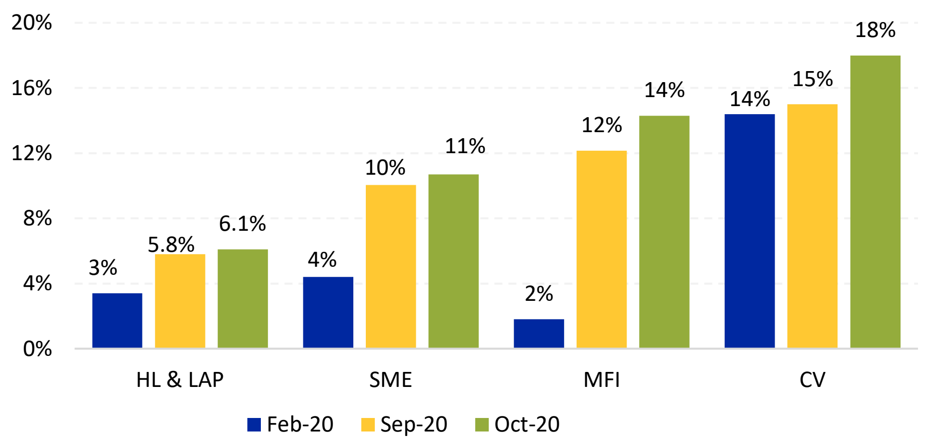
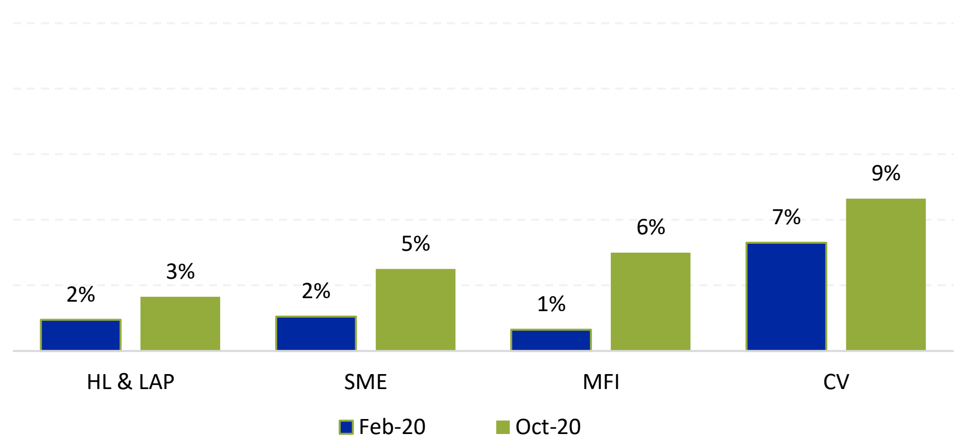


Exhibit 4: Asset class-wise 30+dpd



Source: *ICRA research, Industry*

ICRA had observed a rise in delinquencies in the 0+dpd bucket in September 2020. The delinquencies in the 0+dpd bucket in October 2020 remained largely at the same elevated levels, indicating no material increase from the previous month. Across retail asset classes, ICRA notes that more than 1/3rd of the delinquent borrowers (in 0+dpd) slipped into the 30+dpd bucket in October 2020. The delinquencies in the 30+dpd bucket are higher than the numbers seen in the pre-moratorium period and ICRA expects a part of the same to slip further to the 90+dpd bucket depending upon the collection efforts of the entities and improvement in the borrowers' willingness/ability to repay. In ICRA's opinion, higher slippages in harder buckets would be a concern as recovery from harder buckets would be difficult, given the impact of the pandemic on economic activity and the repayment capability of retail borrowers. Also, the weaker borrower profile prevalent in microfinance would find it difficult to pay multiple instalments making it additionally difficult to roll back from harder buckets. In case of unsecured loans, higher slippages in harder bucket delinquencies would result in the losses being higher than seen in the past due to the absence of a collateral. Nonetheless, ICRA is of the view that the originators would aim to elevate their collection efforts with greater intensity to confine the pace of increase in slippages and delinquencies.

Credit quality of ICRA-rated securitised pools of retail loan receivables to remain resilient

ICRA continues to observe its rated portfolio to identify any material shortfall in collections such that the CC provided as credit enhancement has to be utilised considerably. During the moratorium period, there was no material CC utilisation for most of the transactions despite the lower collections due to investors approval for moratorium on the PTC payouts and change in payout structure to timely interest and ultimate principal (TIUP) for some pools. On the basis of a sequential improvement in collections post the moratorium, any possibility of significant utilisation of CC remains low. Only 4% of the transactions in the ICRA-rated portfolio witnessed cumulative CC utilisation in excess of 10% as of October 2020. Further, ICRA has compared the break-even collection efficiency (BECE) and the collection efficiency of its rated transactions to assess the risk of default in case of variations in collection efficiencies. It was noted that around 5% of its rated portfolio has a BECE almost equal to the collection efficiency while additionally 10% of the transactions have a BECE of less than 10-20% of the collection efficiency, indicating high and moderate default probability in case of deviations in collections. However, ICRA highlights that since the calculation of the BECE does not take into account the overdue collections, they remain available to offset the impact of deviations in collection efficiencies to some extent as well. Thus, ICRA expects the credit quality of its rated securitisation transactions to remain stable amid prospects of a further recovery in collections as the economy and business activity rebound. However, the ICRA-rated securitisation transactions' credit quality would remain exposed to any sustained weakening in the originators' asset quality and credit profile.

Outlook

ICRA expects the delinquencies (90+dpd) to rise for most of the securitised retail loan receivables across asset classes as the softer bucket delinquencies (0+dpd and 30+dpd) have witnessed a considerable spike in October 2020 compared to the pre-moratorium period. However, the pace of increase in harder bucket delinquencies would be decided by the incremental collections trend and the borrower repayment behaviour. Since lower collections during the moratorium period did not result in any material CC utilisation for most of the transactions as the investors had provided a moratorium on the PTC payouts and collections rebounded rapidly, the chances of significant utilisation of CC in future basis a sequential improvement in collections remain unlikely. Thus, ICRA expects the credit quality of ICRA-rated securitised retail pools to remain stable on account of the availability of sizeable credit enhancements and the expectation of a further recovery in collections supported by a rebound in the economy and business activities in H2 FY2021. ICRA is of the view that the originators would aim to elevate their collection efforts with greater intensity to confine any possibilities of higher-than-expected slippages and delinquencies.

ICRA
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ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

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The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder. The participation of Moody's is supported by a Technical Services Agreement, which entails Moody's providing certain high-value technical services to ICRA. Specifically, the agreement is aimed at benefiting ICRA's in-house research capabilities, and providing it with access to Moody's global research base. The agreement also envisages Moody's conducting regular training and business seminars for ICRA analysts on various subjects to help them better understand and manage concepts and issues relating to the development of the capital markets in India. Besides this formal training programme, the agreement provides for Moody's advising ICRA on Rating-products strategy, and the Ratings business in general.

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- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.

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