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The GoI's partial credit guarantee scheme a positive step for the NBFC sector;

Operational ambiguities and limited coverage period might be hindrances to its success

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The GoI's partial credit guarantee scheme a positive step to enhance liquidity in the NBFC sector

The Guidelines issued by the Ministry of Finance for the 'Partial Credit Guarantee (PCG) Scheme' offered by the Government of India (GoI) to Public Sector Banks (PSBs) for purchasing high-rated pooled assets from financially sound NBFCs and HFCs (housing finance companies) are meant to provide additional liquidity to the NBFC / HFC sector. ICRA notes that the introduction of the said scheme displays a positive intent by the GoI to support NBFCs / HFCs to overcome any temporary cash flow mismatches and to give the PSBs a push to extend support to such NBFCs / HFCs. It recognises the role of NBFCs and HFCs in taking forward the government's agenda of financial inclusion as these entities have a farther reach than most banks and also cater to customers of varied credit profiles who otherwise may have been unable to get credit from banks. Over the past few years, PSBs have got increasingly comfortable with the direct buy-out of retail loan pools (from NBFCs/HFCs) as a strategy to maintain / build their loan book, at a time when corporate credit growth is muted[1]. The GoI PCG Scheme can provide some further comfort to the PSBs in this regard.

Key Aspects of the scheme

- GoI will provide a one-time guarantee on a pool of assets purchased by banks from NBFCs and HFCs (but not from micro-finance institutions and core investment companies).
- The GoI guarantee would be available for the first loss up to a cap of 10% and would be valid for the first 24 months from the date of purchase.
- The scheme would be available for a period of six months from the date of issuance of the scheme or till such date the scheme covers Rs. one lakh crore of purchases by banks.
- The scheme also sets forth guidelines for eligibility of NBFCs and HFCs (Annexure I) as well as eligibility of the assets that are being pooled (Annexure II).
- Claims can be raised once any account has unpaid dues for a period of more than 90 days. All claims will be settled by the GoI within 5 working days and all subsequent recoveries from the assets would be passed on to the GoI to the extent of the guarantee drawn.
- The underlying seller would have to bear an annual fee of 0.25% of the fair value of the initial purchase which would be paid to the GoI.

[1] For transactions evaluated by ICRA, PSBs had 38% participation in securitisation/D.A in FY2018-19

…however, more clarity may be required before the scheme picks up

In India, financial institutions are allowed to securitise their receivables and down-sell them through two routes, viz. i) rated transactions where assets are assigned to a trust that issues pass through certificates (PTCs), or ii) unrated bilateral loan direct assignments where the assets are directly purchased by the buyer. The securitisation of assets is required to be in compliance with the guidelines issued by the Reserve Bank of India (RBI) initially in February 2006, and later in May 2012 (for banks) and August 2012 (for NBFCs) as well as subsequent amendments / notifications. This raises the question as to whether the PCG Scheme is meant for 'Direct Assignments' or 'Securitisation' or a separate product altogether. Notwithstanding its positive intent, the GoI's scheme is also ambiguous in certain areas, as highlighted in Exhibit 1.

EXHIBIT 1. ICRA's observation on certain sections of the scheme

As per the scheme	ICRA's observation
Pool of assets being assigned should have a minimum rating of 'AA' prior to the partial credit enhancement by the GoI	Credit ratings are assigned only in case of securitisation transactions. Direct assignment transactions are unrated as there is no credit enhancement permissible for such transactions which would effectively mean that such a transaction can achieve the said rating requirement only if all the underlying assets are rated at a similar level (which is highly unlikely). Thus, the issuer would be required to furnish a first loss support to enhance the rating to at least 'AA' which would be contrary to the RBI's guidelines on securitisation through direct assignment.
The NBFCs / HFCs can have the option to buy back their assets after a period of 12 months	The option introduced by the GoI would allow the NBFCs / HFCs to use the securitisation route for raising funds for a relatively shorter period so as to tide over the current liquidity crunch in the market, and subsequently repurchase their assets if the liquidity situation improves. Nonetheless, the said option is contrary to the RBI's guidelines on securitisation of assets for NBFCs introduced in August 2012 which does not allow the issuer to re-purchase the already sold securitised pool.
The guarantee would be available for the first loss up to 10%.	The scheme document does not specify whether the first loss upto 10% means the first 10% loss on each defaulting loan or 'all the loss' on defaulting loans subject to a cap of 10% of the loan pool. Additionally, it is unclear whether the claim would cover only the unpaid dues for each contract or can the claim be made at an aggregate amount basis i.e. past dues as well as future unamortised principal. Assuming there is other credit enhancement (as discussed above) that enhances the 'pre-

As per the scheme	ICRA's observation
	PCG rating' to AA, there arises a question whether such credit enhancement will be the first loss-absorbing piece or will the first loss be absorbed by the GoI PCG.
The purchasing bank can invoke the GoI guarantee if the interest and/or instalment of principal remains overdue for a period of more than 90 days *(ie.* when liability is crystalized for the underlying borrower)	The meaning of the term 'when liability is crystallised for the underlying borrower' is not clear. It might mean the declaration of Event of Default (EoD) by the lender against the underlying borrower and a demand to pay the entire amount outstanding (acceleration); however this is not inherently clear from the text of the Guidelines, which might potentially cause a conflict at the claim stage.

…limited tenure coverage could be another constraint

The GoI guarantee would be available for the first 24 months from the date of purchase of the assets. Given that the underlying loans typically tend to have a tenure anywhere between 3 -5 years (car loans, truck loans, business loans) to 15 - 20 years (home loans, Home Equity loans), contracts may slip into delinquency even after 2 years, which is not covered by the PCG. Also, even within 2 years, if the intent is to cover only the overdue portion (and not the entire unbilled amount outstanding on a 90+ delinquent loan), the utility of the PCG would be considerably reduced.

ANNEXURE 1 – Eligibility criteria for NBFCs and HFCs

1. The NBFCs registered with RBI under the Reserve Bank of India Act, excluding those registered as Micro Finance Institutions and Core Investment Companies.
2. HFCs registered with National Housing Bank (NHB) under the National Housing Bank Act.
3. The CRAR of NBFCs/CAR of HFCs should not be below the regulatory minimum (i.e. 15% for NBFCs and 12% for HFCs) as on 31.3.2019.
4. Their net Non-Performing Asset should not be more than 6% as on 31.3.2019.
5. They should have made a net profit in at least one of the last two preceding financial years (i.e. FY 2017-18 and 2018-19).
6. The NBFCs/HFCs should not have been reported under SMA category by any bank for their borrowings during last one year prior to 1.8.2018.
7. Micro Finance Institutions and Core Investment Companies are not covered under the Scheme.

ANNEXURE 2 – Eligibility criteria for the pool of assets

1. Assets originated up to 31.3.2019 will only be eligible under this scheme.
2. Assets should be standard in the books of NBFCs/HFCs on the date of sale.
3. The pool of assets should have minimum rating of 'AA' or equivalent at fair value prior to the partial credit guarantee by GoI.
4. Each account under the pooled assets should have been fully disbursed and security charge should have been created in favour of the originating NBFCs/ HFCs.
5. NBFCs/HFCs can sell up to a maximum of 20% of their standard assets as on 31.3.2019 subject to a cap of Rs.5,000 crore at fair value. Any additional amount above the cap of Rs. 5,000 crore will be considered on pro rata basis, subject to availability of headroom.
6. The underlying assets should represent the debt obligations of a homogeneous pool of obligors and individual asset size in the pool is capped at Rs. 5 crore (i.e. asset pool should be sufficiently granular).
7. Originating NBFCs/HFCs cannot assign the following assets under this Scheme:
   a. Revolving credit facilities;
   b. Assets purchased from other entities; and
   c. Assets with bullet repayment of both principal and interest.

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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.

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