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India: Capacity Development for India Infrastructure Finance Company Limited

Prepared by CRISIL Risk and Infrastructure Solutions Limited

Asian Development Bank

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Asian Development Bank

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Progress Report: Final PCG Scheme

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Abbreviations

ADB	Asian Development Bank
ALM	Asset Liability Mismatch
CARE	Credit Analysis and Research Limited
CIBIL	Credit Information Bureau (India) Limited
COD	Commercial Operations Date
CRIS	CRISIL Risk and Infrastructure Solutions Limited
DSCR	Debt Service Coverage Ratio
PM-EAC	Economic Advisory Council to the Prime Minister
EPFO	Employees' Provident Fund Organisation
IIFCL	India Infrastructure Finance Company Limited
IRDA	Insurance Regulatory Development Authority
LIC	Life Insurance Corporation of India
PCG	Partial Credit Guarantee
RBI	Reserve Bank of India
SBI	State Bank of India
SIFTI	Scheme for Financing viable Infrastructure projects Through IIFCL
SPV	Special Purpose Vehicle

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1. Building blocks of Partial Credit Guarantee Scheme

This chapter summarizes the essential building blocks or parameters of the Partial Credit Guarantee product for IIFCL, drawing from the earlier report "PCG Structure and Mechanics", for the development of the scheme.

The key building blocks or parameters for the PCG Scheme are as follows:

- Eligible projects
- Target rating
- Extent of credit enhancement
- PCG terms
- Guarantee fee
- Security cover for investor/IIFCL

The following table summarizes the proposed criteria for each of the above.

Table 1: Summary of the key building blocks or parameters of PCG scheme

Building Blocks	Description
Eligible Projects	
Sector	Projects operating in sectors covered under SIFTI (as modified from time to time)
Project stage	Commissioned projects operating for at least six months post commercial operations date
Quantum of existing loans to be refinanced	Linked to exposure norms of IIFCL based on the quantum of guarantee provided by IIFCL.
Minimum source rating	BBB category (*In case the Issuer uses the PCG, it should ensure that it continues to be rated till the PCG is in use)*
PCG Parameters	
Target rating	AA (SO)
Duration of bond[1] issue to be provided PCG cover	Minimum 10 years *(to reduce the minimum number of investors needed to subscribe to the issue as per applicable IRDA guidelines)*

[1] *Bond includes debentures and bonds issued by entities in India. Debentures and Bonds are used interchangeably in this document and refer to both debentures and bonds.*

Building Blocks	Description
Feature of bond to be provided PCG cover	The investor in a PCG enhanced bond can call for accelerated repayment only if the bond issuer goes into liquidation
Extent of credit enhancement	IIFCL may limit the extent of credit enhancement by an amount which enhances the credit rating of the bond up to a maximum of AA (SO), subject to a maximum of 50% of the total bond service obligations at the time of issue of the bond. IIFCL shall undertake credit enhancement up to 40% of the total project cost (project cost as defined in 3.1 (j) of SIFTI (as modified from time to time)) and the Board of IIFCL may on merits of each case decide on the extent of credit enhancement by IIFCL.
PCG terms	▪ Irrevocable and unconditional ▪ Rolling with the guarantee quantum usable at any time over the tenure of the bond ▪ No automatic reset feature ▪ Automatic repayment of utilised guarantee from subsequent recoveries
Guarantee fee	Guarantee fee to be charged by IIFCL will vary on a case-to-case basis and will be dependent on the extant credit quality of the borrower and the quantum of guarantee needed, subject to a minimum. Any change in the credit quality of the bond during its tenure shall result in a change in the guarantee fee charged by IIFCL.
Security cover for bond investors/IIFCL	Both the bond investors and IIFCL will have pari-passu charge on project assets, with other lenders, to the extent of their outstanding funded exposure to the issuer.

2. Partial Credit Guarantee Scheme

This chapter details the PCG Scheme for IIFCL.

PREAMBLE

Thus far, the infrastructure investment in India has predominantly been funded by the banking sector. In 2011, infrastructure investments have grown to account for about 14 percent of the asset book of the Indian banking sector. Further, infrastructure projects require loans whose maturities are progressively lengthening. In view of these facts, along with the fast growing quantum of infrastructure investment demand, it is unlikely that the banking sector will be able to continue meet a majority of the borrowing requirements of infrastructure investment in India. Moreover, the growing share of lengthening maturity infrastructure lending in banks' asset books is accentuating the asset-liability mismatch (ALM) risk for the Indian banking sector. Further, some large and successful business groups in the infrastructure space in India are nearing their group exposure limits with domestic banks.

Therefore, finding sources of infrastructure finance outside the traditional banking channel is imperative to sustain the 'India growth story'. The most promising option is to facilitate the infrastructure projects' access to bond markets. The development of the non-sovereign bond market in India has been stubbornly tepid, partly because the investment norms of most large bond Investors have an investability threshold of AA or higher. These thresholds shut out bond market access to most infrastructure assets, which tend be rated in the BBB category or thereabout.

Thus, the Economic Advisory Council to the Prime Minister (PM-EAC) has recommended to the India Infrastructure Finance Company Limited (IIFCL) to design a credit enhancement scheme which could be used to enhance the ratings of the infrastructure project bonds such that the projects are able to access finance from a larger number of institutional long-term investors such as insurance and pension funds.

A Partial Credit Guarantee was assessed to be the ideal option for Credit Enhancement, in the Indian context.

TITLE OF THE SCHEME

- The scheme shall be known as "Partial Credit Guarantee Scheme for Operational Infrastructure Projects".
- The Partial Credit Guarantee Scheme shall come into force from the Effective Date.

OBJECTIVES OF THE PARTIAL CREDIT GUARANTEE SCHEME

- To expand the sources of finance for developers of infrastructure projects by providing Credit Enhancement to bonds issued by Project SPVs, thereby facilitating investment by a larger number of institutional long-term bond Investors
- To mitigate the asset-liability mismatch of commercial banks by mobilizing long-tenor financing, inter alia, from bond Investors such as insurance and pension funds

- To help develop a corporate bond market
- To mitigate the risk for investors through a partial credit guarantee of timely payment of principal and interest

DEFINITIONS

Unless the context otherwise requires, in this Scheme:

Agreement means the Guarantee Agreement

Credit Enhancement/Partial Credit Guarantee means a promise by the Enhancement Provider to pay a portion of the interest and principal, in case of shortfall in the cash flows set aside in the Debenture Redemption Reserve Account set up for servicing the bonds as per Section 117 C of Companies Act, subject to a maximum of the Guaranteed Amount (inclusive of top-ups), in a timely manner, subject to the terms of the guarantee.

Credit Rating means a rating issued by an accredited credit rating agency.

Default Event means the non-payment of interest or the repayment of principal on the due dates by the Issuer to the bond Investor

Debenture Trustee means a trustee appointed as per Companies Act 117 B to protect the interests of the investors.

Duration shall mean the term as specified in IRDA's circular IRDA/INV/CIR/027/2008-09 dated 26 December 2008.

Effective Date means ___________________.

Enhancement Provider means the India Infrastructure Finance Company Limited (IIFCL), a company incorporated under the Companies Act, 1956.

Guarantee Agreement means the Agreement signed between the Enhancement Provider, the Issuer and the Debenture Trustee.

Guaranteed Amount is the amount the Enhancement Provider has agreed to pay to the bond Investors in lieu of any repayment shortfall by the Issuer of either principal or interest in respect of the bonds issued by the Issuer.

Infrastructure means those sectors covered under SIFTI, as modified from time to time.

Investor means any legal entity investing in the bonds issued by the Issuer, including but not limited to, individuals, banks, financial institutions, mutual funds, provident funds, insurance companies, pension funds and foreign institutional investors.

Issuer means a legal entity (including a Special Purpose Vehicle) operating an infrastructure project and issuing a bond for raising debt.

Lender means the scheduled commercial banks or any other participating entities that have a funded exposure to the Issuer, after issue of bond. For avoidance of doubt, Promoter(s) of the Issuer or the affiliates of the Promoter(s) shall not constitute the Lender(s) consequent to any debt financing extended by such Promoter(s) and/or any of their affiliates to the Issuer.

PCG means Partial Credit Guarantee.

Promoter means the principal shareholder of the SPV.

Risk Sharing / Backstop Guarantee providing Institution means domestic or international financial institutions that the Enhancement Provider may enter into an agreement for sharing risks in respect of any Guarantee Agreement.

SIFTI means the Scheme for Financing Viable Infrastructure Projects through IIFCL, as modified from time to time.

SPV means any company, trust or other entity constituted or established for a specific purpose and whose activities are limited to those aimed at accomplishing the purpose of the company, trust or other entity as the case may be; and which is structured in a manner intended to isolate the corporation, trust or entity as the case may be, from the credit risk of the Promoter of the SPV.

ELIGIBILITY

In order to be eligible for the Partial Credit Guarantee scheme, the Infrastructure projects shall satisfy the following:

- The project should be from one of the sectors covered under SIFTI (including those appended from time to time) which are as follows:
  - Road and bridges, railways, seaports, airports, inland waterways and other transportation projects
  - Power
  - Urban transport, water supply, sewage, solid waste management and other physical infrastructure in urban areas
  - Gas pipelines
  - Infrastructure projects in special Economic Zones
  - International convention centres and other tourism infrastructure projects
- The minimum stand-alone Credit Rating of the Issuer whose bonds are to be credit enhanced shall be the BBB or equivalent category.
- The minimum period for date of occurrence of credit enhancement shall be at least six months from commercial operations date (COD).

EXPOSURE UNDER THIS SCHEME

The exposure of the Enhancement Provider to a project entity shall be limited to a maximum of 40 percent of the total project cost (project cost as defined in 3.1 (j) of SIFTI (as modified from time to time)) and Board of IIFCL may on merits of each case decide on the extent of credit enhancement by IIFCL. The exposure of the Enhancement Provider to a project entity under this scheme is limited to the guarantee provided to the entity.

QUANTUM OF CREDIT ENHANCEMENT

IIFCL shall provide an unconditional and irrevocable guarantee to the bond issue for an amount that is sufficient to allow the bond to be rated up to maximum of AA (SO). This guarantee shall not

exceed 50% of the total bond obligations at the time of bond issue and shall not exceed 40% of the total project cost (project cost as defined in 3.1 (j) of SIFTI (as modified from time to time)), and shall be called the Partial Credit Guarantee. The Partial Credit Guarantee shall cover all the agreed Default Event(s) during the tenure of the bond.

FEATURES OF PARTIAL CREDIT GUARANTEE

- The Partial Credit Guarantee shall be irrevocable and unconditional
- The Partial Credit Guarantee provided by the Enhancement Provider shall be rolling with a fixed quantum of guarantee, subject to a periodic reset, if any, rolled over the entire tenure of the bond i.e. the PCG provided by the guarantor shall absorb all the losses, up to a maximum of the guaranteed amount (subject to a periodic reset, if any) during the entire tenure of the bond.
- The quantum of Credit Enhancement shall remain fixed over the tenure of the bond issue, and there will be no automatic reset of the quantum of Credit Enhancement. However, reset of the quantum of Credit Enhancement may be introduced with the consent of the Investors and in consultation with rating agencies.
- The PCG shall have an automatic top-up facility. Any recovered amount flowing to Enhancement Provider shall be used to reinstate the utilized guarantee, subject to the fulfilment of the recovery waterfall mechanism. Recovered amounts shall flow in the following order:
  - If the PCG is not fully utilized
    - Obligations to the bond holders, due immediately
    - Interest for the utilized guarantee, if any
    - Guarantee utilized
    - Remittance to the borrower
  - If the PCG is fully utilised
    - Interest due to the bond holders and Enhancement Provider on a pari passu basis.
    - Arrear payments to the bond holders and utilised guarantee to the Enhancement Provider on a pari passu basis
    - Remittance to the borrower

GUARANTEE AGREEMENT

The Enhancement Provider, the Debenture Trustee and the Issuer shall enter into a Guarantee Agreement before issuance of the bonds for the purpose of amount to be guaranteed. The Guarantee Agreement shall also cover the recovery waterfall mechanism and the access rights of the Enhancement Provider to the information provided by the Issuer to the Debenture Trustee to enable monitoring of the Issuer by the Enhancement Provider.

SECURITY FOR INVESTOR/ENHANCEMENT PROVIDER

Investors and the Enhancement Provider shall have a pari-passu charge on the assets of the Issuer, along with other Lenders. The Issuer shall arrange written consent letters from all the Lenders for sharing the aforesaid pari-passu charge on the assets offered as security at the time of entering into

the agreement with investors and the Enhancement Provider. The Issuer shall also get a no-objection certificate from Concessioning authority to issue a partial credit guarantee backed-bond.

OPTION FOR THE ENHANCEMENT PROVIDER TO SHARE RISK[2]

The Enhancement Provider may enter into agreements with domestic or international financial institutions (e.g. Asian Development Bank, International Finance Corporation) for sharing risk in respect of any Guarantee Agreement. Such arrangements could be in the form of a guarantee, reinsurance, unfunded risk participation or similar agreements.

DURATION OF PARTIAL CREDIT GUARANTEE-BACKED BOND

The minimum duration of the bond that will have a Partial Credit Guarantee from the Enhancement Provider shall be 10 (ten) years.

GUARANTEE FEE

The guarantee is best expressed as a percentage of bond value outstanding as under:

Source Rating	Spreads between Source Rating and Target Rating of AA	Guarantee fee (as %age of bond value outstanding)
BBB	1.75-2.75 percent	1.3-2.1 percent
BBB+	1.25-2.25 percent	0.9-1.7 percent
A-	0.75-1.75 percent	0.5-1.3 percent
A	0.26-1.26 percent	0.2-1.0 percent

- The guarantee fee will be payable quarterly for as long as the guarantee is outstanding and be reset for changes in the Issuer's rating.
- Any change in the credit quality of the bond during its tenure shall result in a change in the guarantee fee charged by IIFCL.
- The guarantee fee applicable to new projects will need to be updated every quarter to adjust for the change in interest rates and credit spreads.

[2] *There are no extant guidelines governing 'reinsurance' of a credit enhancement product. As per RBI's circular pertaining to ECBs (RBI/2011-12/203 A.P. (DIR Series) Circular No. 28) dated 26th September 2011, multilateral / regional financial institutions and Government owned development financial institutions can provide credit enhancement for domestic debt raised through issue of capital market instruments such as debentures and bonds, by Indian companies engaged exclusively in the development of infrastructure and by the Infrastructure Finance Companies (IFCs). Potential reinsurers would need to enter into a dialogue with RBI, to seek clarity on such type of reinsurance. Alternatively, they could participate as co-insurers rather than reinsurers and hence become explicitly eligible under the above circular.*

UPFRONT FEES

The Issuer shall pay a one-time upfront fee for the Partial Credit Guarantee offered by the Enhancement Provider. The one-time fee should be a fixed percentage of the bond value outstanding, subject to a minimum value, which is to be decided by the Enhancement Provider based on its cost structure.

The upfront fee shall be payable by the Issuer to the Enhancement Provider 30 (thirty) days before issue of the bond backed by the Partial Credit Guarantee.

APPRAISAL AND MONITORING RESPONSIBILITIES

- The Enhancement Provider may conduct independent appraisal or accept an appraisal by any reputed appraising institution.
- The Enhancement Provider should undertake regular monitoring of the Issuer.
- The Enhancement Provider will ensure that the Issuer maintains a valid rating for the issue until the guarantee is extinguished as stated in the 'DURATION OF PARTIAL CREDIT GUARANTEE BACKED-BOND' clause above.

OTHER FEATURES OF THE SCHEME

- The promoters of the Issuer should not be on the defaulters list of the Reserve Bank of India (RBI) or Credit Information Bureau (India) Limited (CIBIL).
- In case IIFCL notices any fraud or forgery committed by the Issuer, pertaining to this particular transaction after the signing of the Agreement, the Agreement shall automatically stand terminated.
- The Promoter shall obtain prior written approval of IIFCL for divesting its equity stake in the infrastructure project.
- The Enhancement Provider shall ensure that the Issuer has adequately covered the force majeure events such as natural calamities, war and terrorism, by a catastrophe insurance policy.
- The Issuer shall bear the legal expenses including stamp duty necessary for the execution of the Agreement for Credit Enhancement.

3. Legal and taxation issues to be addressed in a Partial Credit Guarantee Scheme

This chapter details out the various legal and taxation issues to be addressed in a Partial Credit Guarantee Scheme.

3.1 Guarantee Agreement

3.1.1 Parties to the Agreement

A Guarantee Agreement will have to be drawn up, which will be signed by three parties – the Issuer, the Debenture Trustee and the Enhancement Provider.

3.1.2 Role of the parties

Different counterparties under the agreement will be obligated to perform the principal roles as follows:

- Enhancement Provider
  - To agree to issue a Partial Credit Guarantee to enhance the Credit Rating of the bond to the target rating of AA (SO).
  - To release funds in a timely manner (as per the timeframe agreed), subject to the terms of the guarantee, in case of shortfall in the cash flows set aside in the Debenture Redemption Reserve Account set up for servicing the bonds.
- Debenture Trustee
  - Right to invoke the guarantee in case of any shortfall in project cash flows.
  - Permit the Enhancement Provider to monitor the Issuer and access documents of the Issuer
- Issuer
  - To agree to reinstate the guarantee in case of recovery as per the recovery waterfall mechanism.

3.1.3 Key commercial terms

This will include the following:

- Duration and quantum of existing loan to be refinanced
- Amortization schedule of bond obligations
- Quantum of guarantee cover
- Guarantee fee
- Upfront processing fee

3.1.4 Events of default and consequences

This clause in the Guarantee Agreement will spell out events of default for parties in the Agreement and consequences of the same.

3.2 Implications on Inter Creditor Agreement (ICA)

- The Inter Creditor Agreement will recognize the Enhancement Provider as party to the ICA, such that all ensuing fundamental inter creditor actions will be subject to approval of all lenders and the Enhancement Provider.
  - For instance, on occurrence of event of default, as defined in the ICA, the other lenders will not accelerate liquidation, without consent of the Enhancement Provider[3]
- The ICA will also contain the following provisions
  - Allowing the Enhancement Provider and bond investors to have pari-passu charge on the assets of the borrower
  - Allowing the Enhancement Provider to participate in consortium meetings
  - The event of drawing of guarantee will not be considered as event of default under the ICA.[4]

3.3 Stamp duty on PCG transaction

In the proposed PCG product, the additional document required over a traditional bond issue is the Guarantee Agreement. Since such a Guarantee Agreement involves a financial obligation, it will attract stamp duty as per Indian Stamp Act, 1899. As per the Act, the stamp duty for a Guarantee Agreement or a deed of guarantee is prescribed by the Government of such state in which the deed is executed and the stamp duty rate on the guarantee agreement will vary from state to state depending on the prevailing stamp duty in a particular state.

[3] *It should be noted that in India, typically 75 percent of the parties (to the ICA) need to agree for acceleration. IIFCL, by virtue of the fact that it plans to take exposure in a project up to 40 percent of the project cost (and thereby more than 50 percent of the debt,) is likely to have the option of blocking such an event of acceleration. It is also pertinent to mention that lenders typically have not resorted to acceleration in infrastructure lending in India.*

[4] *A liquidity facility, amounting to 5-10% of total repayments, may be structured over the partial credit guarantee to absorb peak losses during the tenure of the instrument. Such liquidity facility could provide comfort in case of high short-term volatility in the cash flows. The liquidity facility would be drawn in case of shortfalls, instead of the partial credit guarantee, for a short period of time, say 90 days. Only if the liquidity facility is exhausted, the partial credit guarantee would be utilized. If the project is not able to generate sufficient cash flows within 90 days to repay the liquidity facility (along with interest), the partial credit guarantee would be used to repay the liquidity facility.*

The liquidity facility would have a higher rating, since it derives comfort from the partial credit guarantee. In this case, the rating would be equivalent to the rating of the guarantor (IIFCL), i.e. AAA. Since the rating is higher, the liquidity facility would be priced at relatively lower rates compared to the partial credit guarantee and hence could have been used to structure the instrument.

However, currently there is no third-party liquidity provider in the Indian market. In case, such liquidity providers are operating in the future, such a liquidity facility may be structured in partial credit guarantee transactions.

4. Implications for IIFCL

This chapter highlights implications of implementing the Partial Credit Guarantee Scheme on IIFCL.

4.1 Marketing the scheme

Since this is a new scheme, IIFCL will have to actively engage with each of the stakeholders such as banks, potential investors like insurance and pension funds and developers to educate them about the Scheme and dispel any apprehensions/reservations that the market participants might have on the Scheme.

As seen in the previous report, "PCG Structure and Mechanics", the concession agreements for the various sectors provide for refinancing through bonds and guarantee structures. Therefore, sufficient market interactions by IIFCL could encourage developers to adopt this alternate financing mechanism.

4.2 Operational implications

Currently, IIFCL does not have project appraisal capability and depends on the lead bank to conduct appraisal activities. For such a PCG Scheme, IIFCL will have to develop in-house project appraisal capabilities since it might be the only institution with a non-funded exposure to the project, at least to begin with. To achieve this, IIFCL must initiate the setting up of a robust risk management framework. However, till such a framework is setup and stabilises, IIFCL may consider engaging third parties to help them conduct a robust appraisal of the projects that are extended a PCG. Also, IIFCL might need to strengthen its team and have focused teams for product marketing, monitoring, etc. The legal department will need to design the Guarantor Agreement and look at all the legal/taxation issues associated with such a scheme.

4.3 Risk implications and mitigation

IIFCL will have to be mindful of various risks posed by the PCG Scheme. Such risks and possible mitigation measures are given below:

- Guarantee Fee Risk – Aggressively priced bank loans might lead to unreasonable expectations from the Issuer. In such a scenario, IIFCL might not be able to charge a desired guarantee fee, thereby reducing the returns from this product for IIFCL.
  IIFCL should ensure that a strong project appraisal mechanism is in place such that only those projects where IIFCL earns its minimum desirable guarantee fee are considered. Whenever in-house credit appraisal skills are not fully available, they could be supplemented by deploying credible and independent third-party credit appraisers. Also, IIFCL should educate the Issuers about the importance of this scheme opening up an

alternative source of finance, and thus borrowers should be satisfied with even a minimal saving.

- Recovery Rate Risk – A situation where the actual recovery flowing to IIFCL is lower and spread over a duration longer than that assumed, could pose a risk to IIFCL.
  IIFCL should take active interest in the day to day operations of the project, especially matters of revenue capture and expense justification, to ensure that post distress recoveries are in line with the initial estimates.

- Default Rate Risk – In case of an economic downturn, default rates could be higher than assumed, such that the capital available with IIFCL is not enough to cover these defaults.
  IIFCL should ensure that it maintains a diverse portfolio with projects from various sectors and different developers to benefit from diversifications of risk.

- Credit Rating Risk – A downgrade of IIFCL's rating could affect its role as guarantor. IIFCL has to ensure that it maintains its AAA-rating.
  IIFCL was setup by the Government of India and continues to enjoy its support by virtue of the key role that it plays in the infrastructure sector in India. This limits any potential risk of its rating being downgraded.

- Credit Spread Risk – The prevailing credit spreads or bond yields might be such that they result in lower savings to be shared between the borrowers and IIFCL. In such a scenario, IIFCL might not be able to charge a desired guarantee fee thereby affecting feasibility.
  IIFCL will have to setup a commercial appraisal function to conduct ongoing negotiations with issuers (by explaining to them the benefits of funding diversity arising out of a continuing relationship with IIFCL) and take a commercial call on whether some projects may be un-remunerative to take up under the PCG scheme.

5. Stakeholder consultations

This chapter highlights the interaction with various stakeholders and the key messages derived.

Focused interactions were held with different stakeholder groups to test the views and acceptability of the analysis undertaken on the proposed scheme in the market. The stakeholder groups, with whom interactions were made, are listed below along with a mention of the area of discussion with them.

- Issuers (or Borrowers/Project Developers) – This segment included developers who are involved in development of infrastructure projects across different sectors. The entities covered under this segment included the Punj Lloyd Group, Mundra International Container Terminal, Reliance Infrastructure Limited (Roads Division), DP World Private Limited, CLP Power India Pvt. Ltd, Gangavaram Port Limited, Sadbhav Engineering Limited and IMC Limited. The prime focus of interactions with this segment was to understand their views on the scheme, current sources and costs of funding, constraints in raising funds for infrastructure projects and their general expectations from such a scheme.
- Investors – This segment included the targeted bond investors such as insurance companies, provident fund and pension funds. The entities covered under this segment included LIC, ICICI Prudential, Bajaj Allianz Life Insurance, HDFC Standard Life Insurance, Birla Sun Life Insurance and EPFO. The focus of these interactions was to understand their current profile of investments, exposure to the infrastructure sector and constraints faced in investing in this sector, view on investment in AA rated paper, duration of investment, yields looked at and acceptability of this PCG product.
- Lenders – Interactions with lenders i.e. banks were primarily to understand the prevailing rates for lending to infrastructure, constraints faced such as exposure norms and ALM issues, default and recovery aspects, views on the scheme and sharing pari-passu charge on assets with bond investors. The entities included IDBI and Axis Bank.
- Credit Rating Agencies – Since the basic premise of this scheme involves credit rating of the underlying bond issue, it was felt pertinent to understand from credit rating agencies their view on the PCG product and the level of credit enhancement that would be required for upgrading the rating from BBB to AA (SO). The entities covered included CRISIL, CARE, and FITCH.
- Regulatory bodies – This segment covered entities, which determine the enabling environment for the Partial Credit Guarantee Scheme. These included RBI and IRDA. The emphasis during the interactions was to understand the conduciveness of the regulatory environment for such a scheme.

5.1 Key messages from the stakeholder consultations

Key messages emerging from the stakeholder consultations are highlighted in this section.

5.1.1 Issuers (or borrowers/project developers)

- The developer entities welcome a product which would give them access to the bond market, which would be characterized by market driven pricing. However, developers don't want to hamper existing bank relationships and would therefore only look to partly re-finance outstanding loans.

- While some of the developers, welcoming the diversity in funding options, do not factor savings in the interest rate as a priority others clearly see a benefit in the lower interest rates (current cost of borrowings for the various developers, with whom interactions were made, is in the range of 11-12.5 percent) offered through such a scheme and the savings thereon. But timing the launch of this scheme would be pertinent. Considering the prevailing high interest rate regime, the developers do not want to lock themselves to a high fixed interest rate. A couple of the developers envisage this cycle to continue for the next 1-2 years, thereby possibly hampering the adoption of this scheme for some time.

- Some of the developers are apprehensive that such a scheme, being nascent, will remain a scheme on paper and not be put into practice. They opined that sufficient education would need to be imparted to the stakeholders to quell such apprehensions.

- The developers are of the opinion that IIFCL should strengthen its direct lending and take on more funded exposure rather than unfunded exposure. Also it is felt that pre-COD financing is increasingly becoming difficult and therefore steps must be taken to enhance financing avenues in this phase, rather than the post-COD phase that the PCG is targeting.

- Involvement of an entity such as Asian Development Bank is welcome. Some of the developers are also of the view that a scheme involving a guarantee from an international entity such as ADB should be in place such that the developers are able to access the forex bond market for funds.

- Developers also feel that it is beneficial if they have a put option on the bond i.e. the bond should be redeemable at the option of the issuer.

5.1.2 Investors (insurance companies and the provident fund)

- Insurance companies face constraints in investment in infrastructure sector due to IRDA regulations on the ratings. Therefore, such a scheme is welcome and they would consider investing in such credit-enhanced papers.

- Insurance companies, however, have their own credit appraisal teams and credit rating is just one parameter considered in their appraisal process. Other parameters include

promoter background and cash flows of project. Therefore, investments would be made only in projects which satisfy the internal credit guidelines.

- Investors are of the view that success of this scheme will require the support/endorsement of IRDA. Also, investors felt the need to be protected in case of force majeure events. For instance, in case the bond is downgraded below AA due to a force majeure event, the investor should be protected from repercussions or losses.

- Considering that the duration of investment would be long—around ten years—pricing or yields should be such that they cover the illiquidity aspect. Some of the investors mentioned that the current yield for a three-four year AA bond is around 10 percent. Therefore, for a longer duration bond the expected yield would be higher.

- IRDA currently does not have a norm regarding maintaining exposures in such structured product transactions. However, some of the investors have internal guidelines for establishing/maintaining exposure for such transactions.

- EPFO currently invests only in AAA-rated paper since the stringent internal guidelines do not allow investment in lower rated papers.

5.1.3 Credit rating agencies

- Credit rating agencies consider the PCG product a welcome step for both issuers and investors as a transition from the bank loan market to the bond market could ease cash flow pressures and improve DSCR.

- This scheme should be applicable to projects with minimum BBB rating, since this is considered the investable grade. It was highlighted that a large amount of projects operating six months to one year post COD are in the BBB category.

- Post-default recovery for infrastructure projects would be in the range of 40-50 percent in the Indian context.

- While one credit rating agency opined that extent of credit enhancement to be given would range from 45-55 percent, another is of the opinion that this value could go as high as 60-70 percent, not accounting for any potential recovery.

- One of the rating agencies was of the opinion that bond issue for a pool of assets of a particular Promoter/Investor could be considered to diversify risk and reduce the quantum of Credit Enhancement required.

5.1.4 Lenders

- Banking entities were of the opinion that since they take on the all the risks at the pre-COD stage, refinancing through the issue of bonds takes away the opportunity from banks to earn returns during the positive cash flow phase.

- One entity felt that ALM is not a serious practical issue as long as short-term deposits are replenished on a continuing basis.

5.1.5 Regulators

Views expressed by regulators were highlighting differing perspectives on the product.

- Credit rating is not considered as the primary driver for investment-decision making. Examples of failure of ratings worldwide were quoted.
- Direct exposure to infrastructure projects is a source of concern, considering the risky nature of the asset. It was opined that allowing insurance companies to invest in infrastructure projects would require a 100 percent capital protection guarantee.
- Also, a cash collateral support of a full guarantee by larger well-established PSUs could provide more comfort than a partial guarantee from IIFCL, which has been in existence only for four-five years.

6. Broad Operationalisation Plan

Once the scheme is approved by IIFCL's board, the IIFCL management will need to undertake the following steps to operationalise the PCG scheme:

- Finalise the scheme and pilot testing
- Develop the detailed project selection, appraisal and monitoring mechanism process
- Prepare the Guarantee Agreement draft
- Prepare the Resources Management Plan
  - A framework for efficient and effective Financial Resources Management for such a scheme. This would include details Fund Mobilization, Cash Management and Fund Management
  - Prepare an efficient staffing plan
- Prepare the Risk Management Matrix
- Prepare a Standard Operating Manual incorporating the above

7. Annexure 1 - List of Persons Met During Stakeholder Interactions

Table 2: List of Persons Met During Stakeholder Interactions

NO.	NAME OF FIRM / INSTITUTION	PERSON/S MET
	REGULATORS	
1	Insurance Regulatory Development Authority	o Mr. A. Giridhar, Executive Director o Mr. S. N. Jayasimhan, Joint Director (Accounts)
2	Reserve Bank of India	o Mr. G. Mahalingam, CGM-Financial Markets o Mr. Himanshu Mohanty, DGM-Financial Markets
	INVESTORS	
3	Life Insurance Corporation of India	
4	Employees' Provident Fund Organisation	Mr. Rajiv Bisht, Regional Provident Fund Commissioner, Investment Monitoring Cell
5	ICICI Prudential Life Insurance Company	Mr. Manish Kumar, Head – Investments
6	Bajaj Allianz Life Insurance Company	Mr. Sashi Krishnan, Chief Investment Officer
7	HDFC Standard Life Insurance Company	Mr. Prasun Gajri, Chief Investment Officer
8	Birla Sun Life Insurance Company	Ms. Megha Gupta, Senior Credit Analyst – Investments
	DEVELOPERS	
9	Mundra International Container Terminal Pvt. Ltd.	Mr. Ramji Krishnan, Chief Executive Officer
10	Punj Lloyd Group	Mr. Manpreet Singh, EA to President
11	CLP Power India Limited	o Mr. Samir Ashta, Director Finance & CFO o Mr. Prashant Narkhede, Deputy Manager

NO.	NAME OF FIRM / INSTITUTION	PERSON/S MET
		Project Finance
12	DP World Private Limited	• Mr. Devang Mankhodi – Director, Finance • Mr. Kevin D'Souza – Director, Commercial and Business Development
13	Reliance Infrastructure Limited	Mr. Sudhir Hoshing, CEO – Roads
14	Gangavaram Ports Limited	Mr. Pranav Choudhary, CFO
15	IMC Limited	Mr. Ramamurthy Natarajan, CFO
16	Sadbhav Engineering Limited	Mr. Viswanathan R., Sr. Vice President
	CREDIT RATING AGENCIES	
17	CRISIL Limited	• Mr. Pawan Agarwal, Director – Corporate Ratings • Mr. Somasekhar Vemury, Head – Rating Criteria and Product Development • Ms. Rachna Gupta, Senior Manager
18	CARE Limited	Mr. Vijay Agrawal
19	Fitch Ratings	Mr. S. Nandakumar, Senior Director
	BANKS	
20	IDBI Bank	Mr. Yashpal Gupta, GM-Infrastructure Financing
21	Axis Bank	Mr. Ashish Kumar Saha

Disclaimer

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CRISIL INFRASTRUCTURE ADVISORY

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