SECURITISATION OF STRESSED ASSETS

Another enabler for stressed asset resolution; price discovery and high upfront payments could be challenging

APRIL 2025

Key abbreviations

TALF	Term Asset-Backed Securities Loan Facility
TARP	Troubled Asset Relief Program
SPE	Special purpose entity
HAPS	Hercules Asset Protection Scheme
GACS	Garanzia Cartolarizzazione Sofferenze translated as Non-Performing Loan Securitisation Guarantee
FMS Wertmanagement	A bad bank in Germany, which is part of the Federal Agency for Financial Market Stabilization (FMSA)
NPL	Non-performing loans
CBIRC	The China Banking and Insurance Regulatory Commission
SAREB	Sociedad de Gestión de Activos procedentes de la Restructuración Bancaria (bad bank set up by Spanish Government)
NPA	Non-performing assets
JUSEN	Housing loan corporations set up in Japan

Highlights

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While the draft guidelines are in line with the guidelines for the securitisation of standard assets, features such as price discovery, availability of CE and achieving better recoveries, which would lead to investment grade ratings, are challenges.

The securitisation model may be better suited for retail assets instead of wholesale assets. However, the higher upfront cash payment requirement may dampen interest.

- On April 9, 2025, the Reserve Bank of India (RBI) released draft directions on the securitisation of stressed assets. The proposed guidelines provide a comprehensive framework, which aims to facilitate the resolution of stressed assets by enabling their repackaging into tradeable securities. This regulation aims to improve risk distribution and provide an exit strategy to lenders in the stressed assets segment.
- While lenders have been selling stressed assets to asset reconstruction companies (ARCs) in the last two decades, the haircuts taken by them have remained steep. Further, due to the capital constraints of ARCs, lenders continue to hold a substantial portion of the bad debt in the form of security receipts (SRs) in their investment books. Thus, they have been unable to offload stressed assets from their balance sheets.
- The draft guidelines provide an exposure cap of 20% for the originator (lender), which is likely to free up the balance sheet. Also, the purchase consideration under the new guidelines is to be paid in cash and upfront at the time of assignment. Clarification on the involvement of external valuers, valuation and provisioning norms, and periodic updates on the pool's performance augur well for investor confidence in the securitisation model.
- Moreover, the viability of the securitisation of stressed asset route vis-à-vis the sale to ARC route would depend on the pricing of the securitisation notes. While the share of institutional investors in SRs has been rising, attracting investors to invest in lower rated (BBB and below) securitisation notes, especially those with no credit enhancement (CE; non-senior tranches), may be a challenge.
- While ARCs will continue to have access to a wider universe of stressed assets, they will face higher competition in the key asset classes that account for a major share of the overall credit outstanding.

RBI proposes framework for securitisation of stressed assets

To supplement the specifics pertaining to the securitisation of stressed assets covered under the SARFAESI Act, 2002 and provide willing investors with structured access to stressed assets, the RBI has published a draft mechanism for regulated entities to undertake the securitisation of stressed assets.

The proposed directions provide a comprehensive framework, which aims to facilitate the resolution of stressed assets by enabling their repackaging into tradeable securities. However, given the lacklustre secondary market trading in pass-through certificates (PTCs) backed by standard assets, expecting liquidity in secondary trades for securitisation notes backed by stressed assets remains challenging.

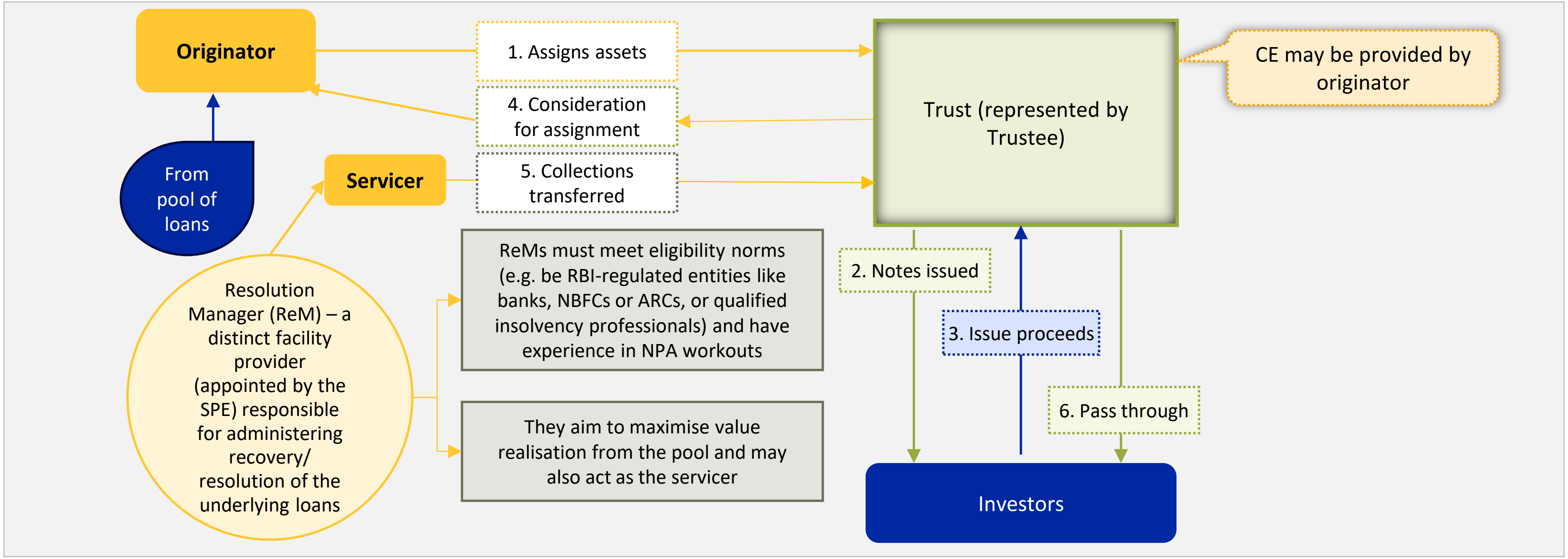
This regulation aims to improve risk distribution and provide an exit strategy to lenders in the stressed assets segment. Prudentially structured securitisation transactions can play a valuable role in the recovery and resolution of stressed assets, while also providing opportunities for more effective risk distribution.

Source: RBI, ICRA Research

Securitisation under proposed guidelines

Securitisation would involve the issuance of notes backed by stressed assets[1]

Transaction schematic of a typical securitisation transaction through the notes route



[1] *Minimum level of non-performing assets to be 90%; NBFCs – Non-banking financial companies; SPE – Special purpose entity*

Proposed regulations, however, exclude certain asset classes

Eligible Assets

Homogenous pool of

- Loans to individuals up to Rs. 50 crore
- Business loan to individuals up to Rs. 50 crore
- Microenterprise loans up to Rs. 50 crore
- Other loans, excluding non-eligible assets as mentioned below

Non-eligible Assets

- Farm loans,
- Education loans,
- Re-securitisation exposures,
- Refinance exposures of AIFIs,
- Loans to other lending institutions, and
- Accounts tagged as willful defaulter and fraud/red flagged accounts are not eligible

Source: RBI, ICRA Research; AIFI – All India Financial Institutions

Responsibility of resolving stressed asset lies with resolution manager

- The resolution manager (ReM) will be responsible for resolving stressed assets.
- While the ReM cannot be a related party to the originator, it must meet other specific eligibility criteria as well.
  - For personal, business and microenterprise loans of up to Rs. 50 crore, scheduled commercial banks, NBFCs and ARCs can act as ReM.
  - For other loans, entities registered with a financial sector regulator, insolvency professional* or an insolvency professional entity can act as the ReM.
- Facility providers, including originators acting as ReM, can offer CE, liquidity, underwriting, and servicing facilities.
- The originator or ReM or both may retain risk as per the contractual arrangement among the parties involved.

*Source: RBI, ICRA Research; *Registered with The Insolvency Bankruptcy Board of India, 2016*

Proposed guidelines also outline requirement for minimum risk retention and sale consideration

There is no minimum risk retention (MRR) requirement, except if the originator is acting as the ReM. If the originator is the ReM, then the MRR requirement is 5%. However, any exposure above 10% and up to 20% shall be treated as first loss. The cap will not be deemed to be breached if its due to amortisation.

The originator of the PTCs will sell assets only on cash basis. The valuation for the same will be based on the report provided by two external valuers. The loan can be taken out of the books only on the receipt of the entire consideration.

Independent valuation reports can lead to more transparency in structures and are conducive for attracting investor trust in the acquisition process. Regular reporting will also augur well for investor confidence.

Source: RBI, ICRA Research

Criteria for eligible pool composition target diversity

The draft directions define 'pool of stressed assets' with reference to homogeneity and allowed concentration. The pools cannot be highly concentrated, and the specified criterion implies a minimum requirement of four assets. The specified criterion is that the sum of the squares of the relative shares* of underlying stressed loans has to be 0.30 or less. In this regard, an illustration is provided in the table below.

If all the loans in the PTC are of equal amounts, a minimum of four loans will be required to meet the proposed condition of diversity. The largest loan in the structure cannot exceed ~50% of the overall pool size if the above criterion is to be met.

Exhibit: Illustration of suggested calculation in relation to composition of the pool of stressed assets

Account number	Loan outstanding (Rs. crore)	Share of each asset	Square of share of individual asset
1	50	52%	52%^2 =0.27
2	5	5%	0.00
3	3	3%	0.00
4	6	6%	0.00
5	3	3%	0.00
6	6	6%	0.00
7	8	8%	0.01
8	9	9%	0.01
9	2	2%	0.00
10	4	4%	0.00
Total	**96**		**0.30**

*Source: RBI, ICRA Research; *The relative shares of underlying loans shall be calculated as the outstanding balance of each loan divided by total outstanding balance of the portfolio on the origination cut-off date. The standards laid out in the RBI's 2021 Directions on Securitisation of Standard Assets must be adhered to for the securitisation of stressed assets*

Risk weights for securitisation notes

The capital requirement for securitisation notes issued under these directions shall be based on the risk weights corresponding to the ratings issued by credit rating agencies, subject to the cap of the actual securitisation exposure, as per the recovery rating-based scale.

Exhibit: Comparison of risk weight across rating bands

	Securitisation of standard assets		Securitisation of stressed assets	
Equivalent traditional scale rating	Senior tranche	Non-senior tranche	Senior tranche	Non-senior tranche
AAA	15-20%	15-70%		
AA category	15-45%	15-140%		
A category	40-70%	60-210%		
BBB+	75-90%	170-260%		
BBB	**90-105%**	**220-310%**	**105%**	**310%**
BBB-	120-140%	330-420%		
BB+	**140-160%**	**470-580%**	**160%**	**580%**
BB	160-180%	620-760%		
BB-	200-225%	750-860%		
B+	**250-280%**	**900-950%**	**280%**	**950%**
B	310-340%	1,050%		
B-	380-420%	1,130%		
C category	**460-505%**	**1,250%**	**505%**	**1,250%**
Below C category	**1,250%**	**1,250%**	**1,250%**	**1,250%**

Source: RBI, ICRA Research

Exhibit: Rating bands for recovery ratings

Recovery rating	Recovery range	Equivalent traditional scale rating
RR1+	>150%	BBB
RR1	100-150%	
RR2	75-100%	BB+
RR3	50-75%	B+
RR4	25-50%	C category
RR5	Up to 25%	Below C category

The risk weight requirement for notes backed by stressed assets is in line with that of notes backed by standard assets. Further, risk weights would increase basis the decline in the recovery range for the underlying stressed assets. Herein, a key difference would be that while the recovery period for SRs is taken typically at eight years, the notes backed by stressed assets are subject to a cap of five years. Hence, downward rating transitions may be quicker and capital provisioning may be higher.

Valuation and provisioning norms

- The valuation of securitisation notes held in the books by the lenders shall be based on the linear amortisation of the issuance amount over the specified maturity, subject to a cap of five years.
- All categories of notes issued under the provisions of these directions must be fully provided for by the end of the fifth year. Comparatively, under the extant framework for ARCs, the RBI initially allows a maximum of five years to resolve assets, with the possibility of extending the same to eight years with board approval.
- The provisions to be maintained by the respective categories of the holders of notes shall be in proportion to the tranche-wise distribution of the risk-weighted exposures as illustrated below.
- If the cumulative provision of the tranche reaches 100%, then the incremental provision will be applicable to the next higher tranche.

Exhibit: Illustration on valuation/provisioning of securitised notes

	End of year 1					End of year 2				
Tranche	Gross outstanding exposure (Rs. crore)	Risk weight	Risk-weighted asset	Proportionate weight	Incremental provision (Rs. crore)	Gross outstanding exposure (Rs. crore)	Risk weight	Risk-weighted asset	Proportionate weight	Incremental provision (Rs. crore)
Senior	50	100%	50*100%=50	1.77%	1.77	30	100%	30	1.07%	0.98
Mezzanine	300	300%	900	31.86%	31.86	300	300%	900	32.09%	29.52
Equity	150	1250%	1875	66.37%	66.37	150	1250%	1875	66.84%	61.5
Total	500		2825		100	480		2805		92
	Cumulative provision = 500*20% = 100					Cumulative provision = 480*40% = 192				

Source: RBI, ICRA Research

Due diligence requirement for investors

- Investors can invest in securitised notes if the originator adheres to the MRR and know your customer (KYC) requirements.
- They must understand the risk characteristics and structural features of their exposures. They should regularly perform stress tests and hold additional capital if needed.
- Further, investors must continuously monitor the performance of the underlying exposures.
- In case of the securitisation of stressed individual loans, business loans and microenterprise loans of up to Rs. 50 crore, investors/ReM may undertake due diligence on a sample basis with the sample comprising at least one third of the portfolio by value and number of loans in the portfolio, subject to the originator retaining at least 10 per cent of the securitisation notes issued.

Source: RBI, ICRA Research

Comparison between SSA, TLE-SA and SAS (1/3)

	SAS	TLE –SA	SSA
Loans not in default	No	Yes	Yes
Purchase consideration transfer	In cash	Cash or SRs (a minimum of either 15% of the transferors' investment in the SRs or 2.5% of the total SRs issued)	In cash
Obligor concentration cap	Sum of squares of relative shares of underlying stressed loans is 0.30 or less	None; stressed asset pool to ARC may be concentrated or granular, single asset sell-down allowed	None; pools are mostly granular, single asset securitisation not allowed
Role of collection and recovery	Can be done by ReM or originator acting as servicer	Done by ARC in most cases	Done by servicer (mostly same as originator)
Homogeneity requirement	Pool of assets should be homogenous	No	Homogeneous needed only for simple, transparent and comparable (STC) transactions
Time frame for provisioning	5 years (can vary accounting standards followed by investor)	The maximum time frame for recovery is 8 years and can be coterminous with other lenders in case of an approved resolution plan	Linked to the balance tenure of the loans in the trust

SAS: Proposed framework for stressed asset securitisation; TLE-SA: Transfer of loan exposure for stressed assets; SSA: Securitisation of standard assets

Comparison between SSA, TLE-SA and SAS (2/3)

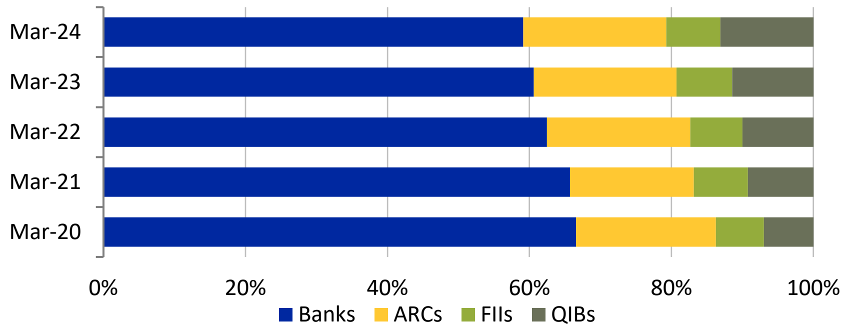
	SAS	TLE –SA	SSA
Servicer/recovery/collection agent fee	May be sizeable (legal costs, etc); fees and incentives need to be decided as they would impact return to investors	May be sizeable (legal costs, trustee fee and recovery incentive)	Minimal (part of waterfall)
Price discovery	The originator shall obtain two external valuation reports before securitising the pool of assets; issuance likely to be done at discount	Generally done at discount	Generally done at par
Types of asset securitised	Expected to be a mix of corporate and retail	Retail and corporate with increasing mix of retail assets in last few years	Mostly retail
MRR	Not compulsory	Not compulsory	Yes
Minimum holding period (MHP)	No	Yes	Yes
Exposure limit for originator	20%	85% of transferor amount	20%
External CE	Can be provided	Cannot be provided	Is generally provided

Comparison between SSA, TLE-SA and SAS (3/3)

	SAS	TLE –SA	SSA
Availability of CE	Only for senior tranche	No CE	Can be used for all tranches of notes
Rating transition of rated instruments	Higher share of ratings downgrade expected basis reducing timeframe for recovery; upgrades may be driven by better-than-expected/quicker recovery or CE buildup for senior tranche	Higher share of ratings downgrade basis reducing timeframe for recovery; upgrades driven by better-than-expected/quicker recovery	Higher share of ratings upgrade basis buildup of CE; downgrades due to underperformance of pool or deterioration in servicer credit profile
Liquidity facility	Can be provided	Cannot be provided	Can be provided, but not provided generally
Cashflows from underlying pool	Cashflows likely to be non-periodic and linked to resolution; timeliness and quantum of cashflows would be difficult to determine	Cashflows tend to be non-periodic and linked to resolution; timeliness and quantum of cashflows are difficult to determine	Cashflows are mostly periodic (monthly); loans have an EMI schedule so timeliness and quantum of cashflows are easier to determine
Cashflows to investors	Promising any cashflows to investor may lead to rating default in case recovery does not happen	No cashflow is promised to the investor; the upside is split between ARC and investor	Market is dominated by TIUP structures but TITP, UIUP and part TITP structures also exist; no upside is passed on to investor

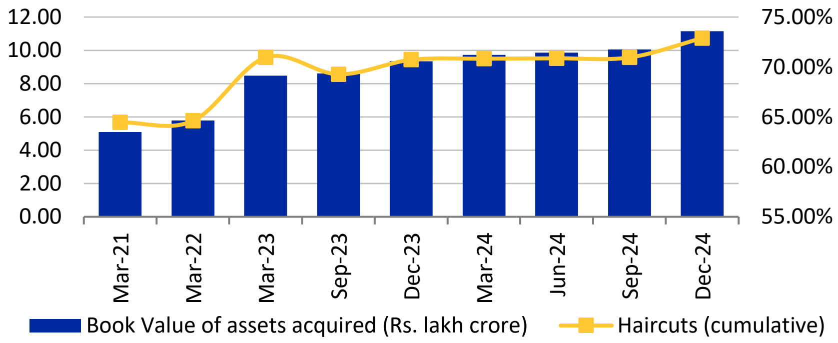
Price discovery could be a challenge; high haircuts likely, given the cash payment requirement

Exhibit: Investor share in SRs



Source: RBI

Exhibit: Cumulative acquisitions



Source: Association of ARCs

- Banks (originators) remain the dominant investors in SRs backed by loans sold by them to ARCs. The share of financial institution investors (FIIs) and qualified institutional buyers (QIBs) has, however, been increasing, indicating a broadening investor base.
- The cumulative amount of debt acquired by ARCs reached Rs. 11 lakh crore by Q3 FY2025, though there was a slowdown in FY2024 as the amount of fresh slippages had been lower on account of the healthy asset quality demonstrated by lenders. Cumulative haircuts, however, remain high and touched ~72% by Q3 FY2025 as the lenders have had to assign debt to ARCs at a price much lower than the debt outstanding.
- The proposed guidelines would act as an alternative to sale to ARCs and are expected to lead to originators retaining a lower share of bad debt while haircuts through this route could be higher, given the need for all-cash payouts (instead of a mix of cash and SR earlier).
- Since originators can retain only 20%, the share of banks and NBFCs is likely to be low under the proposed framework.

Will India mirror the global experience?

Global case studies – Securitisation of stressed assets

Region	Program/Approach	Mechanism & Structure	Recovery Model	Notable Outcome
United States	TALF (2008) & Legacy Loan Program under TARP	Government backed SPEs bought stressed assets Investors got non-recourse funding from Fed	Market-led recovery through securitisation & re-trading of toxic assets	Reactivated market for illiquid assets; total Fed exposure ~$70 billion unwound profitably
EU	HAPS (Greece), GACS (Italy), FMS Wertmanagement (Germany)	Public guarantees on senior tranches of NPL securitisations; originators retained junior tranches	State protects senior investors; resolution via servicers or bad bank arms	Greece: Over 300 million euros NPLs securitised (e.g. Eurobank's 'Cairo' deal); strong investor interest
China	Pilot NPL Securitisation (2016–) under CBIRC	State banks bundled NPLs into pools and sold senior/junior tranches via stock exchanges	Very selective; strict risk retention; high haircut securitisations	Modest volumes; investor confidence remains low due to opaque collateral and legal enforceability
Spain	SAREB ('Bad Bank') Model post-2009	Government created SAREB to absorb real estate NPAs from failed banks	NPA-backed bonds issued; slow recovery via auctions, litigation	Mixed performance; delayed recoveries, but stabilised bank books
Japan	Post-1997 NPL resolution through Jusen disposals	State guarantees + workout companies + banks' loan sales	Loan write-offs + asset securitisation over years	Took more than 10 years to resolve; shaped Asian securitisation reform

Opportunities and challenges

To summarise

Opportunities

- **A** Another avenue for lenders to offload stressed assets
- **B** Cap on originator exposure to lead to deepening of investor base
- **C** ARCs can operate with lower capital requirements as they can act as ReMs only
- **D** Availability of CE for senior tranche to provide credit & liquidity support

Challenges

- **A** Establishing recovery track record; recovery through earlier routes has been low
- **B** Entire purchase consideration to be made in cash; could lead to higher haircuts
- **C** CE only available for senior tranche; non-senior tranche ratings likely to be in non-investment grade, and hence low demand
- **D** Lower recovery time frame for the proposed framework
- **E** Structuring of repayment schedule/yield to investors could be difficult as pool cashflows likely to be non-periodic and resolution based

ICRA-assigned ratings for ARCs

List of ICRA-assigned ratings for ARCs

Name of the NBFC	Long-term rating	Outlook	Short-term rating
Asset Reconstruction Company (India) Limited	[ICRA]AA-	Stable	-
Edelweiss Asset Reconstruction Company Limited	[ICRA]A	Stable	-
JM Financial Asset Reconstruction Company Limited	[ICRA]AA-	Stable	[ICRA]A1+

Source: ICRA Research; Note: Data as on March 31, 2025

Annexure: Evolution of stressed asset resolution in India

Evolution of framework for resolution of stressed assets

Sick Industrial Companies (Special Provisions) (SICA) Act
1985

Recovery of Debts Due to Bank and Financial Institutes Act (RDDBFI)
1993

Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act
2002

Insolvency and Bankruptcy (IBC) Code
2016

Draft guidelines for securitisation of stressed assets
2025

- While recoveries from the SICA and DRT routes continued to be low and time consuming, the introduction of the SARFAESI Act in 2002 was a major gamechanger for lenders as it provided much faster resolution to secured lenders.
- The introduction of the IBC Code in 2016 was the next major reform, which put forth tighter timelines for recovery and provided both secured and unsecured lenders the option of tapping this route.
- While the IBC code has been amended since introduction and has led to the recovery of over Rs. 3.5 lakh crore for lenders, recovery, as a percentage of claims, has been ~30%. Nevertheless, it is better than recovery through the DRT or SARFAESI routes.
- ARCs emerged after the introduction of the SARFAESI Act and helped in the redemption of over Rs. 1.6 lakh crore of SRs with a cumulative redemption ratio of ~54% as of December 2024.
- The introduction of the current draft guidelines would act as an alternative to lenders who would either have to resolve these stressed assets on their own or through ARC sales. Sale to ARCs largely consisted of corporate loans initially while the sale of retail loans has also picked up gradually, especially given the stress seen in the unsecured segment.

Evolution of ARC business model

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Creation of the concept of ARCs in 2002-03, as part of debt securitisation legislation - SARFAESI Act. Initially, ARCs operated with a 5:95 model - they would bring in 5% of the money to buy out the debt. The major risk remained on banks' books. ARC earnings was driven by management fee

Post 2014, the 5:95 formula was changed to 15:85. This led to higher transfer of the stressed book from banks to ARCs. Resolutions improved, especially after IBC implementation

In October 2022, ARC net owned funds requirement was increased to Rs. 100 crore and to be increased to Rs. 300 crore; also, ARCs to now invest 15% of transferor investment in SR or 2.5% of total SR amount, whichever is lower

Many ARCs continue to have capital constraints and the new draft framework allows them to act as ReMs, which is likely to lead to lower capital requirements and new source of income through ReM fees

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Thank You!