

Indian Financial Markets

RBI releases final framework for PCE-backed bonds; improves cost benefit, though challenges persist

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RBI's directions aim to expand the partial credit enhancement (PCE) market and help entities raise funds via the bonds markets, by addressing some of the issues in the earlier regulations. The latter had led to limited traction in the PCE bond issuances over the last decade.



- The Reserve Bank of India (RBI) released final directions on [Non-Fund Based Credit Facilities \(including partial credit enhancement, PCE\)](#) on August 6, 2025, which are largely in line with the [draft directions](#) issued on April 9, 2025.
- The directions aim to expand the PCE market and help entities raise funds through the bonds markets, by addressing some of the issues in earlier regulations, which had led to limited traction in the PCE bond issuances over the last decade.
- Key proposals included expanding the scope of providing PCE to all regulated entities (RE; including scheduled commercial banks (SCBs)[^], all India financial institutions (AIFIs), non-banking financial companies (NBFCs) in top, upper and middle layers, and housing finance companies (HFCs)) compared to the earlier mandate, whereby only banks could provide the PCE.
- The PCE exposure limit by a single RE has been increased to 50% of the issue size, which is significantly higher than the previous [capping of 20% of issue size](#).
- The capital required to be maintained by the PCE provider will depend on risk weights applicable to the pre-enhanced rating of the issuer for the quantum of PCE provided, compared to the earlier formula of capital requirement, which was defined as the difference in capital calculated based on risk weights applied to the total issue size before and after the rating enhancement.
- The PCE shall be a subordinated facility and shall be provided in the form of an irrevocable contingent line of credit at the time of bond issue and will be drawn in case of shortfall in cash flows for servicing the bonds. Drawn PCE facility would become payable within a period of 30 days to the PCE provider. If it remains unpaid for 90 days, it will be classified as non-performing advance (NPA) by the PCE provider.
- Aggregate PCE exposure of an RE shall not exceed 20% of its Tier I capital.

[^] final guidelines have excluded regional rural banks (RRBs) from this framework, while it was not mentioned in draft guidelines

New framework by the RBI would lead to lower capital requirement for the PCE provider, which will eventually reduce borrowers' borrowing costs. In addition, increased credit enhancement can lead to higher notch upliftment in the credit rating.



However, presence of structural safeguards in the facility agreement would be critical to achieve meaningful credit enhancement of PCE-backed bonds.



- Lower capital requirement will make the PCE more commercially lucrative for REs as well as borrowers. For instance, as per ICRA's analysis, credit enhancement on account of the PCE that results in rating upliftment to A category from BBB category, would lead to capital reduction by 60% and some benefit of the same can be passed on to the borrower by way of reduction in fee.
- Under the new framework, an RE can extend PCE facility with maximum exposure to the extent of 20% of its Tier-I capital. Accordingly, the public sector banks (PSBs)* cumulatively having a Tier-I capital of ~Rs. 12.1 trillion as of March 2025 can support issuances of Rs. 4.8 trillion ($12.1 * 20\% * 2$). Similarly, AIFIs^ having a Tier-I capital of ~Rs. 2.0 trillion can support issuances of Rs. 0.8 trillion, whereas large infrastructure NBFCs# cumulatively having Tier-I capital of Rs. 2.5 trillion can support issuances of Rs. 1.0 trillion.
- While the PCE to a single bond issue would be increased up to 50% of the issue size, the structuring of the bonds will be important (such as exclusion of cross-default and/or debt acceleration clauses, amortising repayment schedule), for a meaningful upliftment of credit rating on these PCE-backed bonds.
- The circular mentions that the committed PCE facility would be available, irrespective of the borrower's asset classification. However, since the PCE is not a guarantee, more clarity would be needed on the availability of the PCE if the borrower enters bankruptcy due to default on other debt obligations. Thus, clarity on this and / or presence of mitigants that can reduce bankruptcy risk would be critical for determining the extent of rating enhancement that can be achieved for PCE-backed bonds.

*13 PSBs; ^5 AIFIs (NABARD, EXIM, SIDBI, NHB and NABFID); #includes PFC, REC, IREDA, IRFC, HUDCO, IIFCL



PCE – Credit enhancement mechanism to enhance credit rating of bonds



- Bonds issued by infrastructure companies/their special purpose vehicles (SPVs) often factor in the inherent risk on account of higher gestation and cash flow concerns in the initial stages of a project. Additionally, there can be temporary mismatches in cash flows and debt repayment obligations in case of some disruption in the project. As a result, investor interest for these issuances has remained low, given the higher risk perception, especially if the underlying assets are not diversified.



- With continued focus of the Government of India (GoI) towards infrastructural spending, given the prevalent lack of depth and liquidity in the corporate bond market for lower-rated corporate bonds and keeping in mind the huge credit needs of the infrastructure sector, the RBI in September 2015, had released a framework to allow banks to offer PCE to corporate bonds.



- Given the limited traction in such PCE bond issuances over the last decade, the RBI issued final guidelines in August 2025 (draft guidelines were previously issued in April 2025) to address some of the issues in the earlier regulations.

Enhances credit rating

- Higher-rated RE providing partial/ limited credit enhancement can lead to improved credit rating for the borrower and resultantly lower cost of borrowing



Enables access to larger pool of investors

- Given the improved credit rating, issuance becomes attractive to a larger set of potential investors like insurance and pension funds who predominantly invest only in AA/AAA issuances

Addresses asset liability mismatch

- Investment in long tenured projects is better suited by insurance/ pension funds, given their funding sources and long-term investment horizon compared to banks who rely on short-to-medium-term deposits

Benefits a variety of entities

- Projects with high predictability of cash flows but likely cash flow mismatches due to timing differences, given the nature of operations, such as renewable energy projects and state government-backed road annuity/ hybrid annuity (HAM) projects



The guidelines expanded the scope of providing PCE to all REs {which includes all SCBs (excluding RRBs)*, AIFIs, NBFCs and HFCs} to the bonds issued by all corporates/SPVs, by the NBFCs with asset size of at least Rs. 1,000 crore and by municipal corporations*. However, under the current framework, only banks are permitted to provide PCE. Widening the scope to all REs reduces the dependence of issuers on banks. Given the sizeable net worth of other REs such as AIFIs and infra financing NBFCs that are higher rated, wider participation could be possible.



In line with the draft guidelines, the final guidelines have increased the PCE exposure limit by a single RE to 50% of the issue size, which is significantly higher than the previous capping of 20% of the issue size. An increase in exposure limit, whereby a single RE can provide PCE up to 50%, will lead to higher upliftment of credit rating of underlying borrower's bonds leading to lower borrowing costs and providing access to larger pool of investors. However, certain challenges need to be addressed, which are discussed later in this note.



Capital required to be maintained by the REs providing contingent PCE for an issuance shall be based on the PCE amount and the applicable risk weight corresponding to the pre-enhanced rating of the bond. This will lead to reduced capital requirements for the RE when compared with the existing framework, which requires capital to be maintained as the difference between capital required on the entire bond amount corresponding to its pre-credit enhanced rating and capital required on bond amount corresponding to its post-credit enhanced rating. This shall eventually reduce the cost of availing such PCE and improve the cost-benefit analysis for the borrower.

*The draft guidelines had not excluded RRBs and there was no mention of PCE facility to bonds issued by municipal corporation

[^] RBI released final framework titled '[Reserve Bank of India \(Non-Fund Based Credit Facilities\) Directions, 2025](#)' on August 06, 2025

Existing framework and key amendments

	Existing framework	Proposed framework	Final framework	ICRA's comments
PCE provider	Only banks are permitted to provide PCE	All regulated entities including all SCBs, AIFIs, NBFCs and HFCs	All regulated entities including all SCBs (excluding RRBs), AIFIs, NBFCs and HFCs	<ul style="list-style-type: none"> Expanding the scope to all REs reduces dependence of issuers on banks and opens another avenue for other REs to support the infrastructure sector and earn fee income. Simultaneously, it increases competition for banks, although compensating them with capital release, given the lower capital requirements.
Higher exposure limit	PCE exposure limit for an issuance is capped at 20% of the bond issue size	PCE exposure limit for an issuance to be capped at 50% of the bond issue size	PCE exposure limit for an issuance to be capped at 50% of the bond issue size	<ul style="list-style-type: none"> An increase in exposure limit will lead to higher upliftment of credit rating of underlying borrowers' bonds issuances leading to lower borrowing costs and access to a larger pool of investors. This will, however, be subject to addressing certain challenges, as discussed later in the note.
Applicability	Corporate bonds Bonds issued by NBFCs/HFCs (non-deposit taking)	Corporate bonds Bonds issued by NBFCs/HFCs (non-deposit taking) with asset size of Rs. 1,000 crore and above	Corporate bonds Bonds issued by NBFCs/HFCs (non-deposit taking) with asset size of Rs. 1,000 crore and above; Bonds by Municipal Corporations	<ul style="list-style-type: none"> The entities eligible to get PCE facility remains largely same. However, the final framework adds the bonds issued by municipal corporations as eligible for PCE facility. This is expected to help those municipal corporations, which have weak credit profile, access bonds markets to raise resources for their funding needs.

Existing framework and key amendments

	Existing framework	Proposed framework	Final framework	ICRA's comments
Lower capital requirements	Capital to be maintained is the difference between capital required on entire bond amount corresponding to its pre-credit enhanced rating and capital required on bond amount corresponding to its post-credit enhanced rating	Capital required to be maintained by the REs providing contingent PCE for an issuance shall be based on the PCE amount and the applicable risk weight to the RE corresponding to the pre-enhanced rating of the bond	Capital required to be maintained by the REs providing contingent PCE for an issuance shall be based on the PCE amount and the applicable risk weight to the RE corresponding to the pre-enhanced rating of the bond	<ul style="list-style-type: none"> Lower capital requirement will make providing the PCE more commercially lucrative for REs as it will release capital. This will also enable REs to pass on the benefit to issuers by way of reduction in fee charged for providing PCE. For instance, under the new framework, if an issuance of Rs. 100 crore with a base rating of BBB is upgraded~ to A with a PCE of 20%, the capital requirement for the RE would be much lower at Rs. 1.8 crore $(20\% * 9\% * 100\% * 100)$ compared to the existing framework where the capital requirement is higher at Rs. 4.5 crore $((100\% - 50\%) * 9\% * 100)$. Similarly, release of capital is more for higher notch upliftment. However, the capital release for an instrument with a base rating in the A category, whose rating is being uplifted because of the PCE, is expected to be limited. For instance, in case of rating uplift from A category to AA and AAA, the capital release will be nil and Rs. 0.9 crore, respectively, for a bond issuance of Rs. 100 crore and PCE of 20%.

(% of PCE * required CRAR of bank * risk weight applicable to base rating * bond size)

^ (risk weight differential of base rating and enhanced rating * required CRAR of bank * bond size)

~This is only an illustration, actual extent of rating upliftment would depend on various factors including covenants in the agreement

Other salient operational features of the PCE facility

PCE form	PCE shall be a subordinated [^] facility and shall be provided in the form of an irrevocable contingent line of credit at the time of bond issue and will be drawn in case of shortfall in cash flows for servicing the bonds.
Pre-enhanced rating	REs to offer PCE only to bonds that have a pre-enhanced rating of investment grade (i.e., not below BBB-) by accredited external credit assessment institutions (ECAI).
Investors in PCE bonds	REs not permitted to invest in bonds that are credit enhanced by other REs.
Ringfencing	REs shall ensure that the project assets, created out of the bond issue for which PCE has been provided by them, and the cash flows from the project are ring fenced through an escrow account mechanism administered under a bond trustee arrangement.
Exposure limit for REs	Aggregate PCE exposure of an RE shall not exceed 20% of its Tier-I capital.
Additional conditions for PCE to bonds of NBFCs/HFCs	PCE will be provided to bonds with a tenor of not less than three years. Proceeds from bonds backed by PCE from REs shall only be utilised for refinancing the existing debt of NBFCs/HFCs. The exposure of an RE by way of PCEs to bonds issued by each such NBFC/ HFC shall be restricted to 1% of capital funds of the RE within the extent of single/ group borrower exposure limits.
Treatment on balance sheet	PCE facilities to the extent drawn will be treated as on-balance sheet advance on balance sheet whereas undrawn facilities would be an off-balance sheet item and reported under contingent liabilities.

[^] the clause of subordination of PCE facility is introduced in final framework, while it was not there in draft guidelines

Exhibit 1: Scenario analysis

Tier I capital (in Rs. crore)	Max PCE exposure (in Rs. crore) (maximum exposure capped at 20% of Tier-I of RE)	Max issue size (in Rs. crore) (corresponding to max PCE as 50% of the issue size)
20,000	4,000	8,000
40,000	8,000	16,000
60,000	12,000	24,000
80,000	16,000	32,000
1,00,000	20,000	40,000

- As seen in Exhibit 1, REs with Tier-I capital of Rs. 1,00,000 crore, taking a maximum exposure of 20% of its Tier-I capital, would be able to provide PCE for a maximum of Rs. 20,000 crore. Consequently, given the PCE capping at 50% of issue size, bond issuance of up to Rs. 40,000 crore can be supported by the RE.
- Extending the above calculation, the public sector banks* cumulatively having a Tier-I capital of ~Rs. 12.1 trillion as of March 2025 can support issuances of Rs. 4.8 trillion (12.1*20%*2). Similarly, AIFIs^ having a Tier-I capital of ~Rs. 2.0 trillion can support issuances of Rs. 0.8 trillion, whereas large infrastructure NBFCs# cumulatively having Tier-I capital of Rs. 2.5 trillion can support issuances of Rs. 1.0 trillion. However, certain challenges need to be addressed, which are discussed later in this note.

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Liquidity facility

The PCE facility would become payable within a period of 30 days to the PCE provider. If it remains unpaid for 90 days, it will be classified as an NPA by the PCE provider. This restriction makes the nature of PCE facility akin to a liquidity facility (providing only a liquidity cushion of 30 days) rather than a genuine long-term first loss credit enhancement unit. This feature could limit the extent of rating enhancement possible on credit enhanced debt, solely because of the PCE's availability.



Bankruptcy remoteness

The PCE facility would be a line of credit extended by the REs and not a guarantee. While the circular mentions that the committed PCE facility would be available irrespective of the borrower's asset classification, there is need for more clarity on whether the PCE facility could be drawn if the borrower enters bankruptcy due to default on other debt obligations. Unavailability of the PCE facility during the borrower's bankruptcy would limit the extent of credit enhancement vis-à-vis a partial guarantee, with the similar coverage.

Key considerations to be incorporated in the PCE terms



Invocation and payment timelines

The timelines and mechanism for the invocation of the PCE should be clearly defined to ensure that the payments are made in a timely manner and there is no default on the supported bond (single day single rupee).



Cross-default and acceleration

There should not be a cross-default clause on the PCE-backed bond with other debts of the borrower, which has a weaker credit profile (current or future), else it would align the probability of default (PD) on the PCE-backed bond with that of other debt on the borrower's balance sheet. A default on the latter could trigger debt acceleration on the PCE-backed bond, which in turn could lead to its default (as coverage in event of acceleration of bond would only be partial).

Additionally, a default on the PCE facility should not be classified as an Event of Default, that could trigger acceleration of the borrower's other debt and stress the borrower's liquidity. The PCE provider should also have no recourse to initiate bankruptcy proceedings against the borrower even if the PCE-backed bonds remain outstanding.

Although the final guidelines specify that the PCE facility will be subordinate, which may imply a separation of default risk between the PCE and other facilities, this distinction must be clearly articulated within the facility agreement.

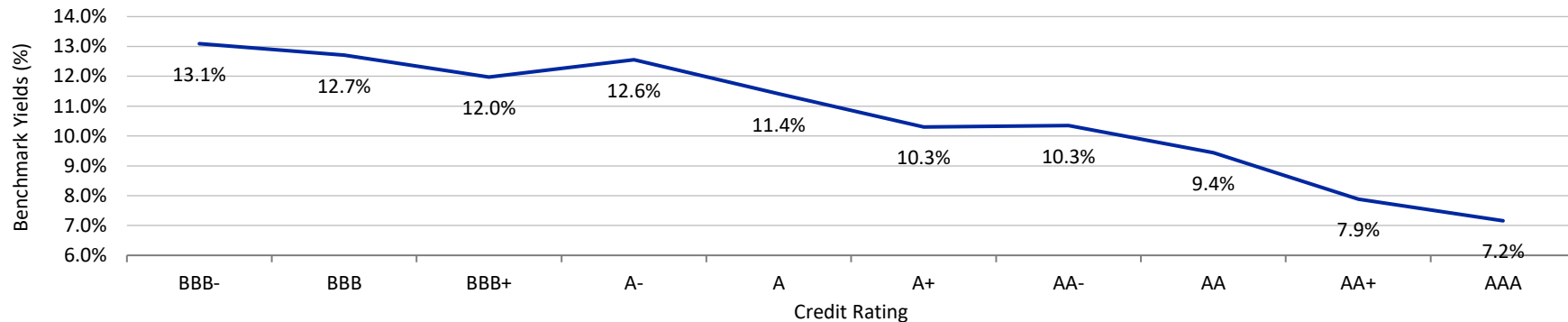


Structural safeguards

Presence of structural safeguards such as absence of any other debt apart from the PCE-backed bond, and covenants that restrict additional borrowing, thereby minimising potential sources of bankruptcy.

Annexure I: ICRA's benchmark corporate yield curve for investment grade issuances

Exhibit 2: Corporate yield curve



Source: ICRA Research; benchmark yields calculated for different rating levels for a tenure of 3-7 years as on July 2025

- A three-notch improvement in the BBB category rating can result in a benefit of up to 170 basis points (bps) reduction in the borrowing costs, whereas a two-notch improvement from an A category rating can result in a benefit of more than 100 bps reduction in the borrowing costs for the issuer.
- With the reduction in capital requirement, the RE can reduce the fee charged. Consequently, ICRA believes the guidelines will be positive from a cost benefit point of view, provided the challenges highlighted earlier are addressed.
- For instance, under the new framework, if an issuance of Rs. 100 crore with a base rating of BBB category gets upgraded to the A category with a PCE of 20%, the capital requirement would be Rs. 1.8 crore under the revised framework; and with a notional return on equity (RoE) for e.g. of 16% for the RE, the annual fee would be 30 bps of the bond issue, whereas the same is higher at 72 bps under the existing framework. This makes the cost of PCE significantly lower compared to savings, as mentioned above.



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