



April 2025

## Proposed Framework on Securitisation of Stressed Loans

The Reserve Bank of India (“**RBI**”) has issued the Draft Directions on Securitisation of Stressed Assets on April 9, 2025 (“**Draft Directions**”). The Draft Directions sets out a Framework for Securitisation of Stressed Assets (“**Stressed Asset Securitisation Framework**”) to be undertaken by specified regulated entities of the RBI.

The Stressed Asset Securitisation Framework is set to deepen the secondary market of stressed loans by providing more flexibility to the banks and financial institutions to convert illiquid loans into tradable securities. Further, it will provide a broader mechanism for the regulated entities to undertake securitisation of their stressed loan exposures, similar to the framework applicable to securitisation of standard assets.

## Overview of the proposed Stressed Asset Securitisation Framework

The key elements proposed in the Draft Directions are discussed below:

### 1. Applicability:

- a) **Regulated entities:** The Stressed Asset Securitisation Framework will be applicable to banks (including overseas branches of Indian banks), non-banking finance companies (including housing finance companies), small finance banks and all Indian financial institutions.
- b) **Eligible assets:**
  - i) a homogeneous pool of stressed loans can be securitised as per these Draft Directions. Such assets can be either: (A) personal loans (except educational loans) to individuals and business loans to individuals and micro enterprises not exceeding INR 50,00,00,000 (Indian Rupees fifty crore) (“**Category A Loans**”); or (B) other loans (“**Category B Loans**”);
  - ii) the ‘pool of stressed loans’ is defined to mean a portfolio of stressed loans in which the sum of squares of the relative shares of underlying stressed loans is 0.30 or less. The ‘relative shares of underlying loans’ is calculated as the outstanding balance of each loan divided by total outstanding balance of the portfolio on the origination cut-off date; and
  - iii) up to 10% of the aggregate outstanding exposures in the underlying pool can consist of standard assets and the remaining 90% must consist of non-performing assets;

c) **Excluded assets:**

- i) the Draft Directions continue to limit securitisation of exposures to other lending institutions, refinance exposures of AIFI, re-securitisation. Other kinds of exposures which are excluded are: (A) education loan; (B) farm credit; and (C) accounts marked as wilful defaulter or fraud or red flagged account; and
- ii) loans with bullet payments and revolving credit facilities are not excluded from the ambit of securitisation exposure;

2. **Key features**

a) **Minimum Retention Requirement (“MRR”) and Minimum Holding Period (“MHP”):**

- i) The originator will be required to maintain the MRR only in the following limited situations:
  - if the originator is acting as the Resolution Manager (“RM”), the originator will have to retain a MRR of 5%; and
  - if the due diligence is performed on a sample basis with sample comprising of at least one third of the portfolio by value and number of loans in the portfolio, the originator will have to retain at least 10 % of the securitisation notes issued;
- ii) the originator and/or servicer can contractually be required to retain MRR; and
- iii) there is no obligation to maintain MHP requirement;

b) **RM:**

- i) the Draft Directions have introduced a concept of RM. RMs are responsible for carrying out resolution/recovery related activities of underlying exposures. Further the eligibility criteria of a RM are provided in the Draft Directions;
- ii) for Category A Loans, the RM can be the originator, or an entity regulated by RBI (including, a bank, non-banking finance company or asset reconstruction company). If the originator is the RM, then it must maintain at least 5% of the securitisation notes as discussed in paragraph 2 (a) (i) above;
- iii) for Category B Loans in addition to the entities which can be appointed for Category A Loans, following may also be appointed as RM: (A) entity registered with a financial sector regulator in India; (B) an insolvency professional registered with IBBI; or (C) insolvency professional entity; and
- iv) RM can also raise finance for the operational purpose of resolution of the stressed assets. Such finances cannot be provided by the originator or its group entities. There is also a threshold applicable for such finance (which is 75% of the total requirement).

c) **Investor pool:** For securitisation consisting of Category B Loans, persons disqualified by 29A of the Insolvency and Bankruptcy Code, 2016 with respect to the borrowers cannot be an investor to such securitisation.

All other conditions applicable to a special purpose vehicle under the Master Direction on Securitisation of Standard Assets, 2021 (“**Standard Asset Directions**”) will also apply for securitisation of stressed assets.

d) **Price discovery sale consideration:** The accounting provisions applicable for a securitisation under the Standard Asset Directions will also apply for securitisation of stressed assets. However, under the Stressed Asset Securitisation Framework, the assets cannot be said to be transferred unless the sale consideration has been paid. Sale consideration will have to be paid on cash basis.

The originators are also required to incorporate the price discovery methodology in their policies such that the realisable value of underlying stressed loans is reasonably estimated in a fair and transparent manner. For any securitisation involving Category A Loans, 2 (two) external valuation reports will also be required.

e) **Credit enhancement:** Originators can provide credit enhancement subject to such originators not exceeding the threshold of 20% of the total securitisation exposures created by such structure or scheme. RBI has

clarified that any exposure beyond the limit of 10% (upto 20%) will be treated as a first loss facility and the originators will have to provide capital accordingly. The 20% limit on total retained exposures will not be deemed to have been breached if it is exceeded due to amortisation of securitisation notes issued.

- f) **Regulatory filings:** Some of the key regulatory filings required to be undertaken are as follows:
- i) the originator is required to submit the details of the securitisation transactions to RBI on a quarterly basis and after the transfer, the special purpose vehicle will have to report the same to RBI. This provision will have to be built into the assignment agreement; and
  - ii) RBI has specified formats for reporting data of underlying borrowers and portfolio by the originators as well as servicers or RM. At least on a quarterly basis, the servicer or the RM is also required to provide the investors data to monitor pool performance.

## Conclusion

RBI seemed to have responded to the industry requests and have considered a balance approach for securitisation of stressed loans. RBI's approach aligns with the global securitisation practices. Such alignment can make Indian securitised products in stressed loans more attractive to international investors and facilitate cross-border investment flows.

Foreign portfolio investors, alternative investment funds and other domestic investors will now have an enabling framework to acquire and resolve stressed loans by investing through a special purpose vehicle without involvement of an asset reconstruction company. Institutional investors will also bring their expertise in faster resolution and turnaround of stressed loans.

The Stressed Asset Securitisation Framework allows for securitisation, which can potentially offer better recovery rates by tapping into a wider investor base and competitive pricing mechanisms.

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