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Introduction & Background

- RBI's existing Master Direction on Securitisation of Standard Assets, 2021 (SSA) governs securitisation of standard (performing) loans.
- However, India lacked a dedicated framework for securitising non-performing assets (NPAs) outside the ARC model.
- SARFAESI-based ARC securitisation remains dominant but limited in market depth and participation.
- The 2025 Draft Directions seek to expand securitisation of stressed assets using SPE and capital-market instruments.

UNLOCKING VALUE FROM STRESSED ASSETS: RBI'S DRAFT SECURITISATION FRAMEWORK, 2025

1. Master Direction – Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021

2. Discussion Paper on Securitisation of Stressed Assets, January 2023

3. Draft – Reserve Bank of India (Securitisation of Stressed Assets) Directions, 2025

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MASTER DIRECTION, 2021 – KEY PRINCIPLES

2. Eligible Assets and Prohibitions

- Only standard, on-balance sheet loan exposures are eligible.
- Exclusions:
  - Re-securitisation
  - Synthetic securitisation
  - Revolving credit facilities (e.g., credit cards)
  - Loans with bullet repayments
  - Loans <365 days maturity (with limited exceptions)

MASTER DIRECTION, 2021 – KEY PRINCIPLES

3. Minimum Holding Period (MHP)

- To ensure asset seasoning, the originator must hold loans for:
  - **3 months** (tenor ≤ 2 years)
  - **6 months** (tenor > 2 years)
- MHP is calculated from registration of security interest or first repayment, depending on circumstances.

MASTER DIRECTION, 2021 – KEY PRINCIPLES

4. Minimum Risk Retention (MRR)

- Ensures skin in the game for originators:
  - 5% for loans ≤ 24 months
  - 10% for loans > 24 months and bullet repayment loans
- MRR must be retained in specific forms (first loss facility, equity tranche, etc.) and cannot be hedged, sold, or encumbered.

MASTER DIRECTION, 2021 – KEY PRINCIPLES

5. SPE Governance and Independence

- SPE should have no ownership links to the originator.
- If set up as a trust:
  - Trustees must be independent.
  - No discretionary powers.
  - Investors must be empowered to replace trustees.

MASTER DIRECTION, 2021 – KEY PRINCIPLES

9. STC Framework (Simple, Transparent, Comparable)

- Transactions that meet STC criteria receive preferential capital treatment.
- STC compliance must be disclosed and verified continuously.

MASTER DIRECTION, 2021 – KEY PRINCIPLES

10. Capital Adequacy Norms

- Based on SEC-ERBA (External Ratings-Based Approach):
- Risk weights assigned as per CRA rating.
- Exposures without valid ratings are risk-weighted at 100% or more.

WHAT THE MASTER DIRECTIONS DID NOT COVER

1. **Securitisation of Non-Performing Assets (NPAs) / Stressed Assets**

- The 2021 Master Directions **only permit standard assets**.
- **Do not allow** securitisation of:
  - Non-performing assets (NPAs)
  - Stressed or defaulted loans
  - Recast or restructured loans

WHAT THE MASTER DIRECTIONS DID NOT COVER

2. No Framework for Resolution or Recovery Post-Securitisation

- No mention of how resolution/recovery of loans should be handled after transfer.
- **No concept of a "Resolution Manager"**, unlike ARCs under SARFAESI.
- Silent on who administers collections, restructuring, or legal recovery for the pool.

WHAT THE MASTER DIRECTIONS DID NOT COVER

3. No Special Provisions for Heterogeneous or Retail Pool Structures

- Requires **homogeneous** asset pools.
- Does not differentiate pools with small-ticket retail vs. corporate or business loans.
- No provisions for **sample-based due diligence** or simplified requirements for granular portfolios.

WHAT THE MASTER DIRECTIONS DID NOT COVER

4. Limited Role Definition for Servicers or Trustees

- While servicing is permitted, there are:
  - No formal eligibility criteria.
  - No escrow requirement.
  - No rules for separation or accountability of servicer/collection agent.

WHAT THE MASTER DIRECTIONS DID NOT COVER

5. No Specific Provisions Against Involvement of Wilful Defaulters / Related Parties

- Does not prevent:
  - Related parties of borrowers from investing in securitisation notes.
  - Persons disqualified under **Section 29A of IBC** from participating.
- No alignment with IBC or fraud/wilful default classification.

WHAT THE MASTER DIRECTIONS DID NOT COVER

6. No Framework for Price Discovery or Valuation of Transferred Loans

- Leaves valuation to contractual agreement without requiring:
  - External valuation reports
  - Pricing policy disclosures
- No specific methods for determining **fair value** or managing price opacity.

WHAT THE MASTER DIRECTIONS DID NOT COVER

7. No Capped Valuation Period or Linear Amortisation Requirement

- Silent on how securitisation notes are to be valued over time.
- No provisioning or write-down framework for securitised exposures held over extended periods.

WHAT THE MASTER DIRECTIONS DID NOT COVER

8. No Provision for Additional Finance to Underlying Borrowers

- Does not allow or contemplate:
  - Additional funding (e.g., working capital) for resolution or revival of underlying borrowers in the pool.

WHAT THE MASTER DIRECTIONS DID NOT COVER

9. Limited Disclosures Specific to Stressed Pools

- While general disclosure norms exist, the following are **missing**:
  - SMA/NPA level classification
  - Upgradation/recovery/loss history
  - Industry/sectoral risk disclosure
  - Security cover and legal status

WHAT THE MASTER DIRECTIONS DID NOT COVER

10. No Special Framework for Enhanced Regulatory Oversight

- No requirement for:
  - Mandatory quarterly regulatory reporting by SPE
  - Audited reconciliation of cashflows
  - Risk-based provisioning regime linked to tranche performance

2023 DISCUSSION PAPER – BRIDGE BETWEEN TWO REGIMES

- **Discussion Paper on Securitisation of Stressed Assets, January 2023**
- **Purpose of the Discussion Paper**

- Issued in **January 2023**, the paper aimed to explore a structured framework for **securitisation of non-performing assets (NPAs)** through the **Special Purpose Entity (SPE)** route, beyond the existing ARC framework under SARFAESI.

- Sought to **fill regulatory gaps** by developing a **market-based alternative** to ARC-led transactions, particularly for stressed asset resolution.

- Aimed to **solicit public and institutional views** on the proposed framework, termed **Securitisation of Stressed Assets Framework (SSAF)**, covering operational, prudential, and governance issues.

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Key Rationale

- To **enable securitisation of NPAs through SPEs**, on similar lines as securitisation of standard assets.
- To **overcome limitations** of ARC-centric resolution, such as:
  - Low investor participation
  - Opaque valuation methods
  - Limited scale and flexibility
- To align India's regulatory approach with **Basel Committee guidelines (CRE 45)** and **global models** like:
  - **EU Regulation 2021/557** on NPE securitisation
  - **UK PRA guidelines (PS24/21)**

Critical Discussion Points

- **Eligible Asset Pool**: Should SSAF be limited to NPAs or permit a small portion of standard assets to enhance structure and investor appeal?

- **Type of Loans**: Whether to prioritize **retail/MSME portfolios** (predictable cash flows) or also allow **large corporate NPAs** (higher recovery potential but more complexity).

- **Minimum Risk Retention (MRR)**: Should MRR be required at all? If yes, who should bear it—**originator, Resolution Manager (ReM), or both**?

Role and Regulation of Resolution Managers:

- Should ReMs be independent entities?
- How to regulate and ensure accountability?
- Can originators continue engagement post-transfer, for transition support?

- **Valuation and Pricing Mechanism**:
  - Proposed use of **Non-Refundable Purchase Price Discount (NRPPD)** as a risk-sensitive valuation method.
  - Explored possibility of **graded NRPPD** (30% to 50%) based on asset vintage.

Capital Treatment:

- Use of **Recovery Rating-based risk weights** under **ERBA**.
- Capital floor of **100%** for senior tranches.
- Explore NRPPD-linked capital relief.

Significance

- The Discussion Paper **laid the conceptual and policy foundation** for securitisation of stressed assets outside the SARFAESI regime.
- It **bridged the regulatory and structural gap** between:
  - The **2021 Master Directions** (for standard assets), and
  - The **Draft Directions of 2025**, which formalised SSAF.
- It marked a **shift from institution-led (ARC) to market-led resolution** of NPAs, encouraging **greater investor participation**, **better price discovery**, and **improved recovery outcomes**.

DRAFT DIRECTIONS 2025 – KEY REGULATORY INNOVATIONS

- **Purpose and Legal Basis**

The Directions are issued under the **Banking Regulation Act, RBI Act, and NHB Act** — and once finalized, will apply to all **scheduled commercial banks (except RRBs), NBFCs including HFCs, All-India Financial Institutions, and Small Finance Banks**, including their overseas branches.

DRAFT DIRECTIONS 2025 – KEY REGULATORY INNOVATIONS

They are intended to:

- Enable SPE-based securitisation of NPAs.
- Address drawbacks in ARC-centric models — such as opacity in valuation, lack of investor diversity.
- Align India's framework with **Basel's CRE 45 guidelines** and global practices (EU, UK).

Chapter I: Scope and Definitions

- **Key terms include:**

- **Stressed Asset Pool:** At least 90% of the pool must be NPAs at origination.
- **Origination Cut-off Date:** Risk/reward transfer date.
- **Resolution Manager (ReM):** Entity appointed by SPE to manage resolution.

Importantly, stressed asset pools are bifurcated into:

- Category (a): **Retail/MSME loans** up to ₹50 crore.
- Category (b): **All other loans**.

Chapter II: General Securitisation Requirements

1. ✓ *Eligible Assets*

- Only **homogeneous** pools allowed — no mixing of retail/MSME with corporate loans.
- Prohibited assets include exposures to other lenders, refinance, farm credit, education loans, fraud accounts, and wilful defaulters.

2. ⊘ *Restrictions*

- **No re-securitisation.**
- Standard assets in the pool must comply with 2021 Master Directions' negative list.

Chapter II: General Securitisation Requirements

3. *Minimum Risk Retention (MRR)*

- **Not mandatory**, except where originator or ReM retains risk under contract or is acting as ReM.

4. *Limits on Exposure*

- Originators can hold up to **20%** exposure — but anything beyond **10% is deemed 'first loss'**.

Chapter II: General Securitisation Requirements

5. *Conditions on SPEs*

- Must ensure investors are **not related parties or disqualified under IBC Section 29A**.
- SPE agreement must include this compliance clause.

6. 💰 *Accounting and Valuation*

- Only **cash sale** allowed.
- Loans can be removed from originator's books only after **full receipt**.
- **Two external valuations** are required for non-retail pools.

Chapter III: Facilities Supporting Securitisation

A. 🔒 *General Conditions*

- Facility providers can offer **credit enhancement**, but **only to senior tranches**.

B. 💼 *Resolution Managers (ReM)*

🔹 Who is the Resolution Manager?

The ReM is a distinct class of facility provider, appointed by the Special Purpose Entity (SPE) to handle resolution and recovery of stressed exposures in securitised loan pools.

This is not just a servicing role — it's a strategic mandate to drive realisation, value maximisation, and resolution planning.

Chapter III: Facilities Supporting Securitisation

- Eligibility – Where IPs and IPEs step in

For retail and MSME loan pools (defined under Paragraph 6(a)), only RBI-regulated entities — like banks, NBFCs, ARCs — can act as ReMs.

However, for large-ticket, corporate and other non-retail loans under Paragraph 6(b):

→The SPE may appoint as Resolution Manager:

- Any RBI-regulated entity,
- Any entity registered with a financial sector regulator, or crucially,
- Insolvency Professionals (IPs) and Insolvency Professional Entities (IPEs) — recognized by IBBI.

Chapter III: Facilities Supporting Securitisation

This is where our professional community gets directly integrated into the RBI-led financial recovery framework.

- **Why this matters**

As IPs and IPEs, we already:

- Understand stressed asset recovery,
- Have experience with resolution strategies,
- Know the borrower and asset ecosystems,
- And operate with fiduciary obligations and statutory safeguards.

The RBI now recognizes this skillset as transferable and critical to the securitisation market.

- Regulatory Conditions for ReMs

Now, a few important guardrails:

1. The ReM must not be disqualified under Section 29A of the IBC.

2. ReMs must not be related parties to the originator, except when the originator itself is the ReM (which is only permitted in certain retail portfolios).

3. All cashflows collected on behalf of the SPE must be kept in escrow — no co-mingling.

The RBI now recognizes this skillset as transferable and critical to the securitisation market.

4. Arms-length conduct is essential in any interface with the originator.

5. ReMs may raise additional funding (up to 75%) from third-party lenders to finance resolution activities — like legal expenses, operations, or due diligence.

6. The originator is barred from funding this — to maintain independence of the ReM.

What is expected from an IP or IPE as a Resolution Manager?

As ReMs, we are expected to:

- Formulate a recovery strategy and business plan for each pool,
- Oversee cashflow collection and monitoring,
- Engage with legal systems, borrowers, and co-lenders,
- Ensure ethical recovery practices aligned with RBI's Fair Practices Code,
- Maintain transparent disclosures to SPEs and investors.

This is not liquidation. This is a market-based resolution model — and it requires everything we are trained to do under the IBC, but in a new setting.

Chapter IV: Requirements for Lenders as Investors

- Due diligence must cover **at least 1/3rd of the portfolio** for retail pools.
- Securitisation notes must be **linearly amortised** over 5 years. After that, they must be valued at **Re 1**.
- These cannot be held in the **HTM (Held-To-Maturity)** portfolio.

Chapter V: Capital Requirements

- Based on a **recovery rating system** ranging from RR1+ to RR5.
- Risk weights for **senior tranches** vary from **105% to 1250%**.
- For **non-senior tranches**, risk weights are much steeper — up to **1250%**.

Chapter VI: Reporting and Disclosures

A. *Regulatory Reporting*

- Quarterly filings required by originator and SPE.

B. *Offer Document Disclosures*

- Must include asset maturity profile, credit quality, security cover, risk retention, and historic recovery data (Annex 2 format).

C. *Ongoing Investor Reporting*

- To be done **quarterly** by ReM or servicer (Annex 3).

Chapter VI: Reporting and Disclosures

D. Annual Financial Disclosures

- Notes to accounts of originators must disclose:
  - SPEs sponsored
  - Assets securitised
  - Exposures retained (Annex 4 format)

CHANGES FROM MASTER DIRECTIONS – DETAILED COMPARISON

Area	Master Direction (2021)	Draft Directions (2025)
Asset Scope	Only Standard Assets	Only Stressed Assets (NPAs ≥ 90%)
MRR	Mandatory (5%-10%)	Optional; only if Originator = ReM
SPE Requirements	Bankruptcy-remote, arm's-length	Similar; but enhanced focus on disclosures
Role of Servicers	Limited to collection	ReMs take control of asset resolution and performance

CHANGES FROM MASTER DIRECTIONS – DETAILED COMPARISON

Valuation	Internal or fair value	Mandatory dual external valuation for large loans
Capital Treatment	SEC-ERBA	SEC-ERBA + Recovery Rating + Risk Floor (105%-1250%)
Recognition of Gain	Unrealised gain separately tracked	Linear amortisation; final value can drop to Re. 1
Pricing of Assets	Not discounted	Must reflect NRPPD and realistic resolution recovery

CHANGES FROM MASTER DIRECTIONS – DETAILED COMPARISON

Disclosures	**Structured investor disclosures**	**Broader reporting to RBI, investors, and financials**

Slide 8: Critical Impacts on 2021 Framework

1. **MRR Relaxation:**

- A fundamental shift from mandatory MRR to a risk-aligned optionality
- Emphasis shifts from originator due diligence to ReM performance

2. **Capital Risk Recognition:**

- Capital provisioning based on **recovery expectations**, not just ratings
- Reflects risk of underlying NPAs (vs. performing pools in SSA)

Slide 8: Critical Impacts on 2021 Framework

3. Enhanced Valuation and Price Discovery:

- Moves away from subjective valuation practices
- Dual independent valuations + NRPPD = pricing integrity

4. Legal Architecture Extended:

- Draws upon regulatory principles under Banking Regulation Act & RBI Act
- Creates a new parallel channel to SARFAESI (not replacing it)

Thank you

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