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A STUDY ON ASSET RECONSTRUCTION COMPANIES

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ABSTRACT

This research paper aims at understanding the market of Asset Reconstruction Companies (ARCs). It also analyses the growth in the sector and aims to analyse the various trends in the ARC segment with regards to issuance, subscription and redemption of Security Receipts. The study will highlight various aspects of the ARCs in an attempt to analyse the sector and determine the challenges ahead.

***Keywords** – Asset Reconstruction Companies (ARCs), NPA*

INTRODUCTION

Under the aegis of The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, (SARFAESI Act) Asset Reconstruction Companies (ARCs) could be set up as a specialised financial institution which would help in alleviating the Non-Performing Asset (NPA) crisis in the Indian banking sector. The objective behind permitting ARCs and thereby securitisation of loans was to reduce the NPAs as the ARCs would buy the bad loans of banks essentially cleaning up the books of banks which were burdened by stressed assets. Thus, reconstruction of banks' assets is done by ARCs which are incorporated as companies under Companies Act and registered with RBI under SARFAESI Act. Under the securitisation process the ARCs issue Security Receipts (SRs) on the underlying stressed assets that have been purchased from the banks. These Security Receipts are purchased by Qualified Buyers, which include entities such as large financial institutions – banks, Non-Banking Financial Companies (NBFCs), insurance companies, asset management companies, etc. There has been a relaxation in minimum asset size requirement for NBFCs and Housing Finance Companies (HFCs) in 2025 thereby easing the eligibility for entities to register as QBs, which can increase the investor base for the SRs and give a boost to the securitisation market of ARCs by widening their capital base. [1]

REVIEW OF LITERATURE

Meher and Puntambekar (2018) analysed the correlation between profitability growth rate of ARC (ARCIL) and growth rate of GNPA and found that there was a high degree of positive correlation between the two variables indicating that an increase in Gross NPA level will increase profitability of ARC as it will have greater business opportunity.[2] **Azash and Reddy (2022)** identified low rates of redemption and inflated acquisition costs as two major issues impeding growth of the ARC segment.[3]

RESEARCH METHODOLOGY

Statement of Problem

The research aims to understand the ARC segment in Indian financial system and delve deep into analysing the various trends and patterns with regards to security receipts, their issuance, subscription and redemption.

Research Objectives

- To assess the overall ARC market in India
- To analyse the growth trends in the ARC market in India

Data Collection

The research is based on secondary data sources. The secondary data has been collected from the following sources - news articles, journals, credit rating agency reports, RBI reports and Reports of the Association of ARCs in India.

Limitations of Study

a) The study relies solely on secondary data sources and does not involve any primary research.

b) The scope of research is limited up to FY 21.

Data Analysis

Assessment of the overall ARC market in India and analysis of growth trends

Currently there are 27 ARCs operating in India registered with Reserve Bank of India (RBI). The oldest ARC established in India was ARCIL in 2002. In 2021, NARCL was set up as a government sponsored ARC with

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public sector banks being the majority stakeholders. The ARCs have seen the following growth trend with regards to book value of stressed assets acquired, with growth declining in FY 2024, however in absolute terms Rs.1,86,303 Crores was added from FY 23 to FY 24. –

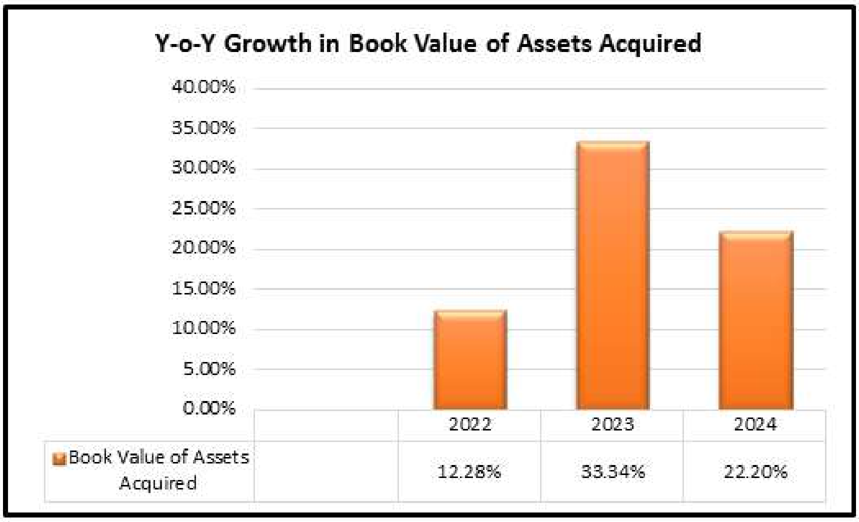

Figure 1

Source: RBI Report on Trend and Progress of Banking in India(FY 22-23, FY 23-24)[4]

In FY 25, the book value of assets increased significantly from 10.2 lakh crores to 16.1 lakh crores showing a Y-o-Y growth of more than 60%, however this growth was primarily driven by one- time acquisition of almost Rs.4.2 lakh Crore of the stressed assets held in the Stressed Assets Stabilisation Fund (SASF) which was set up by the government to deal with the stressed assets of IDBI bank, in 2004. Thus on excluding the legacy assets under SASF, the increase in book value of assets was only Rs.1.71 lakh crore thus showing a decline in growth to approximately 16.7% from FY 24 to FY 25.

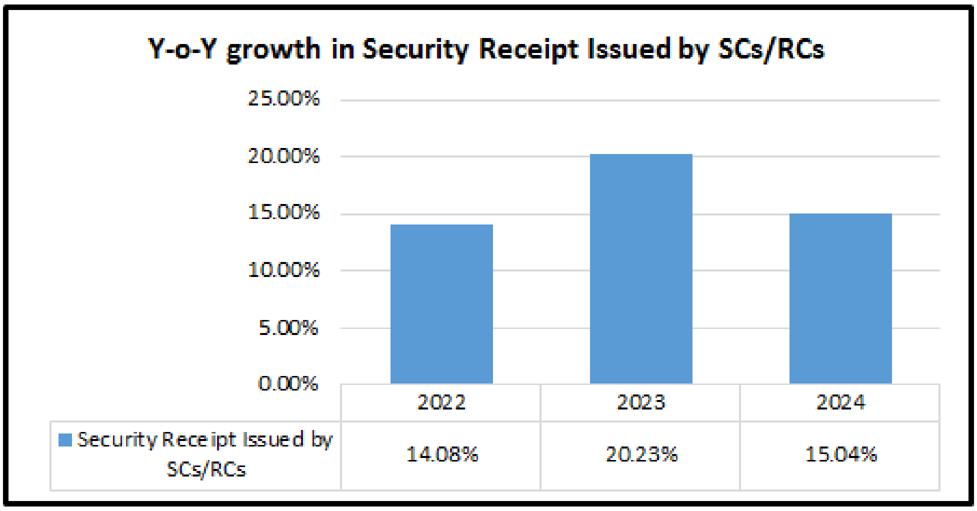

Figure 2

Source: RBI Report on Trend and Progress of Banking in India(FY 22-23, FY 23-24)[5]

Security receipts are an integral part of the securitisation process and the means by which ARCs raise funds against the stressed asset portfolios purchased by them. From FY 24 to FY 25, the issuances of security receipts saw a stagnant growth in absolute terms with numbers being similar to the previous year at approx. Rupees Thirty Seven Thousand Crores.[6]

Table 1: Security Receipts Issuance and Subscription

Particulars	**FY 2021**	**FY 2022**	**FY 2023**	**FY 2024**
Security Receipt Issued by SCs/RCs	179560	204841	246290	283330
Security Receipts Subscribed to by (a) Selling Banks/FIs	117551	128007	149253	167483

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Security Receipts Subscribed to by (b) SCs/RCs	35522	41350	49519	57201
Security Receipts Subscribed to by (c) FIIs	11427	15069	19383	21518
Security Receipts Subscribed to by (d) Others (Qualified Institutional Buyers)	15060	20415	28135	37128

Source: RBI Report on Trend and Progress of Banking in India(FY 22-23, FY 23-24)

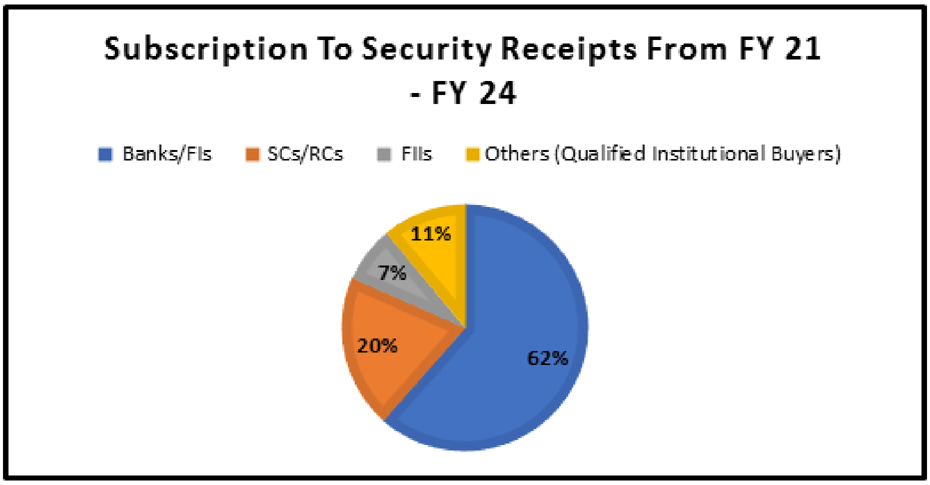

Figure 3

Based on Figure 3 it is evident that main buyers of Security Receipts issued by ARCs have been Banks and financial institutions contributing to 62% of the subscription. However looking at Figure 4 it is clear that growth rate of subscription for banks and FIs has not shown much increase. With FIIs the subscription and thereby interest in the security receipt market as an investment alternative is showing a declining trend.

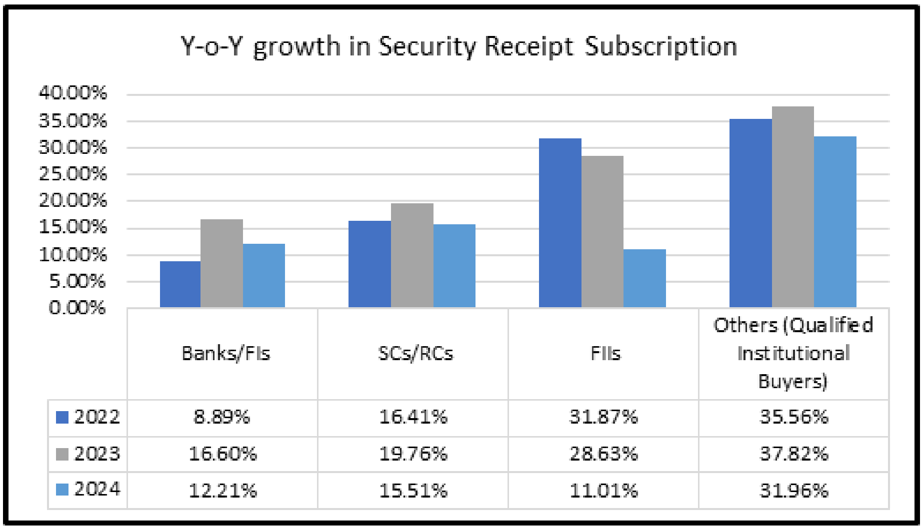

Figure 4

The security receipts issued by the ARCs are to be serviced through the cash flows generated in the recovery or redemption process of the underlying stressed assets which can be analysed using the Security Receipt Redemption value. This is the main source of cash inflow for the ARCs. The redemptions in overall numbers showed an increase by Rs.43,256 crore in FY 25 as compared to an increase in redemptions by Rs.37,364 Crores. This was a positive sign as it indicated a 15.8% increase in redemptions mainly due to recoveries driven by power and infrastructure sector. The major channel for the recoveries was through the legal route under Insolvency and Bankruptcy code which contributed to 2/3rd of the recovery, remaining was through sale of assets.[7]

CONCLUSION

As the ARC segment continues to grow and Security Receipts emerge as a viable investment alternative, the major challenge ahead for the sector is the reduction in Gross NPAs which has reduced the asset base which can be purchased by ARCs to create security receipts over. But the growth and momentum still continues since the government has relaxed several norms such as the restrictions on Net Owned funds to set up ARC, or capital

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restriction on investing in Security Receipts. Permitting NBFCs and HFCs to invest in Security Receipts also gives a big boost to the segment. At the same time with the well-structured legal recovery mechanism under the Insolvency and Bankruptcy Code the redemptions have shown an upward momentum.[8] Thus, securitisation in India through ARCs has been instrumental in cleaning the book of accounts of banks and enhancing liquidity and credit availability in the financial sector.

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