

**Press Release**

August 20, 2019 | Mumbai

**ARC AUM tops Rs 1 lakh crore, but growth slows***Regulatory changes increase capital intensity of ARC business model*

Assets under management (AUM) of asset reconstruction companies (ARCs), as measured by security receipts (SRs) outstanding, crossed the Rs 1 lakh crore mark as on March 31, 2019, up 7% from the previous year, a CRISIL estimate shows (*refer Annexure 1*).

While the value of debt acquired remained range-bound at around Rs 40,000 crore, AUM growth, which was 25% in fiscal 2018, slowed on higher discount rate and increase in SR redemptions.

For CRISIL-rated ARCs (accounting for ~75% of overall industry AUM), the cumulative SR redemption ratio<sup>1</sup> increased to ~15% as on March 31, 2019, from ~8% a year before (*refer Annexure 2*). While this increase has been driven primarily by resolution of a few large stressed accounts, write-offs have also partly contributed.

Notably, regulatory changes in recent years have been aimed at increasing ARCs' skin in the game and diversifying the potential investor base for stressed assets. In August 2014, the minimum investment requirement by ARCs for assets acquired was increased from 5% to 15%. Norms for investment in ARCs as well as SRs, including for foreign investors, were eased subsequently.

But the real push came when the provisioning norms for the selling banks were changed, wherein their investment in SRs over 50% (effective April 1, 2017) led to higher provisioning requirement by banks. This limit is now at 10%, effective April 1, 2018.

**Says Krishnan Sitaraman, Senior Director, CRISIL Ratings, "With selling banks unwilling to invest more than 10% in most cases, the business model for ARCs has become more capital intensive, with a need to either put in their own funds, or bring in other investors. In such a scenario, quicker recoveries by ARCs becomes even more critical as it helps free the capital deployed by them to make way for newer acquisitions and also attract new and repeat investors."**

More importantly, the year saw a structural shift, with a substantial jump in the cash share of the acquisition cost, resulting in sizeable investment by investor groups, apart from the selling institutions and ARCs. Cash as a portion of total acquisition cost for the fiscal 2019 was ~90%, which is a substantial pick up from 28% last fiscal.

**Says Subha Sri Narayanan, Director, CRISIL Ratings, "ARCs have been able to rope in external investors to subscribe to the SRs. In fact, in fiscal 2019, for CRISIL-rated ARCs, foreign banks, stressed assets funds and global pension funds, subscribed to ~60% of total SRs issued. Two years ago, this was negligible (*refer Annexure 3*)."**

Going ahead, given the increased requirement of capital, CRISIL believes the partnership model will be the way forward for ARCs. It could be via various routes – ranging from investment in ARCs themselves to investment in SRs to direct investments in stressed assets.

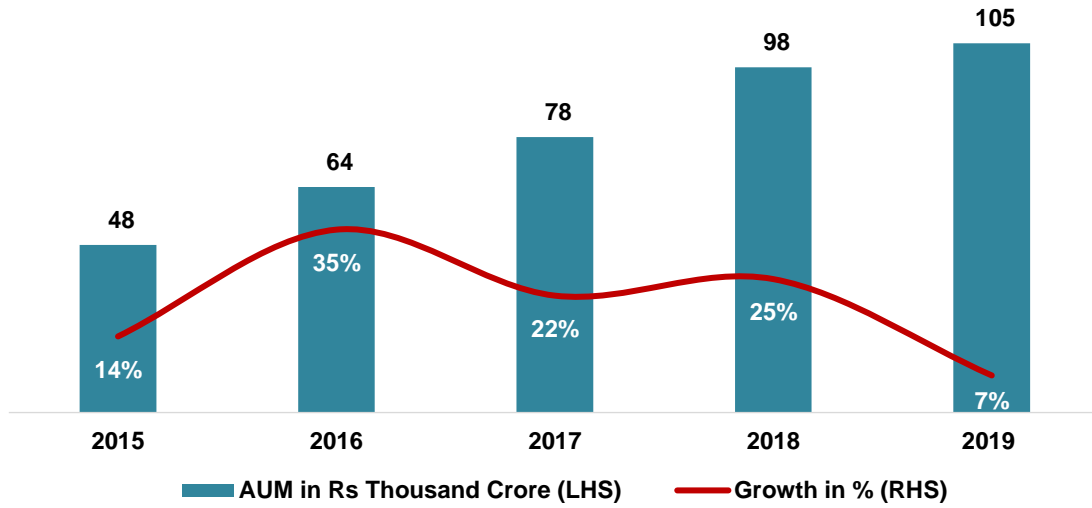
Also, the stressed assets opportunity remains sizable, with gross non-performing assets of Indian banking industry at a whopping Rs 9.4 lakh crore as on March 31, 2019. However, ARCs' ability to tap this opportunity and grow sustainably will hinge on their ability to collaborate with other investors and accelerate their pace of recoveries.

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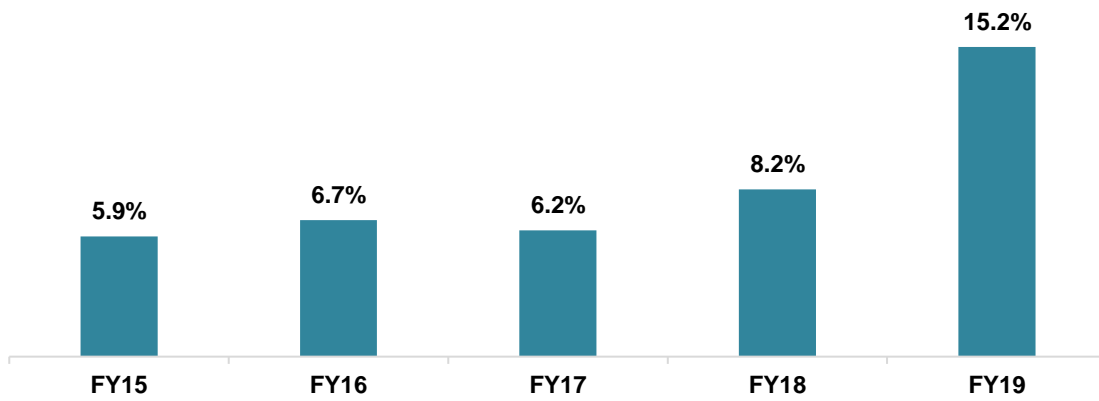
<sup>1</sup> Calculated as cumulative SRs redeemed as of a particular date/ cumulative SRs issued as of the same date.

**Annexures**

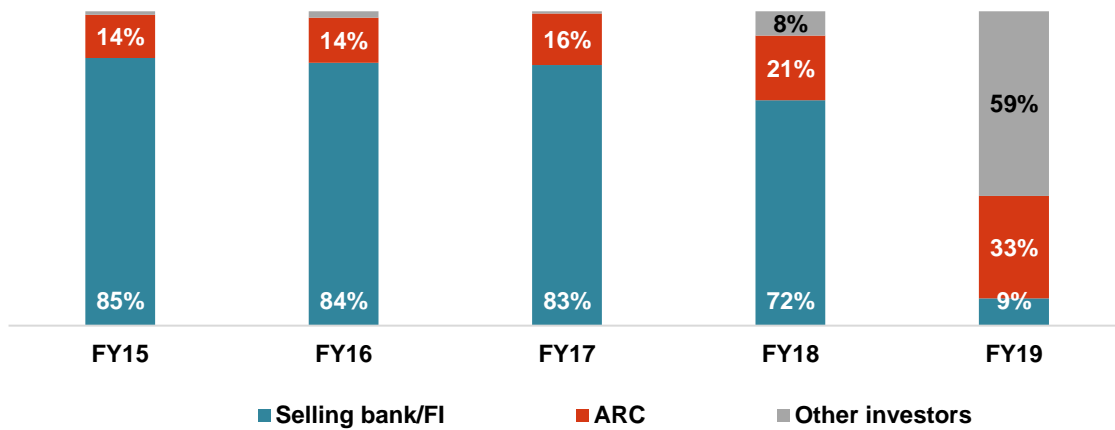
**Annexure 1: Trend of AUM growth of ARCs**



**Annexure 2: Trend of cumulative SR redemption ratio**



**Annexure 3: Trend of investment proportion by different subscriber types in SRs**



*Note: The above analysis is based on CRISIL-rated ARCs, which account for ~75% of the overall industry AUM*

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