Sale of Retail NPAs

- A synoptic overview

Who would sell such pools?

- NBFCs
- Banks

Who would buy such pools?

- NBFCs
- ARCs

Why would one sell them?

Loans turn non-performing in usual course of business, sometimes due to factors like sticky collateral (e.g., in case of LAP loans)

Motivations

Seller	Buyer
To clean up the balance sheet	Rate of return

Sale to ARCs vs Sale to NBFCs

	Sale to ARCs	Sale to NBFCs
Capabilities	Mostly been dealing with corporate assets; recently, some of them have built retail capabilities	NBFCs have long been handling retail loans. Strong recovery teams, and rapport with collection agencies
Cash Transactions	Either cash or by issuing SRs, subject to minimum investment required as per regulation (15% of amount held by seller, or 2.5% of the aggregate)	All cash transactions
Buying of loans	Can buy 1 DPD to 89 DPD or NPAs only	Can buy any loans

Valuation

Seller

If value of loans transferred is more than Rs. 100 crores:

- At least 2 external valuations
- Price discovery through Swiss Challenge Method

Buyer

Should use discounting rate for NPV computation at least 3% higher than contractual IRR. If excess over such value paid, the same will be provisioned

Minimum Holding Period

3 – 6 months depending on the original tenure of the loan

Seller's Risk Retention

Full Credit DD done	If 33% - 99% DD done	Less than 33% DD
No retention required	10% retention required	Not permitted

Performing treatment for the Buyer

- Loans valued at fair value are treated as performing assets in the books of the buyer.
- In case of ARCs, the NPA treatment will be based on "realisation plan".
- In case of other buyers, NPA treatment will be based on record of recoveries relative to estimated cash flows

Profit booking by the Buyer

Only after the full realisation of the principal component