

Distressed assets need a market

The IBC requires a wider pool of investors willing to price distress

ILLUSTRATION: AJAYA MOHANTY



The Reserve Bank of India (RBI)'s recent clarification allows an asset reconstruction company (ARC) to act as a resolution applicant (RA) under the Insolvency and Bankruptcy Code (IBC), 2016, to acquire financial assets covered by the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002, without meeting the net owned funds (NOF) requirement of ₹1,000 crore. It broadens ARC participation in IBC resolutions, enabling smaller ARCs to participate as co-resolution applicants alongside other investors.

The RBI Directions, 2025, had allowed an ARC to act as an RA for IBC resolutions if it had a minimum NOF of ₹1,000 crore and did not retain significant influence or control over the corporate debtor beyond five years. Separately, the minimum NOF requirement for an ARC was ₹300 crore. With only five of 27 ARCs meeting the ₹1,000 crore threshold, those between ₹300 crore and ₹1,000 crore could not act as RAs.

The clarification is, therefore, significant for ARCs and the distressed-assets market. It recognises the ability of ARCs to invest in distressed assets. It brings a specialised distressed-debt investor in the resolution process and allows an ARC to participate alongside an applicant undertaking the non-SARFAESI aspects of a resolution plan, combining financial-asset expertise with capital and operational capabilities.

However, the limitation matters as much as the permission. A resolution plan involves much more than acquisition of debt. Acquiring financial assets is one limb of the plan, and it is this limb alone that the clarification opens to smaller ARCs. They cannot carry a resolution plan on their own, but must participate alongside an applicant undertaking non-SARFAESI aspects.

The rationale for not allowing smaller ARCs to act as full-fledged RAs is not entirely clear. An NOF threshold does not necessarily measure capability, nor does a lower NOF by itself indicate systemic con-

cern. It may also be difficult to segregate SARFAESI-covered financial assets from other assets and obligations within a resolution plan. Further, ARC's returns are tied to the price paid for debt, while much of the upside from a turnaround accrues to equity. The five-year safeguard for ARCs acting as RAs may not match the time a turnaround requires. Such restrictions have equipped ARCs to recover rather than to invest.

This raises the larger question: Does India have a market for distressed assets, or merely a process for disposing of them? The real test of greater ARC participation is whether it brings more credible buyers and improves price discovery, rather than merely allowing assets to change hands.

The IBC was designed as a market mechanism. Expressions of interest presume multiple prospective RAs; the committee of creditors' commercial wisdom envisages competing plans; and the challenge mechanism works only when there is more than one credible plan. Yet when a single plan effectively sets the price, fair value becomes an actuarial opinion and commercial wisdom becomes a choice between one plan and liquidation.

The IBC never aimed to determine value administratively. It envisaged the market to discover value and then give that discovery legal finality. Different investors value the same distressed asset differently: A bank may focus on potential recovery, an entrepreneur on going-concern value, a strategic investor on synergies, and a distressed investor on the hidden value that can emerge with time. The resulting price may not always be high, but it is the price the market is willing to offer.

ARCs were created precisely because distressed assets require specialised investors. They need aggregation, specialised valuation, tolerance for litigation and, above all, time. The RBI Committee in 2021 recognised this and recommended allowing ARCs to act as RAs, citing their stressed-asset expertise and the

ability to hold assets for a longer time. ARCs like National Asset Reconstruction Company Ltd have addressed aggregation at scale, but they cannot by themselves create a market.

Time is perhaps the biggest mismatch. Banks have their capital, provisioning and asset-liability mismatch measured against a much shorter horizon than the life of a distressed asset. When an IBC process contemplated for 330 days stretches into years, the bank's focus shifts from what the business is worth to what it can realise now. A process intended to maximise value consequently favours the upfront cash offer over better long-term economics.

ARCs can help bridge that mismatch. Their *raison d'être* is to acquire distressed exposures and work through the uncertainty of restructuring, litigation, and recovery. A bank can transfer an exposure to an ARC and convert an immediate balance-sheet problem into an investment with a longer horizon. The ARC can assess the asset as a distressed investor rather than through the shorter clock of a lender.

But this requires capital as much as regulatory permission. Security receipts can provide patience at scale only if backed by genuine third-party investors and supported by a credible secondary market. Where receipts are effectively funded by the selling bank, they can defer rather than resolve the recognition of loss. The objective should, therefore, be to build a wider investor base willing to price and hold distressed assets for the time their recovery requires.

Value in distress may lie in some combination of the business, collateral, cash flows, and restructuring potential. Investors, therefore, need room to structure transactions differently. They also need better information and faster resolution, because buyers cannot price what they cannot assess, and delay destroys value. And they need a wider pool of participants, not just ARCs, but alternative investment funds, private-credit investors, strategic investors and turnaround specialists.

India has built much of the institutional foundation for a distressed-assets market through the IBC and ARCs. What it now needs is to make that market work: More participants bringing different valuations, greater freedom to structure transactions, patient capital, and at least one class of investor able to hold an asset for as long as its recovery takes.

ARCs have the expertise, purpose, and experience to deal with distressed assets. The regulatory framework should allow them to play the role they are capable of, subject to safeguards, rather than confining them to the margins. Distressed assets need a market, and ARCs need to help create it.

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