Secondary Market For Corporate Loans

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The **Reserve Bank of India (RBI)** constituted Panel, headed by **T.N. Manoharan**, has given some suggestions for **developing the secondary market for corporate loans in the country**. Suggestions are as follows:

- Setting up a **Self-Regulatory Body (SRB)** of participants to finalise details for the secondary market for corporate loans, including the standardisation of documents.
- Creating a **Loan Contract Registry** to remove information asymmetries between buyers and sellers.
- Creating an **online loan sales platform** to conduct auctions and sale of loans.
- **Widening the Spectrum:** Enabling participation of non-banking entities such as mutual funds, insurance companies, and pension funds.
    - Banks and the **Non-Banking Financial Companies (NBFCs)** are currently the only participants in the primary and secondary loan markets.
- **Single loan securitisation** can be considered to incentivise investors to acquire loans through the secondary market mechanism.
    - Securitisation is currently permitted only for a pool of homogenous assets.
    - Securitization is a process by which a company clubs it's different financial assets/debts to **form a consolidated financial instrument** which is issued to investors. In return, the investors in such securities get interest.
- Allowing **Foreign Portfolio Investors (FPIs)** to directly purchase distressed loans from banks.
    - Currently, FPIs have to come through the **Asset Reconstruction Companies (ARCs)** to participate in the distressed loan market.
- Linking the pricing of all loans to an external benchmark as the current **Marginal Cost of Funds Based Lending Rate (MCLR)** may not be comparable across banks.

Asset Reconstruction Companies

- An Asset Reconstruction Company is a special type of financial institution that buys the debtors of the bank at a mutually agreed value and attempts to recover the debts or associated securities by itself.

- The ARCs are registered under the RBI and regulated under the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (SARFAESI Act, 2002).
- The ARCs take over a portion of the debts of the bank that qualify to be recognised as **Non-Performing Assets**.

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- **Secondary loan market in India** is largely **restricted to** the sale of loans to **Asset Reconstruction Companies** and no formalised mechanism has been developed to deepen the market.
    - **The secondary market** is the market where investors buy and sell securities they already own.
- A vibrant, deep and liquid secondary market for debt would go a long way in increasing the efficiencies of the debt market in general and would aid in the resolution of stressed assets in particular.
- A well-developed secondary market for debt would also aid in transparent price discovery of the inherent riskiness of the debt being traded.
- The secondary market for loans can also be an important mechanism for credit intermediaries to **manage credit risk and liquidity risk on their balance-sheets**, especially for distressed assets.

Source: Mint