Asset Reconstruction Company

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Why in News

In the **Budget 2021-22**, **Asset Reconstruction Company (ARC)** have been proposed to be set up **by state-owned and private sector banks,** and there will be **no equity contribution from the government.**

- The ARC, which will have an **Asset Management Company (AMC)** to manage and sell bad assets, will look to resolve stressed assets of Rs. 2-2.5 lakh crore that remain unresolved in around 70 large accounts.
- This is being considered as the **government's version of a bad bank.**

Key Points

- **About the Asset Reconstruction Company (ARC):**
    - **Objective:**
        - It is a **specialized financial institution** that buys the **Non Performing Assets (NPAs)** from banks and financial institutions so that they can clean up their balance sheets.
        - This **helps banks to concentrate in normal banking activities.** Banks rather than going after the defaulters by wasting their time and effort, can sell the bad assets to the ARCs at a mutually agreed value.
    - **Legal Basis:**
        - The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest **(SARFAESI) Act, 2002** provides the legal basis for the setting up of ARCs in India.
        - The SARFAESI Act helps reconstruction of bad assets without the intervention of courts. Since then, a large number of ARCs were formed and were registered with the **Reserve Bank of India (RBI)** which has got the power to regulate the ARCs.
    - **Capital Needs for ARCs:**
        - As per amendment made in the SARFAESI Act in 2016, an ARC should have a minimum net owned fund of Rs. 2 crore.
        - **The RBI raised this amount to Rs. 100 crore in 2017.** The ARCs also have to maintain a **capital adequacy ratio** of 15% of its **risk weighted assets.**

            Risk-weighted assets are used to determine the minimum amount of capital that must be held by banks and other financial institutions in order to reduce the risk of insolvency.

- **About the new ARC:**
  - **Need:**
    - Of the existing ARCs, **only 3-4 are adequately capitalised,** while the more-than-dozen remaining are thinly capitalised — necessitating the need to set up a new structure to resolve stressed assets urgently.
    - In a report released by Reserve Bank of India (RBI), it was said that **banks' gross non-performing assets may rise to 13.5% by September 2021,** from 7.5% in September 2020 under the baseline scenario.
  - **Functioning:**
    - The transfer of **stressed assets to the ARC will happen at net book value,** which is the value of assets minus provisioning done by banks against these assets. This could enable the banks to alleviate its losses from NPAs - a part of stressed assets.
    - **The bank will get 15% cash and 85% security receipts** against bad debt that will be sold to the ARC.
      - **Security Receipts (SR)** are issued by ARCs, when Non-Performing Assets (NPAs) of commercial banks (CB) or financial institutions (FI) are acquired by the ARCs for the purpose of recovery.
      - As per extant instructions, investment in SRs is restricted to the **Qualified Institutional Buyers (QIBs),** as defined by SARFAESI Act 2002.
  - **Support by Central Government:**

    While the **government will not provide any direct equity support** to the ARC, it **may provide sovereign guarantee** that could be needed to meet regulatory requirements.
- **Expected Benefits:**
  - This structure will reduce the load of stressed assets on the bank balance sheet and look to **resolve these bad debt in a market-led way.**
  - With most banks expected to be on board this company, the resolution is expected to be faster.

- **Other Proposed Reforms:**
  - **Development Financial Institution:**
    - The government could subsume **India Infrastructure Finance Company Limited (IIFCL)** into the proposed **Development Financial institution (DFI)**, which is being set up to enable long-term infra funding worth Rs. 5 lakh crore in 3 years.
    - **The National Bank for Financing Infrastructure and Development (NaBFID),** the proposed DFI, will anchor the **National Infrastructure Pipeline (NIP).**
    - The **Reserve Bank of India** will regulate the proposed DFI, which will be fully owned by the government in initial years.
  - **Privatisation:**
    - With regard to the privatisation of **two state-owned banks and one insurer,** the companies will be identified by a government-defined process.
    - **NITI Aayog** will do the first round for selecting, then it will go to the core group of secretaries on disinvestment and, thereafter, it will be examined by the alternate mechanism.