



## New Bad Bank Structure

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### Why in News

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Recently, the Union Cabinet **approved the Rs 30,600 crore guarantee to back Security Receipts issued by National Asset Reconstruction Company Limited (NARCL)** for acquiring stressed loan assets.

The NARCL is a part of a new Bad bank structure that was announced in the **Budget 2021**.

### Key Points

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- **About the New Bad Bank Structure:**

- For resolution of huge **NPA (Non-Performing Assets)** in the Indian Banking sector, the government of India has set up two new entities to acquire stressed assets from banks and then sell them in the market.
  - **NPA** refers to a classification for **loans or advances that are in default or in arrears**.
- **NARCL:** NARCL has been incorporated under the Companies Act and has applied to the Reserve Bank of India for a license as an **Asset Reconstruction Company (ARC)**.
  - NARCL will **acquire stressed assets** worth about Rs 2 lakh crore from various commercial banks in different phases.
  - Public Sector Banks (PSBs) will maintain 51% ownership in NARCL.
- **IDRCL:** Another entity, **India Debt Resolution Company Ltd (IDRCL)**, will then try to **sell the stressed assets** in the market.
  - PSBs and Public Financial Institutes (FIs) will hold a maximum of 49% stake in IDRCL. The remaining 51% stake will be with private-sector lenders.
- The NARCL-IDRCL structure is the new bad bank structure.

- **Need for NARCL-IDRCL Structure:**
  - **Existing ARCs have been helpful** in the resolution of stressed assets, especially for smaller value loans.
  - Various available resolution mechanisms, including **Insolvency and Bankruptcy Code (IBC)**, have proved to be useful.
  - However, **considering the large stock of legacy NPAs**, additional options/alternatives are needed and thus, the NARCL-IDRCL structure was announced in the Union Budget 2021.
- **Working of NARCL-IDRCL and Guarantee Offered:**
  - The **NARCL will first purchase bad loans** from banks.
  - It will **pay 15% of the agreed price in cash and the remaining 85% will be in the form of “Security Receipts”**.
  - **When the assets are sold**, with the help of IDRCL, the **commercial banks will be paid back the rest**.
  - If the bad bank is unable to sell the bad loan, or has to sell it at a loss, **then the government guarantee will be invoked**.
    - The **difference between what the commercial bank was supposed to get and what the bad bank was able to raise** will be paid from the Rs 30,600 crore that has been provided by the government.
  - This guarantee is extended for a **period of five years**.

## Note

- **Security receipts** are defined under section 2(1) (zg) of **SARFAESI Act**.
- It means a receipt or other security, issued by an asset reconstruction company to any qualified buyer pursuant to a scheme, evidencing the purchase or acquisition by the holder, thereof, of an undivided right, title or interest in the financial asset involved in securitization.

## Bad Bank

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- **About:**
  - The bad bank is an **Asset Reconstruction Company (ARC)** or an **Asset Management Company (AMC)** that takes over the bad loans of commercial banks, manages them and finally recovers the money over a period of time.
  - The bad bank is **not involved in lending and taking deposits**, but helps commercial banks clean up their balance sheets and resolve bad loans.
  - The **takeover of bad loans is normally below the book value of the loan** and the bad bank tries to recover as much as possible subsequently.

- **Effect of Bad Bank:**

- **Commercial Banks' Perspective:** Commercial banks are saddled with high NPA levels, setting up of the Bad bank will help.
  - That's because such a bank will get rid of all its toxic assets, which were reducing its profits, in one quick move.
  - When the recovery money is paid back, it will further improve the bank's position. Meanwhile, it can start lending again.
- **Government and Taxpayer Perspective:** Whether it is recapitalising PSBs laden with bad loans or giving guarantees for security receipts, the money is coming from the taxpayers' pocket.
  - While recapitalisation and such guarantees are often designated as "reforms", they are band aids at best.
  - The only sustainable solution is to improve the lending operation in PSBs.
  - The plan of bailing out commercial banks will collapse if the bad bank is unable to sell such impaired assets in the market. The burden indeed will fall upon the taxpayer.

## Way Forward

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- So long as Public Sector Banks' managements remain beholden to politicians and bureaucrats, their deficit in professionalism will remain and subsequently, prudential norms in lending will continue to suffer.
- Therefore, a bad bank is a good idea, but the main challenge lies with tackling the underlying structural problems in the banking system and announcing reforms accordingly.

**Source: TH**