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IS BAD BANK SOLUTION TO NPA CRISIS IN INDIA ?

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ABSTRACT :

To address the growing non-performing assets of banks (which was further worsened by Covid pandemic), the government created the Assets Reconstruction Mechanism known as the bad bank. What is the concept behind a "bad bank"? How is a bad bank established in India? Can a bad bank or asset rehabilitation firm help India's NPA problem? India failed to meet the anticipated target of transferring the same in 2021, and the answer as to whether a bad bank or ARC can alleviate India's NPA problems will be clear in the coming future. Has it been successful in other countries in the past or is the bad bank notion only a technique to clean up the bank's balance sheet, rather than a lasting solution? This essay seeks to answer the above by analyzing different aspects of the same.

INTRODUCTION :

A prerequisite for a healthy economy is the presence of a stable and well-performing banking system. The basic function of a bank is the accepting of deposits from the public and the further distribution of these deposits in the form of loans. However, in certain situations, it may happen that the assets held by the banks are toxic assets that arise from the non-payment of loans and other advances from the borrowers.

These assets are thus coined as Non-Performing Assets (NPA) as they are unable to generate income for the bank. Bad Banks are thus financial institutes that buy NPAs from existing banks at discounted rates and service these NPAs separately, thereby enabling the stressed bank to free up its balance sheet and further advance loans to the public without constraints.¹ Bad Bank is a concept that has only been recently introduced in India (Economic Survey,2017), and is yet to see the advent of such institutions.

¹ A B, Vijayakumar. (2021), *AN OUTLINE OF BAD BANK IN INDIA*, <https://www.researchgate.net/publication/350006464>

CONCEPTUAL ANALYSIS OF A BAD BANK :

A bad bank is a company that was formed to separate a conventional² bank's stressed assets from its performing assets. Banks rely upon the bad bank to take on their toxic assets, which the bad bank will then manage for a fraction of their book value.

Over time, the bad bank will get its money back, either through reorganisation or liquidation. Henceforth, conventional banking firms may stop fretting over their bad loans without consequences. Although they go by the name "bank," they are not at all like a conventional financial institution.³

A bad bank profit from its operations if it is able to sell toxic assets or bad loans for a better price than it paid to acquire the toxic assets or bad loans from a bank, further in the debt management agreement, it has been described that the National Asset Reconstruction Company Ltd (Hereafter referred as *NARCL*) and India Debt Resolution Company Ltd (Hereafter referred as *IDRCL*) have a private agreement.⁴ It'll be based on a "principle-agent" basis and the concluding approvals for resolution will lie with NARCL. This approach will also be fully compliant with the terms of the *SARFAESI Act*⁵ as well as the Reserve Bank of India's Outsourcing guidelines. Both firms will always follow applicable regulatory rules.

BAD BANKS IN INDIA :

The concept of bad banks in India was brought up in 2017 when the Public Sector Asset Rehabilitation Agency was mentioned in the economic survey.⁶ NARCL will purchase poor loans from banks above a specific level and sell them to prospective buyers who deal with debt. The corporation will also price problematic loans to sell. The corporation would pay 15% cash & 85% in form of securities to the banks, according to Finance Ministry.⁷ However, the same couldn't be implemented in 2019 due to the pandemic. After the pandemic, it left the banks with further baggage of NPA garbage to litter which then has gone down with the passing of time.

² <https://cred.club/articles/what-is-a-bad-bank>

³ Kumar, Sushil. (2022). *BAD BANKS AND THE RECAPITALIZATION OF THE BANKING SECTOR*, <https://www.researchgate.net/publication/359939112>

⁴ H, Harshitha & Shailaja, Dr. (2022). *Bad Bank: The Concept of Making Good the Bad Assets of Banks* , International Journal of Research Publication and Reviews. 352-356.

⁵ Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, Act 54 of 2002.

⁶ <https://ggscw.ac.in/Downloads/article%202.pdf>

⁷ A B, Vijayakumar. (2021), *AN OUTLINE OF BAD BANK IN INDIA*, <https://www.researchgate.net/publication/350006464>

The cabinet authorised a Central Govt guarantee of Rs 30,600 crore to support NARCL (SR). The union government won't own the institution; public sector banks will hold 51% and financial institutions or debt management businesses would own 49%. NARCL will raise money from banks and NBFCs (NBFCs).

When necessary, the firm will raise debt. NARCL Ltd. would cooperate with IDRCL. The IDRCL will administer NARCL's assets. It would enlist market specialists and turnaround experts to manage poor assets. PSBs and FIs will hold a maximum 49% share in IDRCL; private lenders would retain the balance.

NARCL will offer to buy strained assets from banks. IDRCL will manage and add value to NARCL's problematic debts once the bid is accepted. NARCL intends to resolve loan assets above Rs 500 crores each amounting to about 2 trillion.⁸

BAD BANKS AS A SOLUTION FOR NPAS :

Following the proposal of Bad Banks in the Economic Survey 2017, former RBI Governor, D Subbarao had made a strongly made case for the setting up of Bad Banks stating that it is “not just necessary but unavoidable”.

The existing legislative measures in India do not provide a solution for the problem of ballooning NPAs every year. Thus, establishing bad banks could lead to a segregation of good assets from toxic assets, allowing the stressed bank to restructure its business model while also clearing up its books. Simply selling off its NPAs to bad banks enables the stressed bank to not strain its resources either through individual departments or through other subsidiaries to service the NPAs and instead focus its efforts to carry out or increase other banking functions. Further, the pooling of the NPAs of different banks under a single entity can lead to faster servicing of the NPAs through faster decision-making as well as the domain expertise of the bad bank. The transfer of NPAs to a bad bank will have an overall positive impact on the stressed bank prompting a healthy banking sector with the previously ailing assets back into circulation in the economy. Moreover, the absence of NPAs in the balance sheets of banks will increase the confidence of investors and the public in the performance of the bank. However, several risks are also involved when employing bad banks as a means of tackling NPAs.

One of the major threats is the possibility of relentless lending that banks may engage in on the availability of an easy form of disposal of NPAs.

⁸ Supra 6

Another major problem is that bad banks by themselves are not a ready solution to NPAs either. Thus, a clear resolution strategy along with the necessary resources and operational framework must be put in place for the success of bad banks.

Moreover, any bad operational decision taken by the bad bank could result in huge losses for the bank as well.

However, if implemented effectively, with a proper operational framework and resources, a bad bank would be able to be the solution to the rising problem of NPAs.

Planning by Government w.r.t. Bad bank execution

As of June 30, 2017, "State Bank of India, Punjab National Bank, Bank of India IDBI Bank, and Bank of Baroda accounted for 47.4% (totaling Rs.3,93,154Cr) of NPA wherein SBI contributed for about 22.7 percent (or Rs.1,88,068Cr) of the total NPAs of 38 banks".⁹

As per the report by RBI released in 2020, "the gross non-performing assets (GNPAs) of the banks in India had increased from 8.2% (8.48 lakh crore) at the end of march 2020 to 9.1% (9.36lakh crore), however, there has been a decline to these numbers as the Gross NPA ratio of banks has decreased down to 5.9% in March 2022 on June 2022, which is said to be the lowest in six-year whereas the previous the Gross NPA ratio was 7.330%".¹⁰

Initially, an estimated Rs 2 lakh crore in bad assets was scheduled to be transferred; however, some of these accounts have already been resolved, and other resolutions will take place as and when they are submitted to the bad bank.¹¹

The success story of Bad bank in other countries

If we are to see actual implementation and the results achieved by the Bad banks, countries like the USA can be referred to as an example where their success story is coined as a bank born to be bad.¹² Resolution Trust Corporation (RTC) which is the centralized body for recovering NPA in the USA has recovered about \$394 billion. Further seeing in Asia, the Thai Asset

⁹ FBJ Beaura, NPAs in Banks : This is how things stand, Free press Journal, (May 30, 2019, 04:08 AM), <https://www.freepressjournal.in/business/npas-in-banks-june-2017-this-is-how-things-stand>

¹⁰ Livemint, Bad bank gets going, despite RBI silence, Livemint.com, (13 Jul 2022, 12:59 AM), <https://www.livemint.com/industry/banking/bad-bank-scouts-for-npas-as-rbi-remains-silent-on-first-bid-11657645861785.html>

¹¹ Sunny Verma, Explained: Bad bank is ready, how will it resolve stressed assets?, Indian Express, (January 31, 2022 8:38:04 AM), <https://indianexpress.com/article/explained/explained-bad-bank-stressed-assets-7747007/>

¹² H, Harshitha & Shailaja, Dr. (2022). *Bad Bank: The Concept of Making Good the Bad Assets of Banks*, International Journal of Research Publication and Reviews. 352-356, <https://www.researchgate.net/publication/362555946>

Management Company (TAMC) centralized body for recovering NPA in Thailand has recovered 170 billion Bhat (Bhat is Thailand's currency) NPA and decreased the NPA by 33% in the span of 2 years.¹³

In the UK, the UK Asset Resolution Limited (UKAR) had recovered a total of £110,874.4 by 2012.¹⁴ However, the bad bank, National Asset Reconstruction Co. Ltd (NARCL), had hoped to accomplish 50,000 crores in transactions by March 31 but fell short due to some unforeseen procedural circumstances.¹⁵

CONCLUSION :

The idea behind Bad banks as an asset reconstruction mechanism on paper seems very fruitful and its successful implementation in other countries like the US, Sweden or Thailand, and China in Asia for that matter has been successful. But, with its merits and demerits, we as a general public have been ignoring the additional cost that will be needed to recover the debts plus as per the central banks previously stated, the capital was one of the biggest challenges in setting up the same.

A huge number of bad banks (known as asset reconstruction companies) began operations as asset reconstruction companies in India under the SARFAESI ACT. The concept of asset reconstruction through NARCL and IDRCL can be fruitful if the implementation isn't affected by any external factor like politics or pandemic.

In addition, strict legislation is essential for bad banks to operate effectively. It necessitates a different framework and the inclusion of policy implications in the financial statement, as well as the restoration of a good record of their function. Overall, the development of bad is a tricky issue for the financial business.

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¹³ Moseley, F. (2011). *The U.S. Economic Crisis: Fundamental Causes and Possible Solutions*. International Journal of Political Economy, 40(3), 59–71. <http://www.jstor.org/stable/23104262>

¹⁴ Langley, P. (2013). *Toxic assets, turbulence and biopolitical security: Governing the crisis of global financial circulation*. Security Dialogue, 44(2), 111–126. <http://www.jstor.org/stable/26302222>

¹⁵ Livemint, *Bad bank gets going, despite RBI silence*, Livemint.com, (13 Jul 2022, 12:59 AM), <https://www.livemint.com/industry/banking/bad-bank-scouts-for-npas-as-rbi-remains-silent-on-first-bid-11657645861785.html>