



Way Ahead for Asset Reconstruction Companies (ARCs)

This article is based on [“Tackling the Problem of Bad Loans”](#) which was published in the Indian Express on 22/11/2021. It talks about the constraints in clearing the bad loans in India and the solutions to improve the performance of ARCs.

Over the last five years, considerable progress has been made in resolving and recovering bad debts of banks. However, there are still around Rs 10 lakh crore worth of stressed assets hanging around in the system.

The [National Asset Reconstruction Company \(NARCL\)](#) incorporated under the Companies Act, 2013 offers hopes for the faster clean up of lenders' balance sheets.

As much as the NARCL is a welcome initiative, addressing the fundamental problem of accumulation of elevated and recurring [NPAs \(Non-Performing Assets\)](#) generation is also crucial.

ARCs in India

- **Status of ARC's:** Of the 28 ARCs (private sector) in operation, many are bit players; the top 5 ARCs account for over 70% of the asset under management (AUM) and nearly 65% of the capital.
 - Even private sector ARCs have **not done well in the sale of zombie assets**, hardly 13.9% of the assets acquired are actually sold.
 - **Nearly one-third of debts are rescheduled.**
 - This is not much value addition to what lenders would have otherwise done at no additional cost.
- **Previous Initiatives to Resolve Bad Debts:**
 - Over the last three decades, there have been several institutional and policy measures to resolve the bad debts. The institutional measures include:
 - [Board for Industrial and Financial Reconstruction](#) (BIFR), 1987
 - [Lok Adalat](#)
 - **Debt Recovery Tribunal (DRT)**, 1993
 - [Corporate Debt Restructure](#), 2001
 - Securitisation and Reconstruction of Financial Assets and Enforcement, ([SARFAESI Act](#)), 2002
 - However, the resolution for these is a measly 6.2%, 4.1% and 26.7% for Lokadalat, DRT and SARFAESI respectively.
 - The RBI has also launched a slew of measures during 2013-14 to resolve, reconstruct and restructure stressed assets.
 - However, these too **did not serve the purpose well** and were all **abandoned subsequently**.
- **Establishment of NARCL:** The **National Asset Reconstruction Company (NARCL)** has been incorporated under the Companies Act, 2013 and has applied to the Reserve Bank of India for a license as an [Asset Reconstruction Company \(ARC\)](#).
 - The newly-created NARCL in the public sector **offers hopes for the faster clean up of lenders' balance sheets**.
 - This would be the 30th ARC in the business of resolving distressed assets, but the

first in the public sector.

- Its **greatest virtue lies in the faster aggregation of distressed assets** that lie scattered across several lenders. Also, its securitised receipts (SRs) carry sovereign assurance.
- It would **initially focus on large accounts with debts over Rs 500 crore** and is expected to free the banks from the tortuous recovery process and afford them more space to focus on much-needed credit expansion.
- **Progress of IBC:** The [Insolvency and Bankruptcy Code \(IBC\), 2016](#) was landmark legislation and **marked a welcome departure from the earlier measures**, with a legally time-bound resolution.
 - Qualitatively, it has **instilled a sense of fear in mischievous corporate borrowers** who have siphoned off funds, and dethroned them. It **nearly put an end to evergreening**.
 - Even though there are delays under this newfound promise, they are counted in terms of days and not years and decades.

Challenges Faced in Clearing Bad Loans

- **Lack of Adequate Infrastructure in NCLT:** The [NCLT \(National Company Law Tribunal\)](#) is the backbone of the IBC, but **lamentably is starved of infrastructure** and over 50% (34 out of 63) of NCLT **benches were bereft of regular judges**.
 - Over 13,170 cases involving **distressed debt of Rs 9.2 lakh crore are languishing with the NCLT**.
 - This lack of adequate infrastructure, coupled with the poor quality of its decisions, has proved to be the IBC's Achilles' heel.
- **Delayed Recognition and Resolution:** 47% of the cases referred to the IBC, representing over 1,349 cases, have been **ordered for liquidation**.
 - Over 70% of these **cases were languishing at the now-defunct BIFR** for years and decades.
 - Against the aggregate claims of the creditors of about Rs 6.9 lakh crore, the **liquidation value was estimated at a meagre Rs 0.49 lakh crore**.
- **Anchoring Bias Close to Liquidation Value:** The tendency to make decisions on the basis of first available information is called "**anchoring bias**".
 - This information in bidding for distressed assets is the **cost of acquisition to ARCs**.
 - In the case of the IBC process, **it is the liquidation value determined by the IBBI** (Insolvency and Bankruptcy Board of India) valuers.
 - These distressed assets may be taken over by NARCL at 20%.
 - This low cost of acquisition would suffer from the anchor effect and bias. Potential bidders would quote prices nearer to this anchor.

Way Forward

- **Judicial and Regulatory Reforms:** Judicial **reforms for early and final resolutions** are urgently required.
 - Lenders and regulators need to address the issue of delayed recognition and resolution.
 - Incentivising lenders for **more flexible provisioning requirements** would encourage them to recognise early.
 - Business stress and/or financial stress needs to be recognised even prior to regulatory norms on **NPA (Non-Performing Asset)** classification.
- **Mitigating Anchor Bias:** Nobel Laureate **Daniel Kahneman** has argued that "the anchoring effect is not a laboratory curiosity and can be just as strong in the real world".
 - "When people face a difficult situation they clutch at (a) straw and that straw is (the) anchor straw". This may be **mitigated by "opposite thinking"**.
 - He suggests a three-step process to mitigate anchor bias:
 - **Acknowledging the bias.**
 - Seeking more and **new sources of information.**
 - **Dropping your anchor** on the basis of new information.
 - Anchor bias needs to be mitigated by **better extrinsic value discovery.**
- **Measures for the New ARC:** The IBC has made considerable progress in bringing about

behavioural change in errant and wilful defaulters by forbidding them to take back distressed assets.

- The **NARC should uphold this principle** and not dilute it, otherwise, the credit culture would suffer.
- Also, it should have a **sunset clause of three to five years** to avoid the perpetuation of moral hazard and also encourage expeditious resolution.
 - It should also **avoid selling to other ARCs.**
- **Limiting the Accumulation of NPAs:** The NARCL is a welcome initiative, however, no number of resolution and recovery tools and frameworks can address the fundamental problem of accumulation of elevated and recurring NPA generation.
 - **Keeping the accumulation of NPAs below 2% is critical.**

Drishti Mains Question

Discuss the issues faced by the banking sector due to bad loans and how better functioning of the Asset Reconstruction Company (ARCs) can help reduce the stress of bad loans.

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