



## RBI's Approval Pending for the Bad Bank

**For Prelims:** Reserve Bank of India, Bad Bank, National Asset Reconstruction Company Limited, India Debt Resolution Company Limited, Asset Reconstruction Company, Indian Banks' Association, Non-performing loans.

**For Mains:** Monetary Policy, Banking Sector & NBFCs, Bad Bank, National Asset Reconstruction Company Limited, India Debt Resolution Company Limited, Asset Reconstruction Company, Non-performing loans and Related Issues.

### Why in News

The [Reserve Bank of India's \(RBI's\)](#) approval for the implementation of the proposal for setting up a '[Bad Bank](#)' is still pending.

- In **September 2021**, 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](#).

### Key Points

- **NARCL & IDRCL:**
  - The NARCL has been set up and issued a license by the RBI to conduct business 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.
  - Simultaneously, a separate company has been set up to function as an Asset Management Company, named **India Debt Resolution Company Limited (IDRCL), which will provide management and resolution of assets** and also help in the operational aspects, relating to price discovery and aim at evolving the best possible recovery and the resolution process.
    - 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 is majorly owned by public sector banks with 51% ownership** but in the case of the **IDRCL, 51% shares are in private hands**.
- **Functioning of the Dual Structure:**
  - 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.**
- **Demand of Indian Banks:**
  - Normally, a **single entity to be held accountable as owner, and for recovery of the assets**, is the practice followed across geographies.
  - Possibly a 'Principal and Agent mechanism' or similar arrangement may evolve to resolve this issue.
  - The [Indian Banks' Association](#) is learnt to have wanted a dual structure, with the AMC as a privately held entity, to be out of the purview of the regulatory entities.
- **RBI's Reservation:**
  - RBI is **not inclined to permit a dual structure** in which one entity acquires [non-performing loans](#) and another reaches a **resolution**. It has now indicated that **both the acquisition and resolution should be housed under the same legal entity**.
  - The impediments include **issues arising from the ownership structure and operational mechanism**, with the proposed setting up of two separate entities — the **NARCL and the IDRCL**.

## Bad Bank

- **About:**
  - The bad bank **is an 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 (Non-Performing Assets/loans) 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

- 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: IE](#)

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