



NARCL Aims to Acquire Rs 2 Trillion Stressed Assets by FY26

For Prelims: [National Asset Reconstruction Company Ltd.](#), [Bad Bank](#), [Non-performing assets](#), [Reserve Bank of India](#), [Asset Reconstruction Companies](#), [India Debt Resolution Co. Ltd](#)

For Mains: Significance of Bad Bank and Associated Challenges, Bad loans.

[Source: LM](#)

Why in News?

The [National Asset Reconstruction Company Ltd \(NARCL\)](#), the government-backed [bad bank](#), has set an ambitious target to **acquire Rs 2 trillion in stressed assets by FY26**.

- This follows its significant achievement of **acquiring Rs 1 trillion** worth of **distressed assets in FY24**, demonstrating a proactive approach to address the issue of [non-performing assets \(NPAs\)](#) in the Indian banking system.

What is a Bad Bank?

- **About:** Bad banks are asset reconstruction companies that buy, manage, and recover bad loans and manage **NPAs** from [commercial banks](#) to liquidate the transferred assets.
 - **It provides a safety net for banks**, allowing them to offload bad loans and focus on healthier lending activities.
- **Evolution:** The concept of bad banks emerged in the 1980s with institutions like Grant Street National Bank, which acquired bad assets from Mellon Bank.
 - The concept gained prominence during the [2008 financial crisis](#). Countries like **Sweden, Germany, and France** have implemented similar models to manage bad assets.
 - **India's first bad bank, NARCL, was established in 2021** to manage bad assets in public sector banks. Although the concept was proposed in an **Economic Survey 2016**.
 - This move aligns with the global trend of using bad banks to stabilize financial systems burdened by [distressed loans](#).
- **Advantages:** Bad banks **centralize the management of NPAs**, which can streamline efforts and increase efficiency in asset resolution.
 - By transferring NPAs to a bad bank, **originating banks can free up capital** currently held as provisions against these assets. This can potentially lead to an **increase in lending to more creditworthy customers**.
 - Government backing of bad banks can **enhance confidence in the originating banks**, thereby improving their overall capital buffers and financial stability.
- **Disadvantages:** Transferring bad assets to a government-backed entity can merely shift the burden within the public sector, **potentially leading to taxpayer liabilities for any losses incurred**.
 - **Government bailouts might discourage banks from exercising caution in their**

lending practices, potentially leading to a repeat of the same issues in the future.

▪ **Current Challenges for Bad Banks:**

- **Price Discovery:** Bad banks often face difficulties in pricing bad loans and determining future liabilities.
- **Finding Buyers:** Selling portfolios of distressed assets can be challenging, especially **without established market mechanisms or precedents.**
 - Weak economic conditions can further depress asset values and reduce the pool of potential buyers.

What is NARCL?

- **About:** Designed as a "bad bank," NARCL aims to cleanse the financial system of distressed loans, thereby stabilizing banks and fostering a healthier economic environment.
 - **NARCL was announced in the Union Budget 2021-22** to handle large loans of over Rs 500 crore. Initial delays occurred due to the [Reserve Bank of India's](#) dissatisfaction with the proposed structure, leading to a revised plan.
 - Under the new structure **NARCL acquires and aggregates bad loan accounts from banks.** [India Debt Resolution Co. Ltd \(IDRCL\)](#) handles the **resolution process**, operating under an exclusive arrangement with NARCL.
- **Role of NARCL:** Purchase bad loans from commercial banks. Manage these distressed assets.
 - Sell them in the market through bidding methods like **Swiss Challenge** to recover funds and liquidate the transferred assets.
- **Funding and Ownership:** NARCL's acquisition strategy involves paying **15% of the agreed loan value in cash and the remaining 85% in government-backed security receipts.**
 - **State-owned banks hold a 51% stake in NARCL**, with the remaining stake owned by private banks.
- **Challenges Facing by NARCL:**
 - **Dual Structure Issues:** The duality of NARCL and IDRCL has led to **operational inefficiencies.** NARCL retains decision-making authority, but IDRCL handles resolution, creating a complex and costly structure.
 - **Pricing Discrepancies:** Significant differences in pricing expectations between NARCL and banks have deterred transactions, **as banks find NARCL's offers inadequate.**
 - **High Operational Costs:** The need for both NARCL and IDRCL has resulted in higher operational costs, **which are exacerbated by NARCL's reliance on external consultants** and a slower due diligence process.
- **Potential Solutions for NARCL's Challenges:**
 - **Combining IDRCL and NARCL could streamline operations**, reduce costs, and enhance efficiency by eliminating duplicative functions.
 - Implementing **performance-linked incentives** could attract skilled professionals and improve the effectiveness of asset resolution.
 - Investor-friendly policies to facilitate domestic and foreign investor participation in asset resolution.
 - Foster a **secondary market for distressed assets** to improve liquidity and price discovery.

Swiss Challenge Method

- The Swiss challenge method is a **public procurement process that allows private companies to bid on government contracts.** The method is used for projects such as roads, ports, and railways, or for services provided to the government.
- The RBI allowed banks to use Swiss Challenge technique for the selling of NPA accounts in September 2016 it involves:
 - **Initial Offer:** A buyer submits an offer to purchase an NPA account.
 - **Invitation for Counter-Bids:** If the initial offer is in cash and exceeds the bank's minimum threshold, the bank invites counter-bids.
 - **Preference Order:**
 - [Asset Reconstruction Companies \(ARCs\):](#) ARCs with the largest stakes in the bank are given priority.
 - **First Bidder:** If no ARCs participate, the initial bidder is preferred.

- **Highest Bidder:** During the counter-bid process, the highest bid is selected.

Drishti Mains Question:

Q. What is a 'bad bank,' and what role does it play in managing non-performing assets (NPAs) within the banking sector?

UPSC Civil Services Examination, Previous Year Question (PYQ)

Prelims

Q. With reference to the governance of public sector banking in India, consider the following statements:(2018)

1. Capital infusion into public sector banks by the Government of India has steadily increased in the last decade.
2. To put the public sector banks in order, the merger of associate banks with the parent State Bank of India has been affected.

Which of the statements given above is/are correct?

- (a) 1 only
- (b) 2 only
- (c) Both 1 and 2
- (d) Neither 1 nor 2

Ans: (b)

Exp:

- The government has done capital infusion in state owned banks to support credit expansion and to help them tide over losses resulting from the provisions that are to be made for non-performing assets (NPAs). But the capital infusion trend in state-owned banks has not been specific in a direction, like increasing or decreasing trend. While it has increased in some years, it has also decreased in a few years. **Hence, statement 1 is not correct.**
- Union Government in February 2017 had approved the merger of five associate banks along with the Bharatiya Mahila Bank with SBI. The purposes of the merger were rationalisation of public bank resources, reduction of costs, better profitability, and lower cost of funds leading to a better rate of interest to the public at large and improve productivity and customer service of the public sector banks. Parliament passed the State Banks (Repeal and Amendment) Bill, 2017 to merge six subsidiary banks with State Bank of India to affect rationalisation of public bank. **Hence, statement 2 is correct.**