

## What's good about a 'bad bank?'

### Why in news?

The government has set up the new bad bank structure (NARCL-IDRCL) to acquire stressed assets from banks and then sell them in the market

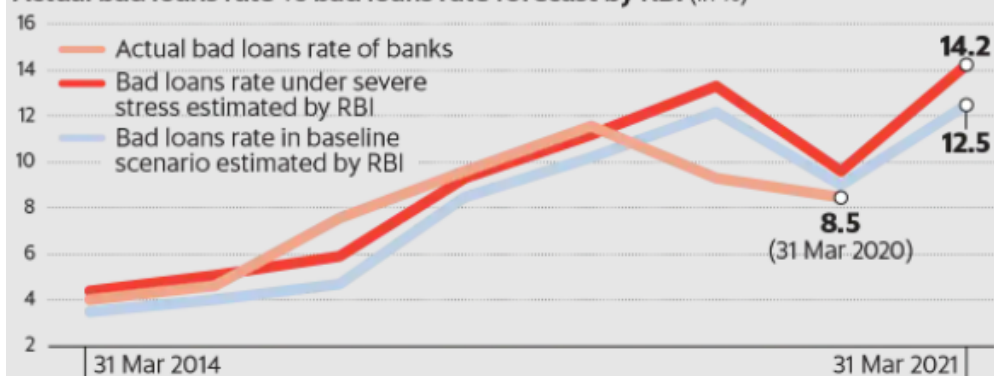
### What are bad banks?

- Technically, a bad bank is an asset reconstruction company (ARC) or an asset management company 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.
- It just 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.
- US-based Mellon Bank created the first bad bank in 1988.

### Repeated discrepancies

In the 31 March 2014 to 31 March 2018 period, when the quantum of bad loans was going up, the actual bad loans rate turned out to be significantly more than RBI's forecast even in the baseline scenario.

Actual bad loans rate vs bad loans rate forecast by RBI (in %)



\*The actual forecast of the baseline scenario as of 31 March 2015 was between 4-4.1%.

Source: RBI Financial Stability Reports

### What is the recent new bad bank structure about?

- India's first-ever bad bank, **National Asset Reconstruction Company Limited (NARCL)** will acquire stressed assets worth about Rs 2 lakh

crore from various commercial banks

- It will pay 15% of the agreed price in cash and the remaining 85% will be in the form of Security Receipts.
- The rest will be paid when the assets are sold by IDRCL
- The other entity, **India Debt Resolution Company Ltd (IDRCL)**, will then try to sell the stressed assets in the market
- To make it work, the government has granted the use of Rs 30,600 crore to be used as a guarantee.
- If the bad bank is unable to sell the bad loan, or has to sell it at a loss, then this government guarantee of RS.30,600 crore will be invoked.

### **What is the need for bad banks?**

- According to RBI's Financial Stability Report, the gross non-performing assets (GNPA) ratio of banks may rise to **9.8 per cent** by March 2022 from the **7.48 per cent** in March 2021
- Within the bank groups, public sector banks' (PSBs') GNPA ratio is **9.54 per cent** in March 2021
- To improve the financial health of PSBs, the government was forced to recapitalise them using taxpayers' money
- So bad banks are needed to relieve the commercial banks of their stressed assets.
- It also improves the bank's position and help them resume their normal banking operations, especially lending.

**Source: The Indian Express**

