

Source: RBI Financial Stability Repo

Data transmitted through the AA is encrypted and are not allowed to store, process and sell the customer's data hence protecting customer privacy

Bad banks 5.16

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

Repeated discrepancies

Actual bad loans rate of banks Bad loans rate under severe stress estimated by RBI

Bad loans rate in baseline scenario estimated by RBI

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 %)

- 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.
- 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.

New bad bank structure

- 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 **India Debt Resolution Company Ltd (IDRCL).**
- Rs 90,000 crore of the asset will be managed in the first phase.
- A government guarantee will back the Security Receipts for a maximum amount of Rs.30,600 crore, and the guarantee will be valid for a resolution period of five years.
- 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.
- Commercial Banks Rad Good Loans NPA's Assets 85% Mutually Agreed Price of The NPA The Bad Bank Cash SR's (NARCL) Buy's the NPA **Bad Bank** at a mutually agreed price NARCL Funded by GOI IDRCL The Bad Bank Realized (IDRCL) sells Amount the asset to a buver **Buver of Asset**

DELHI | BANGALORE | THIRUVANANTHAPURAM

- The NARCL is essentially an Asset Reconstruction Company (ARC) with only two distinguishing features
 - 1. NARCL is intended for dealing in big sized tickets
 - 2. NARCL has a partial government guarantee.
- The effectiveness of ARCs hinges on
 - A focused mandate for setting up the ARCs
 - Limited lifespan of the ARC



