Can bad banks resolve India’s NPA problem?

Photo: Mint

2 min read . Updated: 01 Apr 2021, 05:35 AM IST

Jagadish Shettigar,Pooja Misra

With the surge in NPAs due to the adverse impact of the pandemic, Budget 2021-22 announced that the Centre will set up an ARC, commonly referred to as a bad bank, to resolve the issue. Mint takes a look

With the surge in non-performing assets (NPAs) due to the adverse impact of the pandemic, Budget 2021-22 announced that the Centre will set up an asset reconstruction company (ARC), commonly referred to as a bad bank, to resolve the issue. Mint takes a look.

What are ARCs or bad banks?

An ARC is a specialized financial institution which buys stressed assets from banks and financial institutions. Banks can sell their stressed or bad assets to the ARC at a mutually agreeable price, thereby helping banks to clean up their balance sheets and concentrate on delivering normal banking services. Thereafter, it is the responsibility of the ARC to recover the bad debts or associated securities in a market-led process. Asset reconstruction, simply put, is the purchase of title or rights of the banks or financial institutions in loans, bonds, debentures, etc., for the sole purpose of its recovery or realization.

What are the rules and regulations for ARCs?

The setting up of an ARC is regulated under the SARFAESI Act, 2002. An ARC is required to have a net owned fund of ₹100 crore and maintain a capital adequacy ratio (CAR) of 15% of its risk-weighted assets. The NPAs are to be transferred to the ARC at a reasonable price backed by an arm’s length principle, that is, at the net book value (asset value minus bank provisioning against the stressed assets). For the bad assets sold to the ARC, the banks will obtain 15% cash, and the balance could be by way of bonds or debentures with a maximum maturity period of six years and security receipts issued by the ARC.

How are ARCs funded to buy NPAs from banks?

What are resolution strategies of an ARC?

As per the SARFAESI Act, an ARC can restructure or reschedule the loan, enter into settlements, sell or lease the borrower's business, take over or change the management, and engage in security interest enforcement (sell, take possession or lease the owned asset). But, enforcement or security interest can only be conducted when at least 75% secured creditors and the ARC are in agreement. In case of the debt being unsecured and the ARC being to recover the bad loan, they can file civil suits against the creditors.

How exactly are ARCs different from the IBC?

The Insolvency and Bankruptcy Code (IBC) was introduced with the aim of resolution and reorganization of insolvent companies, while ARCs are set up for clearing up NPAs. ARCs primarily deal with recovery, while the IBC seeks for a resolution, wherein creditors are given the chance to make insolvency resolution an economically viable process and entities can apply for insolvency, bankruptcy or liquidation.

Jagadish Shettigar and Pooja Misra are faculty members at BIMTECH.

Primer