

## THE ENDGAME: ON THE NEW 'BAD BANK'

Relevant for: Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

The Government has offered a sovereign guarantee to help the new 'bad bank', proposed in this year's Budget, extract better value from non-performing loans worth 2-lakh crore in the banking system. To begin with, the National Asset Reconstruction Company Limited (NARCL) will pitch to take over toxic assets worth 90,000 crore that banks have already fully provided for. It will offer a certain value to the lead bank for troubled loans of over 500 crore, and pay 15% upfront in cash, and issue the balance as tradable security receipts. The bad bank will then rope in a separate asset manager being incorporated — the India Debt Resolution Company Ltd. (IDRCL) — to add value to the ailing asset, and resolve it as a 'going concern' or liquidate it. The guarantee, worth 30,600 crore over five years, can only be invoked once an asset is resolved and will cover any shortfall between the face value of the security receipts issued by the NARCL and the actual amount realised from a bad loan. The guarantee fee will be increased each year as a nudge for NARCL and the IDRCL to speed up resolution. After losing precious time dithering over its pros and cons, the Government now believes this approach will be more expeditious to fix the substantial NPAs that persist despite the existing debt recovery mechanisms including the Insolvency and Bankruptcy Code. Terming banks' high provisioning for legacy loans a 'unique opportunity', the Centre thinks NARCL will also help free up bank personnel to focus on faltering credit growth and spur the economy.

To the extent that the NARCL and IDRCL managements will streamline decisions once a loan is taken over, instead of seeking consensus among multiple lenders as the IBC entails, the idea holds some weight. But banks have already provided for these loans, so this is perhaps a tardy gambit and may not work in jump-starting credit flows unless accompanied by their recapitalisation. On the likelihood of the guarantee being invoked, the Finance Ministry has said once the assets are pooled together, 'it is reasonable to expect' that many of them will realise more value than NARCL's acquisition cost. This may be a tad optimistic. As the Finance Minister herself said, 28 existing private ARCs are hesitant about taking a job at extracting value from these bad loans, perhaps owing to their size. That begs the question about the calibre of professionals NARCL and the IDRCL would need to outdo private players. The new entities' ability to get a few good men to deliver more bang for sunk capital would be critical, as would structures to pre-empt a moral hazard that the guarantee poses (of not bothering too much about final realisation value). This self-proclaimed endgame of India's bad loans crisis needs sustained attention for a satisfactory culmination.

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