Bad Bank

What is the issue?

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- The total stress in the Indian banking system is about Rs. 14 lakh crore, i.e., this is the amount for which loans have been given to industry and for which there is now no certainty of repayment.
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- Public sector banks share a disproportionate burden of this stress.
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What is PARA solution?

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- Amid the sharp rise in NPA, talks of setting up a 'bad bank' have been gaining momentum.
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- A bad bank is a bank set up **to buy the bad loans of a bank** with significant nonperforming assets at market price.
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- By transferring the bad assets of an institution to the bad bank, the banks clear their balance sheet of toxic assets but would be forced to take write downs.
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- Shareholders and bondholders stand to lose money from this solution (but not depositors).
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- The government and the RBI are drawing up strategies on how to operationlise a 'bad bank' scheme.
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- The economic survey of 2016-17 pointed out the twin balance sheet problem and advocated a **centralised Public Sector Asset Rehabilitation Agency (PARA)** be established to deal with the bad loans problem.
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- International experience shows that a **professionally-run central agency**

with government backing, while not without its own concerns, can overcome the difficulties and could prove more successful than banks in resolving bad debt.
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What is the biggest challenge in setting up a bad bank?

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- One challenge private sector ARCs face is that of capital. None of the entities till now has been allowed to tap the capital market for raising funds.
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- Some central bank as well as government officials also admitted capital was the biggest challenge in setting up a 'bad' bank.
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- At least Rs. 25,000 to Rs. 30,000 crore of capital will be required to set up a bad bank in the initial stages.
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What are the proposed solutions?

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- RBI deputy governor Viral Acharya recently suggested two models to solve the problem of stressed assets.
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- The first, **Private Asset Management Company (PAMC),** is said to be suitable for sectors where the stress is such that **assets are likely to have economic value in the short run,** with moderate levels of debt forgiveness.
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- Some of the sectors which this model could address metals are telecom and textiles.
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- In this model, each resolution plan would get vetted and rated by at least two credit rating agencies to assess the financial health and in terms of timeline, the banking sector may be asked to resolve and restructure, say, its 50 largest stressed exposures in these sectors, by December 31, 2017.
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- The second model is the **National Asset Management Company (NAMC),** which would be necessary for sectors where the problem is not just one of excess capacity but possibly also of **economically unviable assets in the**

short- to medium-term.
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- Mr. Acharya cited the example of the **power sector,** where projects have been created to deliver aggregate capacity that is beyond the estimated peak utilisation any time soon.
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- Unlike the PAMC where asset recovery is likely to be relatively quick, NAMC assets may require a long time to start generating cash flows.
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Are these supposed to be bad banks?

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- The answer is ‘No’. A ‘bad bank’ conveys the impression that this entity is to operate as a bank but has bad assets to start with. In fact, the idea is not to operate these entities as banks at all.
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- Acharya said it would be better to limit the objective of these asset management companies to orderly resolution of stressed assets with graceful exit thereafter.
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Source: The Hindu

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