

BAD BANKS



Issue

The Union cabinet has given the permission for the formation of India's first-ever "Bad Bank".

Background

The decision of setting up Bad Bank was announced in the Budget 2021. It will be called National Asset Reconstruction Company Limited (NARCL).

Details

- The company has been set up under the Company Act and will acquire assets worth about Rs 2 lakh crore from different commercial banks.
- The stressed assets will be sold in the market through the India Debt Resolution Company Ltd (IDRCL).
- The government will provide Rs 30,600 crore to be used as a guarantee. The NARCL-IDRCL structure will make up the new bad bank.

The Bad Bank

- The deposits from customers are liabilities for the bank whereas the loans are its assets. The whole banking model works on the idea of higher returns on loans that will cover cost of deposits.
- In case where an individual is not able to return the loan due to failure of business, the bank will find itself in trouble. If this condition takes place more often than not banks will be on the verge of sinking.
- The stability of the whole economy will be under threat if such incidents take place with all major banks.

The need for Bad banks

- The NPAs of PSU started to soar after its business began witnessing decline amidst the slowing of economy. The government was forced to recapitalize them to continue operation.
- To ensure that these institutions continue normal business, the stressed assets needed to be taken out of equation. This was done by parking the assets with a 'Bad Bank'.

Working

- The stressed assets from the commercial banks will be bought by NARCL by paying 15% of the cost. The rest 85% will be covered under security receipts. It will be paid after selling the assets.
- If the Bad bank is unable to sell the bad asset at the initial cost, the government security will be invoked and the difference amount will be paid from the Rs 30,600 crore provided by government.

Way ahead

Recapitalization or the creation of Bad banks is funded from the pockets of tax payers. The measure is temporary and a permanent solution can be achieved by improving lending operation in PSBs.

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