



Bad bank – Is it a good idea?

Description

Introduction :-

In January 2017, the Economic Survey of India suggested setting up a 'Public Sector Asset Rehabilitation Agency' (PARA). On May 8th 2018, the then interim finance minister Piyush Goyal hinted towards the possibility of setting up a "Bad Bank" for which a panel was working to assess its possibility in India. A "Bad Bank" is basically an Asset Restructuring Company in its functioning. These steps were taken in light of the increased number of NPAs in the Indian banking sector. The NPAs amount to ?10 lakh crore as of 2019.

The concept :-

The term Bad Bank first came into existence in 1988 in the USA. A Bad Bank is basically an asset restructuring company which takes on the bad loans/non-performing assets of banks at a discount and sells it off. This provides a clean balance sheet to the banks which in turn are able to perform better in the markets. Banks are usually specialized in lending and not in recovery. Bad Banks, in turn, are specialists in recovery. This division of roles helps in faster lending and recovery for both the entities and, in turn, helps the economy to be free from bad loans.

Good Idea or not?

Though the concept looks simple, there are a lot of intricacies that need to be looked upon.

- The first and foremost problem that arises is that of capital required to buy the NPAs from the PSB even at discount rates. The Bad Banks would have to infuse a huge amount of capital for buying off the loans. The government proposed that the required capital would be arranged from the cash reserves of the RBI. This again is a cumbersome and risky proposal.
- The bad loans are mainly due to 25-30 business houses/promoters in the economy. They account for about 50% of the total NPAs. So, just to tackle these 25-30 entities, forming a separate entity would be too costly a proposition

- Though Bad Banks have been successful in a lot of countries, India differs from them in a significant manner. In other countries, the NPAs are from bankrupt companies mostly, but in India, NPAs are mostly due to loss-making companies. If given the right financial help and restructuring, these companies could easily be revived.
- Bad Banks will only be helpful in case of wilful defaulters and not for non-wilful defaulters. The Bankers themselves would have to deal with the non-wilful defaulters.
- India has diverse companies and NPAs, depending on a single entity and its efficiency to get rid of such behemoth of a task would be illogically optimistic.
- The Insolvency & Bankruptcy Code (IBC) already exists in India to tackle NPAs. A better implementation of the IBC could easily help with the NPAs. All the steps taken by the government so far have all been good, but successful implementation of them could really go a long way.

Conclusion :-

In light of the above discussion, it can be seen that the idea of Bad Banks may not be successful in India.

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