Almost a year on, bad bank yet to take off: RBI not in favour of dual structure

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Six months after the setting up of the National Asset Resolution Company Limited (NARCL), the proposal for setting up a 'bad bank' — a key reform measure of this fiscal year's Budget — is yet to take off. The impediments include issues arising from the ownership structure and operational mechanism, with the proposed setting up of two separate entities — the NARCL and the India Debt Resolution Company Limited (IDRCL).

The Reserve Bank of India's (RBI's) approval for the implementation of this dual structure is still awaited, banking industry sources said. The RBI has now indicated that both the acquisition and resolution should be housed under the same legal entity. Accordingly, the NARCL and the IDRCL are reworking the arrangement under which both the processes will be under the former's control.

The NARCL has been set up and issued a licence by the RBI to conduct business as an Asset Reconstruction Company. Simultaneously, a separate company has been set up to function as an Asset Management Company, named IDRCL, which will provide management and resolution of assets and also help in the operational aspects, relating to price discovery and aim at evolving the best possible recovery and the resolution process. The NARCL is majorly owned by public sector banks with 51 per cent ownership but in the case of the IDRCL, 51 per cent shares are in private hands.

Normally, a single entity to be held accountable as owner, and for recovery of the assets, is the practice followed across geographies. Possibly a 'Principal and Agent mechanism' or similar arrangement may evolve to resolve this issue. The Indian Banks' Association is learnt to have wanted to a dual structure, with the AMC as a privately held entity, to be out of the purview of the regulatory entities. However, the RBI is yet to agree to this dual structure. "An early decision in the matter is expected and shall be welcome considering the crucial role of the proposed bad bank," said a banking source.

A senior government official said the government expects this issue to be resolved soon and the first batch of resolutions should kick in before March-end. The first batch of Rs 90,000-crore NPAs were supposed to be acquired by the NARCL in January. "We cannot let it linger on because the delay has a cost and it dents recovery. Dual structure has been common in the capital market where Sebi is the regulator, and this is the best possible solution. The RBI will see how best to regulate it," the official said.

Tarun Bhatia, MD and head, Kroll South Asia, said, "The delay appears procedural and hopefully should get resolved soon. As per previously agreed process, NARCL was going to acquire the NPAs and IDRCL would have driven the resolution process. "One believes this should get resolved soon as the government is keen for NARCL to initiate the process at the earliest," he said.

As a proactive and sustainable solution deal with NPAs in the banking sector, the Finance Minister had, in this year's Union Budget, announced setting up the NARCL to take over stressed debt of banks and manage these in a market-led way.

"The intent was to acquire large value non-performing assets (NPAs) from banks and put them under the ownership of an entity that will take suitable steps to affect recovery/resolution. This would in turn also help the banks to concentrate and focus on their primary functioning of fresh landing. Takeover of assets worth Rs 2 lakh crore was envisaged in a phased manner," said Jyoti Prakash Gadia, MD, Resurgent India.

With a combination of post-Covid moratorium and recoveries, there was an actual decline in NPAs from Rs 8.4 lakh crore in 2020 to Rs 7.8 lakh crore in 2021. "However, the pandemic has adversely impacted some sectors like tourism, aviation, entertainment and private employment/wages. The retail NPAs are, thus, expected to go up besides the worst affected sectors, which may require a special package for revival," Gadia said.

The government approved a 5-year guarantee of up to Rs 30,600 crore for security receipts to be issued by the NARCL as non-cash consideration on the transfer of NPAs. This will address banks and RBI concerns about incremental provisioning, said an analyst.

Banks that transfer their stressed assets will get 15 per cent of value in cash and 85 per cent as tradable security receipts. The government guarantee will cover the gap between the face value of the security receipts and realised value of the assets when eventually sold to prospective buyers. Government guarantee, valid for five years, helps in improving the value of security receipts, their liquidity and tradability. A form of the contingent liability, the guarantee does not involve any immediate cash outgo for the Central government.

"NARCL has commenced operations, and the sale of banks' stressed debt to NARCL is expected to have a positive impact on the books and business of the banks. The impact would be seen by PSBs in FY23, and a positive proposition in terms of government guarantee/fund infusion into the bad bank can be expected in the upcoming budget," Brickwork Ratings said in a report.

With so many ARCs being around in the private sector, the reason for a separate National ARC was the painfully slow process of the sale to private ARCs due to valuation issues, slower and longer resolution given fragmented ARC holdings/legal hurdles and potentially huge upfront capital/ cash required to buy large NPAs, he said.

Bankers were also questioned by auditors and Central agencies on the deals, which largely clogged decision-making process and hurt the transfer/resolution of NPAs. Thus, a national ARC, with a different legal and operational structure and government backing, dispensations and funding support, was essential to break the chain.