

BAD ₹ BANK

What is Bad Bank



A bad bank is an entity established for the purpose of separating the stressed assets held by a regular bank from its performing assets.

The idea was first proposed in the 1980s by the US based Mellon bank. In 1988 it resorted to creation of a bad bank i.e. the Grant Street National Bank. The 4 types of Bad Bank schemes are: On-balance sheet guarantee, Internal restructuring unit scheme, Off-balance sheet special purpose entity, Bad bank spin off.

About



- The Indian Banks' Association has submitted a proposal to set up a bad bank for approximately Rs 75,000 crore worth of non-performing assets (NPAs).
- Three pillars will be Asset Management Company, Asset Reconstruction Company and Alternative Investment Fund.

Background



- **2015:** Asset Quality Review had also sparked a debate on bad bank as a possible solution.
- **2017:** Economic Survey: create a Public Sector Asset Rehabilitation Agency.
- **2018:** Sunil Mehta committee to study the feasibility of National ARC.

NPA Problem in India



The domestic banking sector is already grappling with bad loans worth Rs 9 lakh crore and India Ratings and Research forecast it may witness fresh NPAs of Rs 5.7 lakh crore. This means a gross NPA ratio of 15 per cent for domestic banks.



Pros

- Banks can focus on long term operations
- Positive impact about the bank in the eyes of the credit rating agencies, investors, lenders, borrowers and depositors
- Enable banks to involve itself in growth-oriented business activities
- Facilitating better management of toxic assets
- Performing assets of the banks are less exposed to risks of failure



Cons

- Fire sale externality
- Banks will tend to be less careful while granting loans
- Strong political will and legal system is required
- Huge costs are involved in the creation and running of bad banks, transfer and restructuring of toxic assets and their eventual disposal etc.
- Sufficient number of skilled and specialized staff may not be available



Essential factors to be taken into consideration before establishing a Bad Bank:



- Structure and specific purpose
- Ownership and Funding
- Toxic Asset Transfer Pricing and Nature of transfer
- Types of assets to be transferred, Asset management and its disposal
- Governance of bad bank and Legal Framework