NPAs and the Bad Bank

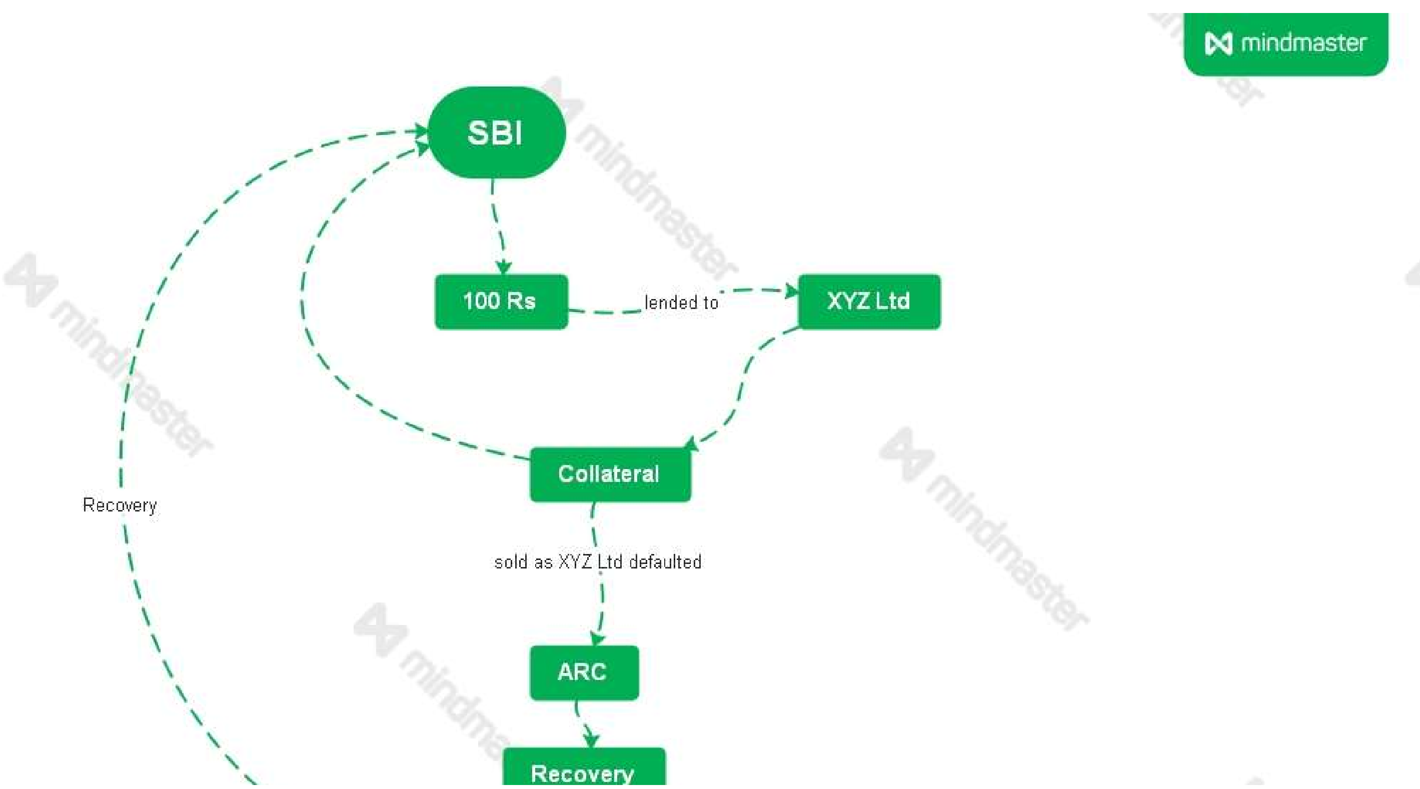
NPA:- No Recovery within 90 days (180 days in some cases)

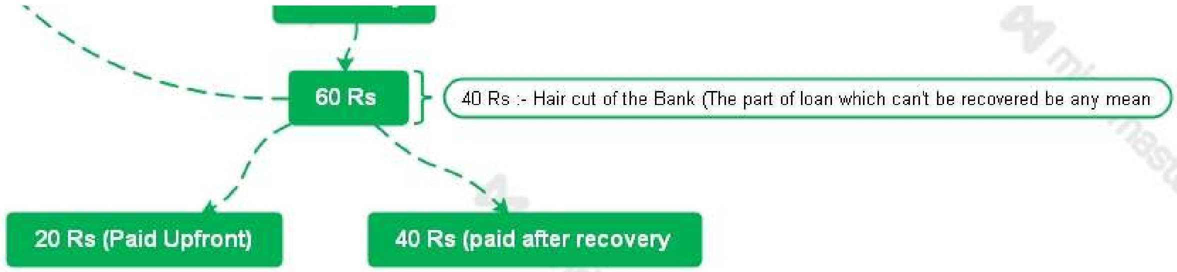
Provisioning of loan:-

- Sell asset and maintain the liquidity to satisfy the depositors/to bear the shocks of cash crisis
- The lending power of the bank decreases

* Till 1991:- No formal identification of NPAs
* 1994:- NPA of PSBs was 3.2 Tn Rs.
  - Written off (One Time)
    - Removing it from Bank's balance sheet to some other institution to be recovered later
  - Govt recapitalized entire 3.2 tn Rs

* 2002:- SARFAESI ACT (Securitisation and reconstruction of financial assets and enforcing security interest act) :-
  - Allowed the lender to take over the asset or collateral of the borrower, sell it to some other entity and recover its dues
* 2004-05:- Pvt ARCs/AMCs started their businees in India





- 2008:- Total Loan outstanding : 5.2 Lac Cr & Total NPAs :-1.6 la cr

  Sub Prime Crisis:- Govt followed Easy money policy (Printing Currency, Loans @ lower rates)

- 2008-13:- Loans Outstsanding: 5.2 lac cr
  - NPAs:- 2 Lac cr (In reality: Evergreening of loans

Evergreening of Loans:-

I know after 90 days, loan will become NPA

I'll have to do provisioning.

To avoid NPAs
I'll make Borrowers

Take a fresh Loan

Pay older loan

Money Comes back. No NPA
Excellent!

- 2013:- Asset Quality review (AQR)
  - No Evergreening of Loans
    - Qualify them as NPA
  - 100% Provisioning
  - Identifying NPAs diligently

Year	Till 2013	Till 2014	Till 2016	Till 2018
NPAs	2 lac Cr	5 lac cr	8 lac cr	10 lac cr

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Fugitive economic offences started as their hidden loans started coming out

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Reasons for High rise in NPAs

- High dfault from infra sector due to failing public-private partnership
  - Delays in decisions
- Drastic fall in commodity prices b/w 2014-16
  - Companies went into loss
- Losses in export market
  - Textile, Leather
- Telecom, Power + Coal -------> Due to poor policies b/w 2009-2016

Larger Problem of NPAs -----> Institutional issues

- Reluctance of PSBs managers to write off loans by taking Hair Cut
- Lack of co-ordination among lenders
- Higher provisioning reduced liquidity
  - Lead to Twin Balance Sheet Syndrome
- Stopping ever-greening of loans

Possible Methods to come out of TBS

- Write-off
- Use Insolvency & Bankruptcy code (IBC)
  - Recovery rate:- 43%
  - All companies aren't feasibly liquidated
  - Delays upto 1 year
- Conversion of Debt into equity
  - SDR (Special Debt Restructuring)

Bad Bank

- 2016-17:- Economic Survey
  - PARA (Public Asset Rehabilitation agency)
- **Initial capital:-** Funded by the FIs
  - To provision NPAs upto 5 lac Cr
  - Guaranteed by the Govt
- Public owned ARC
- **Sunil Mehta panel** had proposed a company, Sashakt India Asset Management, for resolving

Sunil Mehta panel had proposed a company, Sashakt India Asset Management, for resolving large bad loans two years ago.
- The **Troubled Asset Relief Program**, also known as **TARP**, implemented by the U.S. Treasury in the aftermath of the 2008 financial crisis, was modelled around the idea of a bad bank

Benefits:-
- Better co-ordination in credit management
- Getting rid off TBS
- Will have deeper pocket and better legal sydtem
- Easy write-off

Challenges:-
- Proper managerial functioning and avoiding politics
    - Accusation of favouritism
    - **Sol^{n} :-** Make Bad bank an autonomous body
- **Moral hazard:-** Bank managers will delibrately provide risky loans as they know that the NPA will be taken up by the Bad Bank
- Bad Bank may purchase assets @ inflated prices
    - **Sol^{n} :-** Develop market based price
        - Create a large market for bank collaterals
        - Give strong legal backing

Alternative Options to setting up of a Bad Bank:
1. Instead of creating a Bad Bank, **infusing the capital** that would be given to the bad bank directly into the public sector banks is an option.
2. The enactment of **Insolvency and Bankruptcy Code (IBC)** has reduced the need for having a bad bank, as a **transparent and open process** is available for all lenders to attempt insolvency resolution.
3. According to RBI, banks recovered on average more than 40% of the amount filed through the IBC in 2018-19, against just over 20% in total through the SARFAESI, Lok Adalats and Debt Recovery Tribunals.
4. A model of **Private Asset Management Company (PAMC)** which would 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, can be set up.
5. **National Asset Management Company (NAMC)** for sectors where the problem is not just of excess capacity, but possibly also of economically unviable assets in the short- to medium-term, such as in the power sector can also be set up.

term, such as in the power sector can also be set up.