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# 2 Min -series

*(Foundational topics prerequisite for Civil Services*

*For*

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# Economy

## 1. Bad Bank

### What is a Bad Bank

- A financial entity set up to buy non-performing assets (NPAs), or bad loans, from banks. They help ease the burden on banks by taking bad loans off their balance sheets.
- The bad bank can then try to restructure and sell the NPA to investors who might be interested in purchasing it.

### The primary purpose of a Bad Bank

- To ease the burden on banks which are holding a large pile of stressed assets. So that they can be made to lend more actively.

### How does it make Money

- It makes a profit in its operations by managing to sell the loan at a price higher than what it paid to acquire the loan from a commercial bank.

### National Asset Reconstruction Company Limited

- NARCL has been set up by banks to aggregate and consolidate stressed assets for their subsequent resolution.
- PSBs will maintain 51% ownership in NARCL.
- NARCL has been incorporated under the Companies Act and has received Reserve Bank of India's license as an Asset Reconstruction Company (ARC).

### What is India Debt Resolution Company Ltd. (IDRCL)

- IDRCL is a service company/operational entity which will manage the asset and engage market professionals and turnaround experts.
- Public Sector Banks (PSBs) and Public FIs will hold a maximum of 49% stake and the rest will be with private sector lenders.

### Are there any existing ARCs?

- There are 28 existing ARCs.
- They have been helpful in resolution of stressed assets especially for smaller value loans. Considering the large stock of legacy NPAs, additional options/alternatives are needed.
- The NARCL-IRDCL structure announced in the Union Budget is this initiative.

### How will NARCL and IDRCL work

- The NARCL will acquire assets by making an offer to the lead bank.
- Once NARCL's offer is accepted, then, IDRCL will be engaged for management and value addition.

## How will it benefit Banks

- It will incentivize quicker action on resolving stressed assets thereby helping in better value realization.
- This approach will also permit freeing up of personnel in banks to focus on increasing business and credit growth.
- As the holders of these stressed assets and SRs, banks will receive the gains. Further, it will bring about improvement in bank's valuation and enhance their ability to raise market capital.

## What if the Bad Bank's investments didn't pay off

- Government guarantee will be invoked to cover the shortfall between the amount realised from the underlying assets and the face value of SRs issued for that asset.
- It is subject to overall ceiling (initial of ₹30,600 crore, valid for 5 years).
- Since there shall be a pool of assets, it is reasonable to expect that realisation in many of them will be more than the acquisition cost.

## Capital structure of NARCL

- Capitalization of NARCL would be through equity from banks and Non-Banking Financial Companies (NBFCs).

## An important input

- The NARCL will take over identified bad loans of lenders.
- The lead bank with an offer in the hand of the NARCL will go for a 'Swiss Challenge', wherein other asset reconstruction players will be invited to better the offer made by a chosen bidder for finding a higher valuation of a non-performing asset on sale.