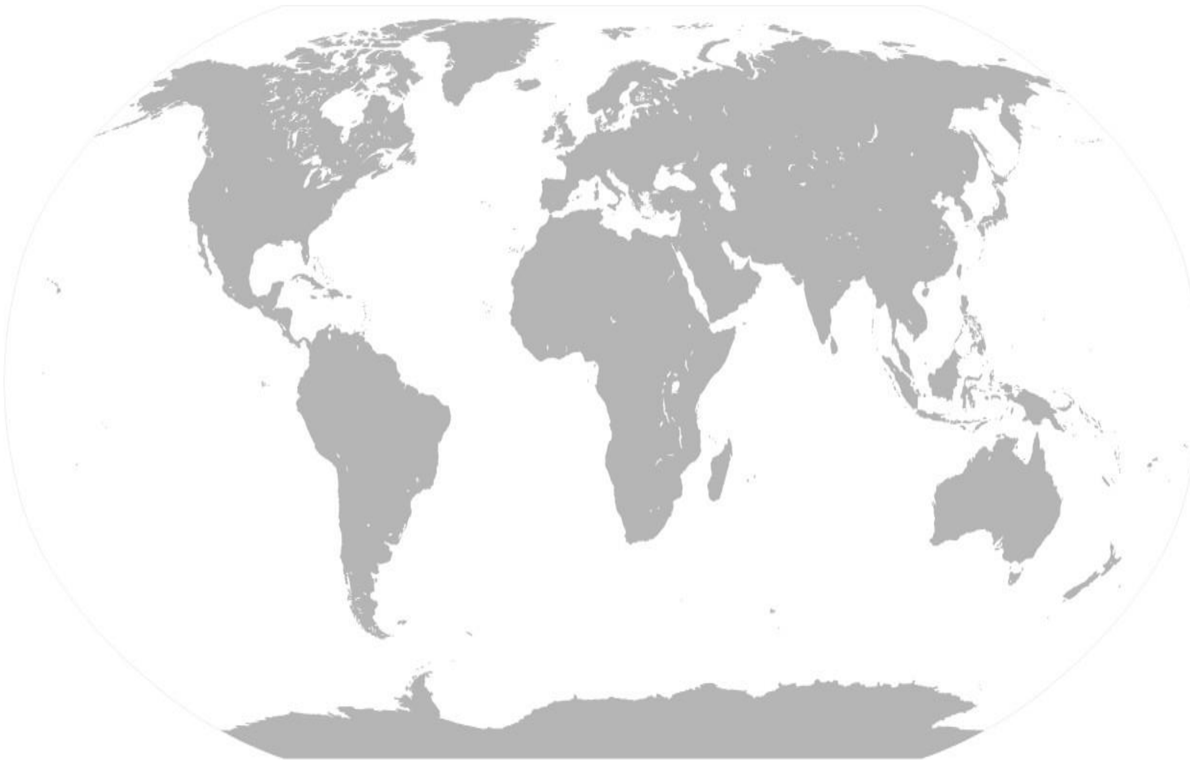

Bad Banks – Union Budget 2021

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Bad Banks – Union Budget 2021

As part of the Union Budget 2021, Finance Minister Nirmala Sitharaman announced the setting up of an entity that will help tide over the problem of bad assets by absorbing Non-Performing Assets (NPAs) of banks and improve credit flow in the economy. It is understood that this entity, popularly known as a 'bad bank' will be akin to an asset reconstruction company, which will purchase bad assets from banks at a discounted price.

A bad bank will therefore serve as an aggregator of stressed assets in the banking ecosystem, and shall aim to fix the bad asset problem by allowing banks to hive off its sticky assets to this entity and clean up their balance sheets. The uncertainty around future defaults discourages banks from taking on additional exposure and has an adverse impact on credit flow to productive sectors. Also, with provisioning of bad loans over a period of time, banks have lost value in these bad assets; and though banks may have taken a haircut on paper, there is no actual recovery against these bad loans. With the establishment of a bad bank, there will be a recourse for banks to cull out these bad loans and transfer these at a fair price, to the bad bank. A bad bank being in the nature of a bad asset repository, will also serve as a convenient shopping ground for bad loan buyers such as private sector asset reconstruction companies, Alternative Investment Funds and other potential investors.

Though the bad bank has been formally announced in this year's Union Budget, discussions on setting up a bad bank were initiated in the past and shelved. Now, understandably there is an urgency for setting up this entity as the COVID pandemic has ballooned the NPA crisis. It cannot be denied that the Insolvency and Bankruptcy Code, 2016 (IBC) even with all its successes, may prove to be inadequate to handle the insurgence of new NPAs. The IBC with all its advantages, does not offer a quick turnaround solution that is desirable. Legal complexities, the time period for insolvency resolution coupled with the risk that there may not even be a viable resolution at the end of the process, mar the effectiveness of the IBC resolution process. Therefore, the asset turnaround process through a bad bank, outside of the IBC framework may prove to be successful especially in an economy that is grappling with the COVID crisis.

What remains to be seen is the source of capital funding for the bad bank and the equity participation in this entity. The Finance Minister has clarified that the bad bank entity will have participation from the Government but will have a larger equity participation from the Indian Banks' Association front. This is a pathbreaking development and with balanced synergies between the Government, the banks, and the potential asset buyers, one can be hopeful that the bad bank will not turn out to be a mere dump for toxic assets.