Bad Bank can resolve the NPA woes?

A 'bad bank' is a bank that buys the bad loans of other lenders and financial institutions to help clear their balance sheets. The bad bank then resolves these bad assets over a period of time. As the problem of non-performing assets persists in a sector stressed by the pandemic, the RBI Governor has agreed to look at a proposal for creating a bad bank.

Union Finance Minister Nirmala Sitharaman had announced the concept of bad bank in the country. In her budget speech, Sitharaman said that an Asset Reconstruction Company Limited and Asset Management Company will be set up that will manage the bad debt of public sector banks like State Bank of India, Punjab National Bank and others.

As the Covid-related stress pans out in the coming months, proponents of the concept feel that a professionally-run bad bank, funded by the private lenders and supported the government, can be an effective mechanism to deal with NPAs. The bad bank concept is in some ways similar to an asset reconstruction company (ARC) but is funded by the government initially, with banks and other investors co-investing in due course. The presence of the government is seen as a means to speed up the clean-up process.

The industry reacted in a positive mood to the decision to create a special vehicle to house banks' sour debts. The existing stock of bad loans is a big worry for public sector banks. As of September 2020, the total gross NPAs of the banking system was 7.5 per cent of the overall industry loan book. According to an estimate, non-performing assets totalling Rs 899,803 crore will be transferred to the bad bank.