General Studies-3; Topic – Indian Economy – Issues

Public Sector Asset Rehabilitation Agency (PARA)

1) Introduction

- The Central government has revived the idea of setting up an asset reconstruction or asset management company, a sort of 'bad bank'.
- In the Economic Survey Report 2017, Chief Economic Adviser Arvind Subramanian had suggested the creation of Public Sector Asset Rehabilitation Agency (PARA) which will work as a "Bad bank" to absorb the losses from the PSBs.

2) What is a bad bank?

- A bad bank is an entity that buys NPAs or stressed loans from banks and financial institutions (FIs), mostly at a discounted market price.
- It then works to recover and turnaround the assets through professional management, sale or restructuring.

3) Need of Bad Bank

- The stockpile of bad loans has had several ill-effects on the economy at large.
- Stressed assets of banks are making it difficult for new lending.
- This is constraining new investments in projects that can power the economy.
- As bad debt keeps rising, it raises the costs for the government to finance the PSBs.
- High NPAs force banks to keep their lending rates high to boost their profits.
- Private Asset Reconstruction Companies (ARCs), Joint Lenders Forum (JLF), Strategic Debt Restructuring (SDR) and Scheme for Sustainable Structuring of Stressed Assets (S4A) haven't proved successful in resolving bad debts.
- Bad Bank is expected to solve these problems, by relieving the banks of their NPAs.

4) Arguments for Bad Bank

- Bad bank has been experimented in several countries especially after the financial crisis of 2008-09.
- It has witnessed some success in Malaysia, Sweden, Spain and few other countries.
- It will help relieve the banks of their NPAs and expedite ways for the corporate borrowers to settle their debts.
- Once stressed assets are sold to Bad bank, the RBI can lean harder on banks to pass on its rate cuts.
- A single government entity will be more competent to take decisions rather than individual PSBs.

5) Benefits

- This helps banks or FIs clear-off their balance sheets by transferring the bad loans and focus on its core business lending activities.
- Large debtors have many creditors. Hence bad bank could solve the coordination problem, since debts would be centralised in one agency.
- It can effect speedier settlements with borrowers by cutting out individual banks.
- It can drive a better bargain with borrowers and take more stringent enforcement action against them.
- It can raise money from institutional investors rather than looking only to the Government.

6) Arguments against Bad Bank

- Former RBI governor Raghuram Rajan said that it would simply mean the transfer of NPAs from one entity to other.
- Banks may have to take hefty hair-cuts or discounts while selling the loans, even at the cost of their profitability.

7) Concerns / Challenges

- The bad bank will require significant capital to purchase stressed loan accounts from public sector banks.
- The chances of private participation are low unless investors are allowed a major say in the governance of the new entity.
- Bad bank will not address more serious corporate governance issues plaguing public sector banks that led to the NPA problem.
- Setting up a new institution would be very time-consuming.
- Challenges on its ownership structure as well as the pricing of bad loans taken over from banks.

8) Way Forward

- The larger focus must be on the ‘Twin Balance Sheet’ (TBS) problem of corporates and banks.
- Instead of recapitalising the banks year after year, it would be better for the government to focus on recovery.
- Just setting up one PARA will not be enough to get the banking sector back on track.
- The most efficient approach would be to design solutions tailor-made for different parts of India’s bad loan problem.

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