



Bad bank can help improve NPA resolution

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Highlights

The need for a new institution is warranted due to two basic reasons.

- The first is to do with the principle of separation of good and bad assets. The separation of bad asset helps the banks to focus on their business expansion.
- The second relates to maximum recovery and hence minimum burden or cost on the banks or the government.

These are the principles around which a new institution should be framed.

- International experience shows that a 'bad bank' or 'Asset Management Company (AMC)' has the potential to fulfil the above vital principles and can possibly address the NPA resolution challenge more effectively.

Governance

- The new institution should be independent and transparent in its operation with high emphasis on professionalism.
- While the government needs to own and oversee governance at the institution, the managerial staff, however, can be outsourced to strengthen operational and managerial efficiency.
- The experience in other countries offers two key commonalities that were inherent in their respective institutions - accountability to the government or its agencies and managerial efficiency

Financing

- There can be four ways of financing an asset management company as seen in several countries.
- These include equity injection by the government, special loans from the central bank, AMC bonds and public offering of shares.
- Issuance of AMC bonds has been the major source of finance in a majority of the countries. Ideally, the government must invest first for the creation of such an institution.

Way Forward

Mere creation of a new institution in the form of either 'bad bank' or 'AMC' does not guarantee automatic success. International experience suggests that the success of the AMC will depend on three critical conditions:

- There should be a clear distinction between the bad and good assets (in other words, the definition of a bad asset has to be followed strictly);
- Over time, the economy should bounce back to high growth trajectory;
- Preventive measures must be in place so that every new loan that is disbursed does not become an NPA too soon.

The fulfilment of the above conditions will determine the degree of success of the 'bad bank' or the asset management company.

Source: [The Hindu](#)

