ABSTRACT

The concept of “bad banks” is now taking the core shape in the current question on prospective solutions to the banking crisis in India. As this burning issues becoming central problem among the nation, it become very important to look into the effectiveness of the different kinds of bad banks. This paper discusses upon the various organization model of bad bank and possible goals governments are working to setting up bad-bank structures. India has built the environment that attract large inflows of foreign capital which making Indian market booming which encouraged banks to explore new areas and terms of lending loans, which are responsible for the large Non-performing asset in Indian banking sector so far. This problem could be handle easily if proper measure taken at right time but it time seems to be running out. Governments need to create the transparency with the public and define the plans which minimize the cost to the public from the bad-bank solution as most of the solution come from tax payer’s money. Looking forward, governments should better coordinate with regulators and central banks to minimize the risk of any further shocks to the banking system.

Keywords: Bad Bank, banking crisis, Non-performing asset

INTRODUCTION

Once again Bad Bank take the breath. It’s not a new concept perhaps a simple model. As the name it’s self suggest that it deal with something bad in the financial sector. It’s a banking system where toxic asset of a normal bank are parked. In other words its new bank created to take over the largest & most difficult stressed toxic asset from another bank in order to clean its balance sheet. Under this concept a normal bank divide its assets into 2 head viz. good & bad. Under Bad pile, all illiquid risky security & NPA come which has less scope of recovery. By separating the two, normal bank can avoid the contagious effect of toxic asset on good asset bank. This help bank to remain new strategy, asset from business or asset which simplify no longer required by bank as bank seek to lesser their risk or deleverage its.
It also assuages the concern of investor & helps in future lending, inventory etc. by making its balance sheet more healthy & transparent and reduce the uncertainty within the stakeholders. What come under good pile bank continue its normal operation.

Both Reserve Bank of India & Government had tried various measures to reduce the burden of Bad Asset /Toxic Asset in order to revive the health of Banking sector so that private sector could boost up but with little success. In fact, such late measure has to lead to more debtors joining the cost of defaulter. However, while the concept of a Bad Bank seems to be simple but its execution can be complex.

OBJECTIVE OF STUDY
1. To analyse the various options for banks facing NPA problem
2. To analyse the various Organizational models of making Bad bank

Option for Banks
Banks normally categorize loan as nonperforming /bad loan after 90 days of non-payment of principle or interest or both. A loan can also be categorized as nonperforming if a corporate pay it’s of interest on loan but fail to pay principle amount. Once an asset is acknowledged as a nonperforming, bank must decide how to deal with it. A bank has several ways to handle bad loan.

1. They can snatch the assets given as collateral by the borrower and sell theses, but it involve huge losses because bank may have to wait for appropriate deal to cover the amount of bad loan ,which take long years . Normally collateral asset are sold at steep discounts to their book value as bank cannot hold an asset for years due to its daily cash needs and other requirement.

2. Under RBI’s strategic debt restructuring (SDR) scheme, bank can convert loan into equity i.e. acquire share in the management and can bring new promoter in company. This method is very famous in advance countries but has no impact in India. Indian banks neither have experience in running business nor placing promoter in management

3. Bank can restructure the term and condition of loan so that borrower are able to repay the loan amount to bank. This involve increasing period of payment, waiving a part of loan, or decreasing the interest rate on loan. In any restructure banks involve huge losses

4. Bank can sell its bad loan to bad bank at a discount. It again involves huge loss to the bank but this method help the bank to clear it balance sheet. The bank’s capital reduces to the extent of losses in the transfer of bad loan to bad bank, but banks capital adequacy ratio improves. It help the bank to presents its financial report more striking to investor. Bad bank will manage these bad loans better than a normal bank because bad bank has more expertise on recovery of loan due.

Bad bank will manage these bad loans in suitable ways-some of them are liquidated, other may be restructured etc.

Why to be Concern about Bad Loan
Indian Bank has history of huge Bad Loan & nonpayment of loan amount which is a huge drag in the economy. It drains the surplus of Bank because of declining surplus, Banks cannot raise enough capital to fund the credit growth of economy which effect overall growth rate of economy .That’s why this need effective solution.

Another reason of concern is that who will run the majority stake in the Bad Bank? either there will be Government or private sector. If government is to be majority owner, how does it find fund for Bad Bank since size of NPA of Indian Banking Sector required substantial amount of capital Last a government entity may not be able to provide specialist service in Bad Banking system .It seems that
government owned Bad Bank is to be transforming the problem from one department to another department of government.

Private Investor has a majority stake in Bad Bank. Under this price at which Normal Bank sold its NPA to Bad Bank could be a critical issue. If price is too high, Bad Bank could not run its business. If price is too low, Normal Bank will get huge loss & accused of selling their loan too cheaply to private investor Possibility of a “Scam”.

There are other issues also printed out by former Reserve Bank of India governor Mr. Raghuram Rajan that it will lead to moral hazard, enabling Bank to continue with their reckless lending system as they know that they will be bailed out one day by the Bad Bank.

Selling Toxic asset to Bad Bank would also a time consuming process that take lot of negotiations round with Bad Bank & Normal Bank. It could ultimately block the fresh flow of fund in the economy. Mr. Raghuram Rajan had pointed out that Bad Bank are meant for non-viable project only and not for viable project.

Organizational Models

A report by McKinsey & Co., “Understanding The Bad Bank”, proposes four organizational models for a bad bank which is based on two decision factors:

1. It is to decide whether to keep the bad assets on their balance sheet. Moving assets off the balance sheet is better for investors and stakeholders and provides more transparency into the bank’s main operations. But it is more difficult and costly.

2. It is to decide whether the bad-bank assets will be managed in a special purpose vehicle (SPV). Based on the choices made by banks, the four bad-bank models could be formed given as follows:

On-balance-sheet guarantee

In the on-balance-sheet guarantee structure, the bank gets a loss-guarantee from the government over arrange of assets. Therefore it’s just a transfer of risk to government by Banks. The model is easy, less expensive and can be implemented rapidly with minimizes the requirement for upfront capital. However, this transfer of risk has limited impact and bad assets still appear on the bank’s balance sheet, overshadow its core performance. This approach is useful for stabilizing a bank in a short run so that the banks get enough time to develop a more widespread solution.

Internal restructuring unit

In the internal restructuring unit Banks set up an internal bad bank for the handling up the toxic asset of their balance sheet. The bank put all their bad assets in a separate internal unit, provide a separate management team to handle those toxic asset and gives them clear incentives i.e. time to recover the bad loans and commission thereof. This increases the bank’s transparency, if the outcomes are shown separately. However, if the Banks is looking to put its bad loans aside, this is not an effective solution.

Special-purpose entity

In a special-purpose entity structure, bad assets are put into a SPV, securitized and sold to different investors. This model works best for small, uniform assets. An efficient solution would be to transfer bad loans into sector-specific SPVs, securitize them and sell them in a public sale. For example Bad loan of 1000 Crore could to sell in a public sale/auction for 900 Crore. Thus the loss of banks would be limited to 100 Crore only and banks can make its balance sheet healthier.

Bad-bank spin-off

In a spin-off, the bank transfer bad assets into a separate banking up. Under this maximum risk could be transferred. But the model is difficult and costly because it requires setting up a separate banking entity, having trained management force, IT systems and a regulatory compliance set-up. Also, the
problem related to valuation of bad loans and pricing will be the most difficult part in this model. The Public Sector Asset Rehabilitation Agency (PARA) proposed by the Economic Survey 2016-17 comes under this group.


**Things to Consider While Creating a Bad Bank**

The first is that creation of bad bank creates a moral hazard because bank continues to give loans without making effective research of buyer since government is there to give bail. Second, there should be strict performance criteria for the banks to sell such toxic assets. It help to reduce moral hazard problem, making banks more responsible of their bad assets Third, the criteria for buying assets should be transparent so that all stakeholders could get real time information. Last, a competitive approach should there among the banking sector so that they work hard to the sale of bad assets to the bad bank.

**SUGGESTIONS**

- Distressed banks should be supported and are given a fresh start.
- Once given the support to the bank, greater regulatory compliance should be imposed on that bank so that future crisis could be avoided.
- The taxpayer is not unreasonably troubled.
- Moral hazard should be avoided.

**CONCLUSION**

The current Indian banking with respect to growing NPAs and toxic assets passing from its bad times. Bad bank’s organisation models are many but none of them seem to be a good option that is we are looking for probably the least bad solution. The additional stability that toxic asset is to be guarantees would provide to the banking system more strength. Handling of bad loans is the major challenges that our nation is facing today. It’s a challenge that requires a response on multiple fronts. Setting up a bad bank is a very complex procedure. It cannot solve all the problems in the Indian banking sector in one
go. More importantly, a one-size-fits-all approach to designing a bad bank can be very expensive and less effective in Indian economy. 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 custom-made for different parts of India’s bad loan problem to handle each one of them in unique manner. Identification of unviable assets and inability to agree on sale price will continue to be an issue and cause delay. Such unviable asset may further invite a banking sub crisis. The aim should be to cut losses and recover as much as possible. The sooner we understand that, the less fresh capital we need to inject into the system. It is more important to address the root causes of Indian banking system rather creating bad bank waiting for happening something bad in the economy.

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