NARCL in India- Is Bad Bank effective or just reallocation of funds from one pocket to another?

*Ankit Sharma[1], Dr. Hemal Pandya[2], Kiran Shree Baruah[3], Dr. Vishwanath G Y[4]**

[1]*Assistant Professor, International School of Management Excellence Bangalore*

[2]*Principal , SD School of Commerce, Gujarat University*

[3]*Research Scholar, International School of Management Excellence Bangalore*

[4]*Senior Associate Professor - International School of Management Excellence Bangalore*

Abstract

Purpose: Bad Bank' as a concept was formally suggested for the first time in India in the Economic Survey of 2015-16 for the Resolution and Reform of the Twin Balance Sheet Challenge. A bad bank is supposed to acquire bad loans from Scheduled Commercial Banks and recover them using the means at their disposal, thereby helping banks clean up their balance sheet and improve the overall health of Indian Banks & the Indian Economy. 'Bad Bank' in India was incorporated as NARCL (National Asset Reconstruction Company Limited) in 2021. Although the concept was in discussion for a few years, it quickly drew criticism and comments, including one from Mr. Raghuram Rajan (former Governor of RBI) where he said "... [If] Poorly designed, the bad bank will just shift bad loans from one pocket of the government to another". As of December 2024, NARCL has acquired 22 accounts with an exposure of Rs. 95,711 crores as opposed to the target of acquiring assets worth Rs. 2 lakh crores by the end of 2024-25.

Objective: This research aims to study the structure, operations, and effectiveness of NARCL, comparing it with similar institutions in other countries. This research also analyses the challenges being faced by NARCL and the role of NARCL in resolving the bad loans in the Indian Banking Sector.

Methodology: This research is a mix of qualitative and quantitative research. Bad bank as a policy, its structure, and recovery mechanisms have been compared as qualitative factors. And by leveraging secondary data from NARCL's annual reports and Reserve Bank of India (RBI) reports, quantitative evaluation of the performance of the bad bank model in India and its impact on the recovery of bad loans in the banking sector has been analyzed.

Originality/value: As the bad bank model is fairly new in India, an attempt is made to study the structures, mechanisms, and success of the bad banks of other countries as compared to India. The paper also delves into the challenges faced by NARCL, such as slower-than-expected asset acquisitions. Additionally, it assesses NARCL's role within the broader framework of India's financial sector reforms to tackle the problem of bad loans. The findings contribute to the existing literature on asset recovery and financial stability, providing insights for analysts and researchers.

Keywords: NPAs, Bad Bank, NARCL, RBI, Asset Recovery, Indian Banking Sector, Financial Institutions.

**Corresponding Author E-mail address: vishwanathgy@isme.in*

Introduction

Bad Bank: A bad bank is primarily responsible for taking over the bad loans accumulated in the commercial bank(s) of a country over many years with the purpose of recovering them using the means at their disposal. This helps the banks in cleaning up their financial statements and focus on its core operations instead on recovery of loans. Such bad banks are formed in order to save the banks and the economy of a nation from severe financial distress or a larger economic stress. Bad Banks are often formed with a hybrid of public-private partnership setup. Several countries, including USA, UK, Ireland, Spain, Germany, China, Japan, Malaysia, Thailand, etc. have formed bad banks to tackle NPAs. USA, however, was the first country to introduce the idea of a bad bank in the 1990's. The concept of Bad Bank, however, gained popularity after the financial crisis of 2008, with the examples of implementation of Securum in Sweden and TARP (Troubled Asset Relief Program) in the US.

Why was Bad Bank required in India?

The growth of NPAs in the Indian Banking Sector kept on increasing since 2010. Owing to this, the Indian Economy faced a situation where the borrowers were not able to pay back their loans and the banks were not getting their money back, ultimately resulting in impaired Balance Sheets for the borrowers as well the banks. This situation was termed by the RBI as the 'Twin Balance Sheet' problem, or the TBS problem. It was also called as the 'Balance Sheet Syndrome with Indian Characteristics'. There were many schemes introduced by the RBI to facilitate the recovery or rehabilitation of stressed assets, like the 5:25 scheme, SDR scheme, CDR Scheme, S4A, etc. These schemes are explained in the later part of this paper. Apart from the existing laws of insolvency and bankruptcy, these schemes were aimed at offering various options to the borrowers like giving more time to the borrower to repay the loan, or to restructure the terms of their loan, or to restructure their capital to convert debt to equity, etc. A suggestion to set up a 'bad bank' was made for the first time in the Economic Survey of 2015-16. The consequent Economic Survey of 2016-17 termed the bad bank as 'Public-sector Asset Rehabilitation Agency' or PARA. The Insolvency and Bankruptcy Code (IBC) was introduced in 2016, which improved the recovery rates of stressed assets but it faced procedural delays and legal challenges.

As per the RBI's Financial Stability Report of June 2018, "The stress tests indicate that under the baseline scenario, the GNPA ratio of all SCBs may increase from 11.6 per cent in March 2018 to 12.2 per cent by March 2019. However, if the macroeconomic conditions deteriorate, their GNPA ratio may increase further under such consequential stress scenarios. Among the bank groups, PSB's GNPA ratio may increase from 15.6 per cent in March 2018 to 17.3 per cent by March 2019 under severe stress scenario, whereas PvB's GNPA ratio may rise from 4.0 per cent to 5.3 per cent and FB's GNPA ratio might increase from 3.8 per cent to 4.8 per cent." Despite the existing laws and the schemes mentioned above, just due to sheer size of the NPAs existing in the economy and to fasten the process of recovery, a need was felt for the rehabilitation of the stressed assets by a vehicle owned or controlled by the government.

Structure and Operations:

The formation of a bad bank was officially announced by the Hon'ble Finance Minister of India in the Budget of 2021. A structure of ARC-AMC was formed for resolution of the biggest stressed assets in the country. An Asset Reconstruction Company (ARC) primarily focuses on the resolution of stressed assets while an Asset Management Company (AMC) primarily focuses on the management of funds/assets for generating value for its investors. In India, the bad bank structure is implemented with the National Asset Reconstruction Company Limited (NARCL) as the ARC and the India Debt Resolution Company Limited (IDRCL) as the AMC. IDRCL works exclusively with NARCL and provides end-to-end assistance with managing the assets acquired by NARCL and providing the most optimum resolution as per the RBI framework, like Corporate Insolvency Resolution Process proceedings under Insolvency and Bankruptcy Code, 2016, Enforcement of security/liquidation, sale of assets/slump sale, sale to Stressed Funds, Alternate Investment Funds, Strategic Investors, etc.

NARCL was incorporated on 07th July 2021 as a government entity under the Companies Act, 2013. NARCL is also registered as an ARC with RBI under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act). NARCL is a company limited by its shares with an authorized and paid-up capital of Rs. 2,750 crores. The table below shows the shareholding pattern at NARCL as per their annual report. There is a public-private partnership with 84% shareholding by public sector banks.

NARCL's principal activity is acquiring of bad loans or NPAs from banks and financial institutions and resolving them through various mechanisms included in the scope of SARFAESI Act, 2002. It was set up to resolve legacy stressed assets in the Indian banking system valuing Rs. 500 crore or more.The acquisition structure offered by NARCL to the selling banks or financial institutions is a mix of cash and SR (security receipts). These SRs are backed by a guarantee of the Government of India, which makes for an attractive offer to selling banks or financial institutions. The idea behind backing by the government was to aid NARCL in easy aggregation of stressed assets. By aggregation of stressed assets under one roof, NARCL aims to resolve these assets efficiently in a concentrated effort by one institution (NARCL) instead of scattered efforts made by different government bodies and banks against defaulters.

NARCL follows a 15:85 model of Cash :S Rs being paid to the sellers of bad loans. The SRs, as discussed above, are backed by the sovereign guarantee of the Government of India. To put it simply, for example, if NARCL acquires an NPA for Rs. 1,000 crore from SBI, Rs. 150 crores will be paid to SBI in cash and SRs worth Rs. 850 crores will be issued by NARCL. If the asset account is realised for Rs. 840 crores, the entire amount will be transferred to SBI, but as the SR was issued for Rs. 850 crores; the remaining Rs. 10 crores will be paid by the government as the SR was backed by its sovereign guarantee. On the other hand, if the asset account is realised for Rs. 860 crores, only Rs. 850 crores will be transferred to SBI and the remaining Rs. 10 crores will remain with NARCL, resulting in no overall liability of the government as the SR is never called upon.

As per the Financial Services Secretary Mr. M. Nagaraju "Originally, the estimated stressed assets stood at Rs 2 lakh crore. With an 18 percent recovery rate, we expected to recover about Rs 36,000 crore. As per the 85 percent SR-backed calculation, Rs 30,000 crore SRs were held". And as per the Press Information Bureau, "GoI Guarantee of up to Rs 30,600 crore will back Security Receipts (SRs) issued by NARCL. The guarantee will be valid for 5 years. The condition precedent for invocation of guarantee would be resolution or liquidation. The guarantee shall cover the shortfall between the face value of the SR and the actual realization. GoI's guarantee will also enhance liquidity of SRs as such SRs are tradable".

NARCL's performance since inception

The targeted acquisition of bad loans or NPAs by the NARCL was Rs. 2 lakh crores as per the Press Information Bureau in its notification in September 2021, which said "NARCL proposes to acquire stressed assets of about Rs. 2 Lakh crore in phases within extant regulations of RBI". As of February 2025, NARCL acquired 24 accounts with an exposure of Rs. 1.05 lakh crores, as per the Financial Services Secretary Mr. M. Nagaraju. The exact details and the amounts of each account acquired are not available in the public domain. Subsequently in March 2025, another account has been acquired for Rs. 12,700 crores. While NARCL is more than half way of its target and while it has improved transparency and brought many NPAs of the Indian banking sector under one roof, it is, however, yet to attain the final resolution of any account.

Relevance and Novelty of the research:

While many laws and schemes exist in India for the resolution of stressed assets in the economy, the need for a bad bank existed. As a result, the NARCL-IDRCL combination was introduced in India in 2021 with the hopes of resolution of legacy stressed assets. In almost four years since its inception, NARCL is yet to resolve any asset. Although many studies have been done on NPAs in India, very less literature is available on the analysis of NARCL and its resolution of NPAs. This study looks into the challenges being faced by NARCL, with a comparison of its structure and operations with the bad banks of other countries. This study also looks at the trend of recovery of assets through various mechanisms over the last 10 years as per RBI data and if the NARCL-IDRCL is the need of the hour.

Literature Review:

The model of a "bad bank" has been adopted by several economies in response to systemic banking crises. The Swedish experience with *Securum* during the early 1990s is often cited as a benchmark for effective asset resolution. Ingves and Lind (1996) observed that "the strong legal and institutional frameworks, along with operational independence from political influence, were instrumental in Securum's successful performance." Bergström, Englund, and Thorell (2003) further emphasized that Sweden's bad bank facilitated orderly liquidation and restructured assets without requiring large-scale taxpayer losses. In the United States, the *Troubled Asset Relief Program (TARP)* was enacted in response to the 2008 global financial crisis. According to the U.S. Department of the Treasury (2015), the initiative "helped stabilize the financial system during a period of extreme uncertainty," with over $390 billion of the $426 billion disbursed ultimately recovered. Paulson (2010) argued that TARP's structure combining capital infusion and asset purchases helped restore market confidence by demonstrating government backstop in a controlled manner.

Ireland's *National Asset Management Agency (NAMA)* was set up in 2009 to manage the fallout of a real estate-fueled banking crisis. Although NAMA succeeded in acquiring €74 billion in distressed assets, Kelly (2014) contended that "the process was marred by asset overvaluation and political opacity," resulting in delays and reduced public trust. India's asset resolution landscape has evolved through several legislative and institutional measures, beginning with the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002. This act allowed banks to enforce collateral without judicial intervention.

However, the Reserve Bank of India (2017) noted that "ARCs in India operated with limited capital and recovery rates remained modest," with redemption of Security Receipts (SRs) often falling below 30%. The Insolvency and Bankruptcy Code (IBC), introduced in 2016, was intended to address these shortcomings through a time-bound resolution framework. While initially successful, later assessments revealed implementation bottlenecks. Sengupta and Roy (2020) stated that "despite initial improvements, average resolution times increased substantially due to delays in the National Company Law Tribunal (NCLT) and frequent legal appeals." PwC India (2022) reported that average haircuts under the IBC process stood at 69%, raising questions about the efficacy of recoveries.

Academic scrutiny of India's asset reconstruction system reveals critical shortcomings. Acharya, Kulkarni, and Rajan (2014) identified "significant inefficiencies in India's government-driven resolution process," emphasizing that public sector-dominated ARCs lacked market incentives and competitive pressure. Chakrabarty (2019) warned that "repeated capital infusions into PSBs without corresponding structural reforms create moral hazard and compromise credit discipline." Empirical studies have corroborated these findings. For instance, data from the RBI (2023) showed that "the average recovery rate for ARCs and IBC combined stood at only 20.8% in FY2022–23," compared to higher expectations at the time of their inception. These insights indicate a need for structural redesign rather than incremental fixes.

As noted by Krugman (2008), public backstopping of private losses without penalties may incentivize reckless behavior. In the context of NARCL, the sovereign guarantee on Security Receipts potentially encourages banks to offload poor-quality assets without due diligence.

Buchanan and Wagner (1977) argued that governments often obscure the real cost of public interventions through off-budget liabilities. NARCL's guarantee of ₹30,600 crore, while not immediate expenditure, creates contingent liabilities that affect long-term fiscal health. Stigler (1971) theorized that industries may "capture" regulators to serve their own interests. With NARCL being primarily owned by public sector banks, which are also the originators of distressed assets, there exists a risk of leniency and non-transparent valuation.

OBJECTIVES

1. To study the existing laws in order to understand the need for a 'bad bank' structure for the Indian Banks.
2. To study the structure of NARCL and analyse it with the structure of Bad banks of other countries.
3. To study the performance of NARCL and its effectiveness against the set expectations (annual report data, recovery, RBI source of recovery data)
4. To study the challenges involved in the functioning of NARCL and attempt to draw conclusions and/or proposed solutions.

RESEARCH METHODOLOGY

1. Theoretical and policy research.
2. Secondary data is taken from NARCL annual reports to analyse the performance of bad bank.
3. Secondary data is taken from RBI reports (RBI Report on Trend and Progress of Banking in India, Financial Stability Reports, etc.) to analyse bad bank as a source of recovery for bad loans.

ANALYSIS

The need for 'Bad bank' in India - The Twin Balance Sheet problem. Started as an aftermath of the Global Financial Crisis of 2008.

Table 1: Shareholding pattern of NARCL

S. No.	Name of the Shareholder (S - Sponsor, NS-Nonsponsor)	No. of Shares	Percentage %	Type of Bank
1	Canara Bank (S)	33,00,00,000	12	Public
2	SBI (NS)	27,22,50,000	9.9	Public
3	UBI (NS)	27,22,50,000	9.9	Public
4	BoB (NS)	27,22,50,000	9.9	Public
5	IB (NS)	27,22,50,000	9.9	Public
6	PNB (NS)	24,75,00,000	9	Public
7	BoI (NS)	24,75,00,000	9	Public
8	BoM (NS)	13,75,00,000	5	Private
9	IDBI Bank (NS)	13,75,00,000	5	Public
10	ICICI Bank (NS)	13,75,00,000	5	Private
11	UCO Bank (NS)	12,10,00,000	4.4	Public
12	HDFC Bank (NS)	8,25,00,000	3	Private
13	Axis Bank (NS)	8,25,00,000	3	Private
14	IOB (NS)	8,25,00,000	3	Public
15	Punjab & Sind Bank (NS)	5,50,00,000	2	Public
Tot		2,75,00,00,000	100	

When it comes to the recovery of stressed assets, the options are varied but limited. The solution could be as simple as restructuring the financial structure of the company, i.e., conversion of debt into equity, or the solution could be the overtaking of stressed assets by the bad bank in complex cases. The following options are available with the borrower and the lenders for the recovery of loans:

a. Restructuring of the borrower's capital: If the borrower doesn't have enough cash inflow in the company, repaying the mandatory debt instalment could be problematic as any default is going to raise flags and the borrower could end up in legal trouble. The first step here is to understand the amount of cash inflow of the borrower's business and accordingly restructure the capital structure of the borrower as per their debt appetite. A portion of the debt could be converted to equity after taking necessary approvals. Doing this would serve two purposes : First, the lender now holds equity which would give them more say in the decision making of the business, effectively enabling them to ensure that the business runs smoothly and that there is more cash inflow, and Secondly, there are no mandated debt instalments that the borrower is required to pay anymore, thus relieving them of the risk of default.

b. One-Time Settlement (OTS): The borrower may propose to settle their loans with the banks in a one-time settlement payment which the bank may reject or accept depending upon its viability.

c. Provisions of the SARFAESI Act 2002: As per the provisions of the SARFAESI Act, the banks can take possession of the secured assets of the borrower and the sell them without the intervention of the court. This helps in speedy recovery for the banks.

d. Insolvency and Bankruptcy Code 2016: This is overseen by the National Company Law Tribunal and a Resolution Professional (RP) is appointed to propose solutions to the Council of Creditors (CoC). The RP can propose solutions like restructuring of capital, sale of assets, etc. on default by a company, the lenders can initiate proceedings against it called the Corporate Insolvency Resolution Process (CIRP) under the IBC framework. The IBC was different from the earlier laws as it sought the resolution of cases within a time frame of 180-270 days. If there was no resolution within this timeframe, the borrower can be put in liquidation.

e. Debt Resolution Tribunals: DRTs were created in 1993 for quick resolution of bad loans amounting more than Rs. 10 lakhs. DRTs take less time than the traditional civil courts. However, the IBC set up in 2016 can prove to be quicker than DRTs. On failure of the borrower to repay the loan, a petition can be filed by the lenders to the DRT. On acceptance of the petition, the DRT can attach the assets of the borrower for the recovery of loan.

f. Lok Adalats: The system of usage of Lok Adalat as a source of recovery of NPAs was started in 1987. Lok Adalat runs with the principle of reconciliation and compromise. The cases are resolved here by a mediator, usually a panel of judges or legal experts. Lok Adalat is a cost-efficient approach and can resolve matters before a formal route, like a court case, is filed by the lender(s).

g. ARCs: Asset Reconstruction Companies are registered with the RBI under the SARFAESI Act, 2002, and primarily focuses on buying stressed assets from Banks or Financial Institutions and then recover them to the maximum extent possible. At the time of purchase of stressed assets from the banks or the financial institutions, these ARCs could either pay the amount in cash or issue Security Receipts (SRs) which are redeemable at the time of the sale of stressed assets in the market by ARC. The purchase price of the stressed assets is also a discounted price as the ARC has to factor in the cost of recovery, probability of recovery, management costs, etc. For example, a bad loan of 100 crores exists in the books of ABC Bank. An ARC can offer to buy this account for 70 crores factoring in all the costs and probability of recovery. The ARC could either pay 70 crores in cash to ABC Bank at the time of purchase or could issue SRs worth 70 crores. When the ARC actually realizes the amount, let us say 80 crores, the SRs of ABC Bank worth 70 crores will be redeemed. ARCs help the bank in asset recovery and let them focus on their banking operations instead of loan recovery. There are about 29 ARCs active in India.

h. 5/25 Scheme- RBI started in 2014, loan restructuring scheme for long terms loans of infrastructure projects. Moratorium of 5 years. Extension of 25 years. Delay in recognition of NPAs, as they may not start paying at the end of 5th year also due to project delays or regulatory hurdles. Phased out by 2019 as IBC resolution mechanism became more prominent.

i. SDR Scheme- Strategic Debt Restructuring, introduced by RBI in 2015, loan restructuring mechanism particularly for large corporate loans. Allows banks to take over stressed assets that have become NPAs and convert loan exposure to equity. Management control- can employ new people in higher management to see over operations. Designed to provide a strategic restructuring to address cases of financial distress incorporates and help them turn around their economic trajectory. Total 60% share of total debt of the company must be owed towards banks for them to implement SDR. Strict timeline of 180 days- if not resolved- refer to IBC (NCLT). SDR allows lender to take proactive measures to resolve the financial distress in the company before moving over to insolvency proceedings under IBC as the last resort.

j. CDR- Corporate Debt Restructuring- mechanism introduced by RBI to address NPAs particularly in the case of corporate loans. If a company is undergoing financial distress due to operational reasons, economic conditions, market conditions, etc., CDR can be implemented by banks or financial institutions to restructure the conditions of the loan to ensure repayment by the borrower. Conditions such as the loan period, interest rate, repayment schedules, etc. can be restructured by the lenders. CDR helps in revival of stressed assets without the need of going for SDR, or insolvency proceedings under IBC, or forcing liquidation of the borrower. The minimum exposure for such accounts should be Rs. 10 crore and the account should either be classified or at the verge of being classified as an NPA. 75% holders of the debt must agree to implement CDR. The CDR cell of the RBI must be notified about such restructuring and the approval of the CDR cell along with the CDR Empowered Group, which consists of senior representatives from the banking sector, must be taken to implement the scheme. The restructuring plan should be implemented within 180 days of the start of the discussions.

DISCUSSION AND CONCLUSION:

Based on the available data, we can see that it is a complex problem for the banks to recover the bad loans which has been imbibed in the system. As discussed earlier the following methods like Restructuring of the borrower's capital, One-Time Settlement (OTS), Provisions of the SARFAESI Act 2002, Insolvency and Bankruptcy Code 2016, Debt Resolution Tribunals, Lok Adalats, Asset Reconstruction Companies, 5/25 Scheme, Strategic Debt Restructuring Scheme and Corporate Debt Restructuring can be used in conjunction with other methods to solve the NPA problem. However, a lot need to be done in the legal framework and the practical implementation of laws.

References:

Acharya, V., Kulkarni, N., & Rajan, R. (2014). State Ownership and Systemic Risk: Evidence from the Indian Financial Sector during 2007-09.

BERGSTRÖM, C., ENGLUND, P., & THORELL, P. (2003). Securum and the Way out of the Swedish banking crisis.[Online.] Summary of a report commissioned by SNS–Stockholm: Centre for Business and Policy Studies.

Bhala, R. (2018). Reserve Bank of India. In Research Handbook on Central Banking (pp. 68-93). Edward Elgar Publishing.

Buchanan, J. M., & Wagner, R. E. (1977). Democracy in Deficit: The Political Legacy of Lord Keynes. Academic Press.

Chakrabarty, K. C. (2019). Banking on Government: The Moral Hazard of Public Sector Bank Recapitalization in India

Ingves, S., & Lind, G. (1996). The management of the bank crisis in retrospect.

Pillay, M. T., Keshri, K., & Chaudhari, S. REVIEW OF RECENT INTEREST RATE INCREASE BY RBI. Enhancing Productivity in Hybrid Mode: The Beginning of a New Era, 175.

Krugman, P. R. (2008). Trade and Wages, Reconsidered. Brookings Papers on Economic Activity, 39(1), 103-154.

Kumar, C. S. An Overview of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (SARFAESI Act).

SenGupta, A., & Roy, M. (2023). Circular-statistics-based estimators and tests for the index parameter α of distributions for high-volatility financial markets. Journal of Risk and Financial Management, 16(9), 405.

Stigler, G. J. (1971). The Theory of Economic Regulation. The Bell Journal of Economics and Management Science, 2(1), 3-21.

Treasury, U. D. (2010). US Department of the Treasury. Retrieved June, 11, 2010.

Veronesi, P., & Zingales, L. (2010). Paulson's gift. Journal of Financial Economics, 97(3), 339-368.