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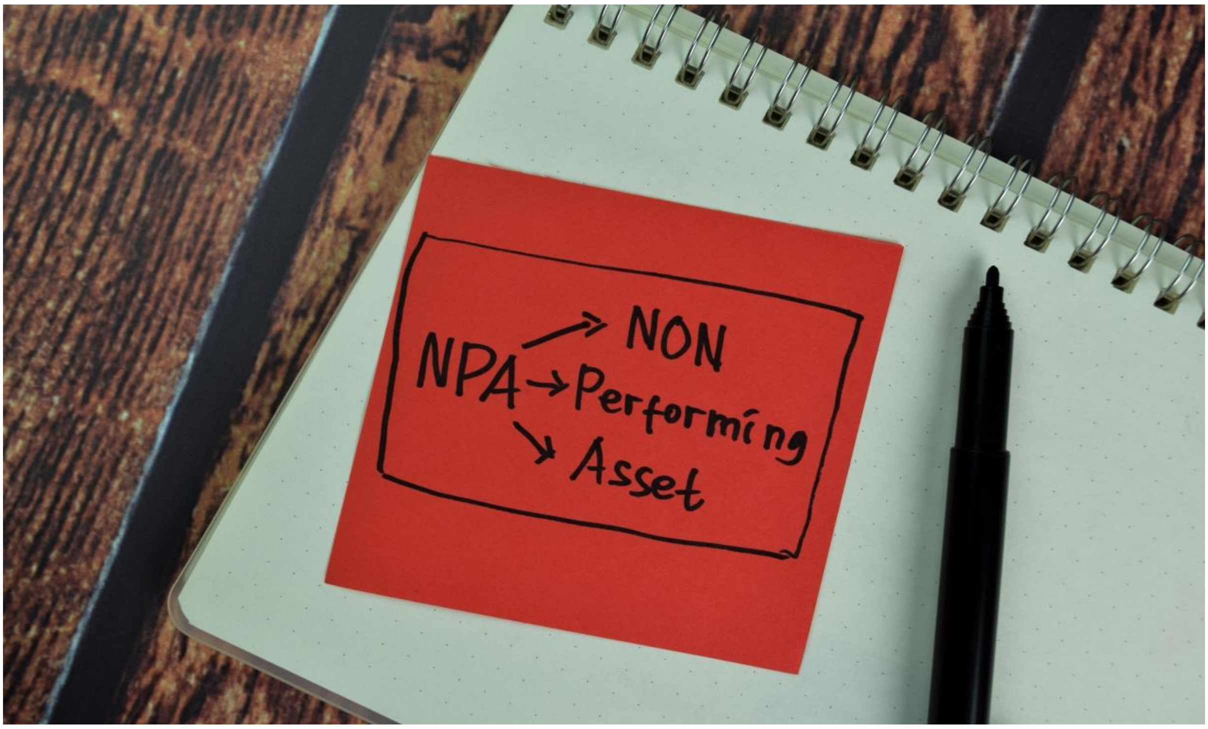
OPINION

How ARCs are solving India's NPA crisis

Asset reconstruction companies (ARCs) were set up in India to solve the NPA problem. India's 29 ARCs are a reflection of the success of the ecosystem in alleviating the stressed asset challenges.

By **RASHESH SHAH**, Mar **16, 2021** 4 min read



The first asset reconstruction company (ARC) was set up in India in 2002 with the intention of resolving NPAs of the financial sector and contributing to developing a distressed asset resolution ecosystem. ARCs were envisaged as an infrastructure to resolve and recover from NPAs either through asset reconstruction/revival or through asset liquidation. The 29 ARCs in the country, as on date, are a reflection of the success of the ecosystem to alleviate the stressed asset challenges while being economically viable. Clearly, the structure has worked well and established a strong track record over the last two decades.

Over the years, the model has also evolved from a pure agency model to a more equitable fee-cum-investment model, changing the dynamics of investment, risk, and return. All of this has helped ARCs acquire debt of ₹3.88 trillion as of June 2019. However, compared to the overall NPA book of the banking sector, the assets assigned to ARCs is still low. We have nearly ₹10 trillion worth of stressed assets in the system so clearly the extent of the problem (and opportunity for ARCs) continues to be immense. It is with this background that the government introduced the proposal for a new ARC-AMC mechanism to resolve the stressed assets of public sector banks in this budget.

Bad Bank

The structure broadly proposes acquisition of assets from banks at a nominal value, aggregated exposure being managed by the AMC set up under the Bad Bank banner with an option to involve private sector entities for resolution of these assets and subsequent sale of these assets.

The proposed structure aims mainly to address large accounts with banking exposure of ₹500 crore and above to start with which can help provide a strong start to the process. This might include stalled projects and large EPC companies which could also be potentially the most challenging assets. However, once that is done, the process is expected to ease out comparatively.

Strong tailwinds

The ARC structure has traditionally worked for a number of reasons—most of these are equally relevant to the proposed structure and, hence, will provide strong tailwinds for implementation and success.

ARCs have singular focus on resolution and recovery unlike a lenders infrastructure which is oriented mainly on lending. The other advantage is debt aggregation and ability to restructure and provide some additional funding, which is difficult for banks in NPA accounts.

Additionally, ARCs have built good infrastructure for NPA resolution / recovery and have skilled human resources to meet the challenges of NPA resolution. Major ARCs also have large in-house legal resource and turnaround teams which have helped in resolution and turnaround of some of the classic assets by additional funding, strict monitoring of process and cashflow, effective restructuring etc. These entities have seen good enhancement in their EBITDA levels, and the operations have been revived creating stakeholder value while preserving employment of thousands of workforces.

Challenges to solve

While this is overall a good step, there are some challenges which most traditional ARCs have faced which will need to be solved by the new structure as well.

Legal challenges continue to be a bugbear for most asset resolutions and even the ARC structure has struggled to get a workaround for it. Legal timeframes have often led to delays in resolution timelines, but this has improved recently under NCLAT.

Another challenge faced by many ARCs after regulatory changes over the last few years has been around the constraints on resources – this should hopefully not affect the new structure as it will be supported by capital from the government. At the same time, as the cumulative value of these assets will be large, the limited resources available with ARCs / funds may prove inadequate for aggressive participation and needs to be thought through.

Execution is key

While the overall construct is encouraging, like all operational ideas, execution will remain the key to determining the success of the process. It would be prudent to align with ARCs and utilize their infrastructure and skill set in resolution of these assets on agency models to expedite the resolution process.

If the market considers / facilitates borrowing by the ARCs as standalone entities, they may also be able to acquire the consolidated exposure from Bad Bank ARC and create headroom for the new entity to further acquire assets.

ARCs can also continue to play their role in resolution of medium and small value assets and same could be made more effective by relaxing certain norms like 15% minimum stake on assets acquired on 100% cash basis (where selling lender has no SR exposure), waiver of provision maintenance on sale under SR structure (to help better price realisation and upside sharing by the lenders), facilitating bank / market borrowing by ARCs similar to NBFCs amongst others.

On balance, the Bad Bank structure brings efficiency of aggregation with the opportunity to use the existing ARC / Fund platform for better resolution of the distressed assets. With some enablers, ARCs would also be able to play a pivotal role in resolution of NPAs of the banking system.

Views are personal. The author is Chairman, Edelweiss Group.