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How Effective are bad Bank Resolutions? New Evidence from India (NARCL)

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Abstract
Non-performing assets have remained a persistent challenge for the Indian banking system, constraining credit growth and financial stability despite multiple recovery mechanisms. In response, the Government of India established the National Asset Reconstruction Company Limited (NARCL) as a government-backed bad bank to address large and legacy stressed assets. This study examines the effectiveness of bad bank resolutions in India by analysing NARCL's institutional design and early performance. Using secondary data from regulatory reports and government disclosures, the paper evaluates pre-NARCL recovery channels and assesses the transfer of 22 large stressed assets to NARCL through a structured analytical framework. The findings indicate that while traditional mechanisms showed limited effectiveness, NARCL offers structural advantages in balance-sheet clean-up and coordinated resolution of complex NPAs, with recovery outcomes still evolving.

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1. Introduction

In recent decades, the global financial system has experienced recurring episodes of banking distress driven largely by the accumulation of non-performing loans (NPLs) and non-performing assets (NPAs). Rising levels of impaired assets weaken bank balance sheets, erode profitability, constrain credit intermediation, and ultimately undermine financial stability and economic growth. Consequently, policymakers across jurisdictions have continuously debated the most effective institutional mechanisms for relocating distressed assets away from banks while ensuring that value recovery and corporate restructuring are incentivised rather than delayed (Caprio & Klingebiel, 1996; Tirole, 2012) [9].

A central element of this policy response has been the creation of specialised entities commonly referred to as bad banks, asset reconstruction companies (ARCs), asset management companies (AMCs), or special purpose vehicles (SPVs) to acquire and resolve troubled assets. These entities are designed to assume multiple functions, including debt aggregation, asset restructuring, liquidation, securitisation, and negotiated settlements, with the overarching objective of restoring bank balance sheets and revitalising distressed firms (Barodawala, 2023; Vijayakumar & Venkatesh, 2021) [2,3,31]. International experience suggests that such mechanisms can be effective when supported by strong governance frameworks, transparent valuation processes, and enabling legal infrastructure, but can also fail if they devolve into repositories of bad debt without meaningful resolution outcomes (Garrido, 2016; Honohan, 2019) [11,14].

The historical evolution of bad banks across countries illustrates both their potential and limitations. Sweden's Securum and Retriva, established in the early 1990s following a severe banking crisis, are widely regarded as successful examples, having resolved nearly 95% of acquired NPAs within a relatively short period through aggressive restructuring and asset disposal strategies (Ingves & Lind, 1996) [16].

Similarly, Malaysia's Danaharta, created during the Asian financial crisis, demonstrated the importance of centralized authority, legal empowerment, and professional asset management in achieving high recovery rates (Tan, 2006). In contrast, experiences in Spain (SAREB) and certain European economies reveal that weak price discovery, political interference, and overvaluation of assets can severely limit the effectiveness of bad banks, leading to prolonged balance sheet stress and fiscal exposure (Garrido, 2016; Brei *et al*., 2023) [8,11].

Against this global backdrop, India's banking system has faced a persistent and intensifying NPA problem, particularly after the

global financial crisis of 2008. Indian banks recorded NPAs of ₹53,917 crore in 2008, which escalated sharply to ₹3.23 lakh crore by March 2015 and further to ₹9.36 lakh crore by March 2019 (Reserve Bank of India, 2022). Empirical studies document that this rise was disproportionately concentrated in public sector banks and was driven by a combination of macroeconomic slowdown, aggressive lending to infrastructure and capital-intensive sectors, governance weaknesses, and deficiencies in credit risk management (Joshi *et al*., 2022; Ranjan *et al*., 2003) [17,26]. Forecasting evidence further suggests that, in the absence of structural reforms, NPAs tend to exhibit persistence and cyclical resurgence rather than self-correction (Joshi *et al*., 2022) [17].

India has experimented with multiple institutional mechanisms to address stressed assets, including Lok Adalats, Debt Recovery Tribunals (DRTs), and the SARFAESI Act, 2002. While these mechanisms differ in scope and legal authority, their collective performance has been uneven. Lok Adalats, despite handling millions of cases annually, have consistently recorded recovery rates below 6%, limiting their effectiveness to small-value settlements (Swain *et al*., 2017; RBI, 2023) [30]. DRTs, though intended to expedite recovery of large debts, have suffered from procedural delays, capacity constraints, and mounting case backlogs, resulting in fluctuating recovery outcomes. SARFAESI has demonstrated relatively higher recovery efficiency, particularly for secured assets, yet remains constrained by litigation, asset valuation challenges, and market illiquidity (RBI, 2023).

Table 1: Recovery Performance of NPA Resolution Channels in India (2017–18 to 2021–22)

Year	Recovery Channel	Number of Cases Referred	Amount Involved (₹ billion)	Amount Recovered (₹ billion)	Recovery Percentage (%)
2017-18	Lok Adalats	33,17,897	457	18	4
	DRTs	29,551	1,333	72	5.4
	SARFAESI	91,330	1,067	265	24.8
2018-19	Lok Adalats	40,87,555	53,484	2,750	5.1
	DRTs	51,679	2,68,413	10,552	15.9
	SARFAESI	2,35,437	2,58,642	38,905	15
2019-20	Lok Adalats	59,86,790	67,801	4,211	6.2
	DRTs	40,818	2,45,570	10,018	4.1
	SARFAESI	1,05,523	1,96,582	52,563	26.7
2020-21	Lok Adalats	19,49,249	28,084	1,119	4
	DRTs	28,182	2,25,361	8,113	3.6
	SARFAESI	57,331	67,510	27,686	41
2021-22	Lok Adalats	85,06,741	1,19,006	2,778	2.3
	DRTs	30,651	68,956	12,035	17.5
	SARFAESI	2,49,645	1,21,718	27,349	22.5

Source: Reserve Bank of India, Report on Trends and Progress of Banking in India (various years).

Table 1 highlights the persistent inefficiencies in India's traditional NPA recovery mechanisms. Lok Adalats, despite handling the largest volume of cases, consistently record the lowest recovery rates, underscoring their limited suitability for resolving large and complex NPAs. DRTs exhibit moderate but volatile recovery performance, reflecting procedural delays and institutional constraints. In contrast, SARFAESI emerges as the relatively most effective channel, with recovery rates peaking at 41% in 2020-21. However, even SARFAESI remains constrained by litigation delays and asset disposal challenges. Collectively, this evidence indicates that existing mechanisms have been insufficient to address legacy NPAs, particularly large consortium-based exposures.

The introduction of the Insolvency and Bankruptcy Code (IBC) in 2016 marked a significant shift toward time-bound resolution of corporate distress. However, evidence indicates that while the IBC improved recovery outcomes compared to earlier mechanisms, legal delays, frequent appeals, and sector-specific complexities diluted its overall impact on legacy NPAs (Reddy, 2020). As a result, a substantial stock of unresolved stressed assets persisted, raising concerns about the long-term health of the banking sector and the effectiveness of existing resolution frameworks.

It is within this context that the Government of India announced the establishment of the National Asset Reconstruction Company Limited (NARCL) in the Union Budget 2021-22. Conceptually aligned with international bad bank models, NARCL was designed as a government-backed asset reconstruction company mandated to acquire large stressed assets with exposure of ₹500 crore and above. Unlike private ARCs operating since 2002 under the SARFAESI framework, NARCL introduced a hybrid acquisition structure involving a 15:85 split between upfront cash and

Security Receipts (SRs), with the latter backed by a sovereign guarantee. This design aimed to accelerate asset transfers, ease provisioning pressures on banks, and facilitate coordinated resolution of large consortium-based exposures (Barodawala, 2023; Vijayakumar & Venkatesh, 2021) [2,3,31]. However, the institutional design of NARCL has generated significant academic and policy debate. Chandrasekhar (2021) [10] questions the necessity of creating an additional ARC in an ecosystem already populated by private ARCs, arguing that historical experience suggests limited success in NPA recovery and that ARCs may benefit more than originating banks. From a fiscal and market-design perspective, Prasad (2023) employs economic modelling to demonstrate that government-backed guarantees may distort price discovery, encourage overpricing of NPAs, and shift contingent liabilities to the public sector. The study cautions that, in the absence of strong governance and transparent valuation mechanisms, NARCL risks becoming a warehouse for distressed assets rather than a genuine reconstruction vehicle.

At the same time, international empirical evidence provides support for asset segregation through bad banks as a crisis-resolution tool. Using a difference-in-differences framework across 18 European countries, Brei *et al*. (2023) [8] find that banks transferring NPAs to bad banks experience stronger recovery in lending activity and lower funding costs compared to those relying solely on recapitalisation. These findings suggest that, when properly designed, bad banks can play a complementary role in restoring credit flows and supporting economic recovery.

The Indian literature further highlights the broader consequences of NPAs on bank performance and financial stability. Gaur and Mohapatra (2021) [12] empirically establish a strong negative relationship between NPAs and bank profitability, showing that rising NPAs significantly erode returns on assets and equity. Studies on securitisation and security receipts argue that excessive reliance on contingent instruments without robust secondary markets weakens resolution effectiveness and obscures true asset values (Prasad & Mathur, 2022). Collectively, this body of literature suggests that while bad banks and ARCs can contribute to NPA management, they are not standalone solutions. Their success depends critically on institutional design, valuation transparency, legal efficiency, and complementary reforms aimed at preventing the generation of fresh NPAs.

Despite the growing literature on bad banks and asset reconstruction, empirical evidence on NARCL's effectiveness as a government-backed bad bank remains limited, particularly with respect to asset transfers, resolution outcomes, and systemic impact. Most existing studies focus either on conceptual critiques or international experiences, leaving a gap in India-specific evidence on whether NARCL represents a structural improvement over prior mechanisms. Addressing this gap, the present study examines the effectiveness of bad bank resolutions in India from the perspective of NARCL, analysing its institutional framework, asset transfer experience, and early resolution performance to assess its role in restoring banking sector stability.

Against this backdrop, the present study seeks to examine the effectiveness of bad bank resolutions in India with specific reference to the National Asset Reconstruction Company Limited (NARCL). The study aims to assess the limitations of traditional NPA recovery mechanisms, analyse the institutional design and operational framework of NARCL, examine the nature and scale of stressed assets transferred to NARCL, and evaluate its early role in facilitating balance sheet clean-up and asset resolution. In doing so, the paper contributes India-specific evidence to the broader literature on bad banks and stressed asset resolution in emerging economies.

2. Research Methodology

The present study adopts a descriptive and analytical research design to examine the effectiveness of bad bank resolutions in India with specific reference to the National Asset Reconstruction Company Limited (NARCL). Given the policy-oriented and institutional nature of the research problem, the study relies exclusively on secondary data drawn from authoritative sources, including publications of the Reserve Bank of India, press releases and policy documents issued by the Ministry of Finance, official disclosures related to NARCL, and peer-reviewed academic literature on non-performing assets, asset reconstruction companies, and bad bank frameworks. The scope of the study is confined to the Indian banking sector and focuses on large corporate stressed assets, particularly the 22 accounts transferred to NARCL, along with an examination of traditional NPA recovery mechanisms such as Lok Adalats, Debt Recovery Tribunals, and the SARFAESI Act during the pre-NARCL period. The analysis employs a Stressed Asset Resolution Framework as the analytical framework, which conceptualises the resolution process into sequential stages of asset identification and transfer, valuation and structuring, resolution strategy selection, and recovery or exit. Using this framework, the study undertakes a descriptive assessment of recovery performance across different channels and a case-based evaluation of assets transferred to NARCL, enabling a structured examination of institutional effectiveness without imposing restrictive econometric assumptions. This methodological approach is consistent with existing literature on bad banks and is appropriate given the aggregate and case-based nature of the available data.

3. Model

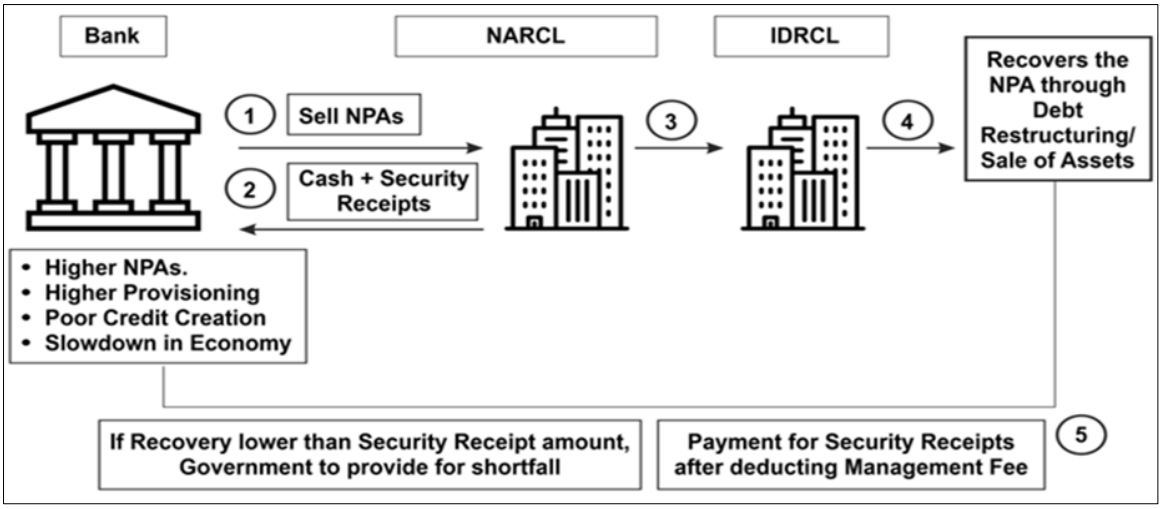

Fig 1: Stressed Asset Resolution Framework under NARCL

The above model illustrates the Stressed Asset Resolution Framework adopted in the present study to evaluate the effectiveness of the National Asset Reconstruction Company Limited (NARCL). The framework conceptualises the resolution of large non-performing assets into four sequential stages: (i) identification and transfer of stressed assets from banks to NARCL, (ii) valuation and structuring through cash payment and issuance of security receipts, (iii) selection of resolution strategy through restructuring, asset sale, or insolvency proceedings, and (iv) recovery and exit through realization of proceeds and balance sheet clean-up. The framework is applied to the 22 large stressed assets transferred to NARCL to assess resolution pathways, institutional coordination, and early effectiveness of the bad bank mechanism.

3.1. Nature of NPAs Transferred to NARCL

Table 2: Borrower-wise NPA Accounts Transferred to NARCL (with Amounts)

S. No.	Borrower / NPA Account	Sector	Reported Exposure / Amount (₹ crore)	Cash Paid by NARCL (≈15%)	Security Receipts (≈85%)
1	Videocon Oil Ventures Ltd	Oil & Gas	~14,000	~2,100	~11,900
2	Amtek Auto Ltd	Automobile / Manufacturing	~12,000	~1,800	~10,200
3	Reliance Naval & Engineering Ltd	Shipbuilding	~9,000	~1,350	~7,650
4	Jaypee Infratech Ltd	Infrastructure / Real Estate	~9,234	~1,385	~7,849
5	Jaiprakash Associates Ltd	Infrastructure / Cement	~12,700	~1,905	~10,795
6	Castex Technologies Ltd	Auto Components	~2,000	~300	~1,700
7	GTL Ltd	Telecom	~8,000	~1,200	~6,800
8	GTL Infrastructure Ltd	Telecom	~7,500	~1,125	~6,375
9	Visa Steel Ltd	Steel	~1,700	~255	~1,445
10	Wind World (India) Ltd	Renewable Energy	~13,000	~1,950	~11,050
11	Lavasa Corporation Ltd	Infrastructure	~6,000	~900	~5,100
12	Consolidated Construction Consortium Ltd (CCCL)	Construction	~9,000	~1,350	~7,650
13	Ruchi Soya / Ruchi Group	FMCG / Edible Oil	~4,000	~600	~3,400
14	Rainbow Papers Ltd	Paper	~2,500	~375	~2,125
15	McLeod Russel India Ltd	Tea Plantation	~1,105	~166	~939
16	Future Retail Ltd	Retail	~15,000	~2,250	~12,750
17	Future Enterprises Ltd	Retail / Infrastructure	~10,000	~1,500	~8,500
18	Mittal Corp Ltd	Mining / Steel	~3,000	~450	~2,550
19	Meenakshi Energy Ltd	Power	~6,500	~975	~5,525
20	Simhapuri Energy Ltd	Power	~4,500	~675	~3,825
21	Kwality Ltd	Dairy / FMCG	~1,900	~285	~1,615
22	Gayatri Projects Ltd	Infrastructure	~5,000	~750	~4,250

The above table shows the details of 22 large non-performing asset (NPA) accounts that were transferred to the National Asset Reconstruction Company Limited, covering sectors such as infrastructure, power, telecom, oil and gas, steel, manufacturing, retail, and FMCG. These accounts involve well-known stressed companies like Videocon Oil Ventures, Jaypee Infratech, Future Retail, Amtek Auto, and Wind World (India), with reported loan exposure ranging from

about ₹1,100 crore to ₹15,000 crore. For each account, NARCL paid banks roughly 15% of the asset value in cash, providing immediate liquidity and balance-sheet relief, while the remaining 85% was issued as Security Receipts (SRs), which are expected to be redeemed over time as recoveries are made. This payment structure shows that NARCL is designed to take over large, long-pending, and difficult-to-resolve NPAs, mainly from capital-intensive sectors that previously failed under traditional recovery mechanisms. The dominance of infrastructure, power, and industrial accounts highlights that NARCL is targeting systemic and legacy stress in the banking system rather than small or routine defaults, supporting its role as a centralised bad bank for long-term resolution (Barodawala, 2023; Ministry of Finance, 2024; Reserve Bank of India, 2023) [2],3.

3.2. Recovery Status and Early Effectiveness of NARCL

Table 3: Recovery Status of NPAs Transferred to NARCL

Particulars	Status
Total accounts transferred	22
Accounts fully resolved	0
Accounts under resolution	22
Aggregate recovery reported	₹1,421 crore
Mode of recovery	SR redemption

The above table shows that all 22 accounts remain under active resolution, with aggregate recovery of ₹1,421 crore reported through SR redemption. At first glance, the recovery rate of approximately 10-11% appears modest when compared to earlier mechanisms such as the Insolvency and Bankruptcy Code (IBC). However, this must be interpreted in the context of NARCL's back-loaded recovery model. Unlike traditional mechanisms where NPAs remain on bank balance sheets until recovery occurs, NARCL enables immediate removal of stressed assets, while recoveries materialise gradually. Given the complexity and litigation history of these accounts, the absence of full resolution at this stage reflects the early phase of operations rather than ineffectiveness.

3.3. Comparative Effectiveness: Why NARCL Is Structurally Superior

Table 4: Comparison of Traditional NPA Recovery Mechanisms and NARCL

Basis of Comparison	Old Recovery Mechanisms (Before NARCL)	NARCL (Bad Bank Mechanism)	How NARCL is Better
Nature of mechanism	Fragmented and bank-driven	Centralised and institution-driven	Single specialised entity handles stressed assets
Major mechanisms used	SARFAESI, Lok Adalats, DRTs, IBC, ARCs	NARCL + IDRCL (resolution arm)	Combines acquisition and resolution under one framework
Ownership of NPAs	NPAs remained on banks' balance sheets	NPAs transferred out of banks	Immediate balance-sheet clean-up
Focus of banks	Recovery + regular banking together	Banks focus on core lending	Reduces managerial burden on banks
Handling of large NPAs	Each bank handled its own exposure	Large NPAs aggregated centrally	Better bargaining power and resolution
Consortium loan problem	Coordination issues among banks	Single owner after transfer	Eliminates inter-bank coordination delays
Speed of resolution	Slow and time-consuming	Faster decision-making expected	Fewer approval layers
Capital requirement for banks	High provisioning pressure	Lower immediate capital strain	15% cash + 85% SRs ease stress
Pricing of stressed assets	Often uncertain and inconsistent	Standardised pricing framework	Reduces valuation disputes
Risk borne by banks	Entire recovery risk on banks	Risk partly transferred to NARCL	Risk sharing through SRs
Government support	Limited or indirect	Explicit GoI guarantee on SRs	Improves confidence and participation
Recovery approach	Legal enforcement focused	Market-based + legal resolution	More flexible recovery strategies
Transparency	Bank-wise, inconsistent reporting	Central monitoring	Better oversight and accountability
Impact on credit growth	NPAs constrained fresh lending	Cleaner balance sheets	Improves lending capacity
Overall effectiveness	Moderate and uneven	Still evolving but structurally stronger	Addresses systemic NPA problem

The table demonstrates that NARCL addresses several structural weaknesses of India's earlier NPA resolution framework. Traditional mechanisms were fragmented, bank-driven, and legally constrained, leading to coordination failures in consortium lending and prolonged resolution timelines. In contrast, NARCL introduces centralised ownership, unified decision-making, and professional resolution management, significantly improving institutional efficiency.

While traditional mechanisms focused largely on legal enforcement, NARCL adopts a resolution-oriented approach combining restructuring, monetisation, and insolvency

proceedings. The immediate transfer of NPAs from bank balance sheets also alleviates capital and managerial constraints, thereby enhancing banks' capacity to support fresh credit growth.

4. Discussion: Advantages of NARCL as a Bad Bank Mechanism

The findings of this study indicate that the National Asset Reconstruction Company Limited offers several structural and institutional advantages over India's traditional NPA recovery mechanisms. The most significant advantage of NARCL lies in its centralised and institution-driven design, which directly addresses the fragmentation and coordination failures that historically constrained NPA resolution in India. By aggregating large stressed assets under a single specialised entity, NARCL eliminates inter-bank conflicts common in consortium lending and enables unified decision-making, thereby improving the efficiency of the resolution process (Barodawala, 2023; Vijayakumar & Venkatesh, 2021) [2,3,31].

Another key advantage of NARCL is its ability to facilitate immediate balance-sheet clean-up for banks. Unlike earlier mechanisms where NPAs remained on bank balance sheets until recovery or liquidation, the transfer of assets to NARCL allows banks to remove legacy NPAs upfront. This reduces provisioning pressure, improves asset quality indicators, and releases managerial and capital resources, enabling banks to refocus on core lending activities. From a systemic perspective, such balance-sheet relief is essential for reviving credit growth and strengthening financial intermediation (Reserve Bank of India [RBI], 2023; Gaur & Mohapatra, 2021) [12].

The risk-sharing acquisition structure adopted by NARCL further enhances its effectiveness. The combination of upfront cash payment and deferred consideration through security receipts allows banks to retain economic interest in recoveries while transferring operational responsibility to the bad bank. This structure avoids distress-driven asset pricing and supports long-term value maximisation, while the explicit government guarantee on security receipts improves confidence among participating banks (Ministry of Finance, 2021; Prasad, 2023). Such risk-sharing arrangements are consistent with international best practices in bad bank design (Garrido, 2016) [11].

NARCL also benefits from a more flexible and market-oriented recovery approach compared to enforcement-focused traditional mechanisms. Through its resolution arm, NARCL can pursue multiple strategies such as restructuring, asset monetisation, negotiated settlements, and insolvency proceedings, depending on asset-specific and sectoral conditions. This flexibility is particularly important for resolving large infrastructure and industrial NPAs, which historically faced prolonged delays under SARFAESI, DRTs, and even the Insolvency and Bankruptcy Code (Chandrasekhar, 2021; Brei *et al*., 2023) [8,10].

Overall, the discussion suggests that while recovery outcomes under NARCL are still evolving, its advantages lie primarily in institutional design rather than short-term recovery metrics. Consistent with international evidence on bad banks, NARCL's effectiveness should be assessed in terms of balance-sheet stabilisation, coordination efficiency, and long-term resolution capacity (Brei *et al*., 2023; Honohan, 2019) [8,14]. In this sense, NARCL represents a structural improvement in India's stressed asset resolution architecture and offers a viable framework for addressing systemic NPAs in emerging economies.

5.1. Recommendations

Based on the analysis of the National Asset Reconstruction Company Limited and its early performance, several recommendations emerge to enhance the effectiveness of the bad bank mechanism in India.

First, greater transparency in asset valuation and resolution progress should be ensured through periodic public disclosures on resolution status, recovery pathways, and timelines. This would strengthen market confidence, improve accountability, and reduce concerns related to asset warehousing.

Second, NARCL should be provided with greater operational flexibility and autonomy, particularly in choosing resolution strategies across sectors. Complex infrastructure and power sector assets require customised, long-term restructuring approaches rather than uniform legal enforcement. Strengthening the professional capacity of the resolution arm and encouraging sector-specific expertise would improve recovery outcomes.

Third, there is a need to streamline legal and judicial processes associated with large NPA resolution. While NARCL reduces coordination problems, delays arising from litigation under the Insolvency and Bankruptcy Code and other laws continue to affect resolution timelines. Fast-track mechanisms or specialised benches for NARCL-related cases could significantly enhance resolution speed.

Finally, the bad bank framework should be complemented with preventive banking reforms, including improved credit appraisal, stronger governance in public sector banks, and early warning systems to curb the future accumulation of NPAs. Without such measures, the effectiveness of NARCL may remain limited to legacy stress rather than long-term systemic improvement.

5.2. Conclusion

This study examined the effectiveness of bad bank resolutions in India with specific reference to the National Asset Reconstruction Company Limited. The findings indicate that NARCL has played a meaningful role in absorbing legacy and systemically important NPAs, facilitating balance-sheet clean-up, and addressing coordination failures inherent in traditional recovery mechanisms. Although recovery outcomes are still evolving, NARCL's effectiveness lies primarily in its institutional design and long-term resolution capacity rather than immediate recovery ratios. Overall, the evidence suggests that NARCL represents a structural improvement in India's stressed asset resolution framework and has the potential to support banking sector stability and sustainable credit growth.

5.3. Policy Implications

The findings of this study carry important policy implications for banking sector reform in India and other emerging economies. The evidence suggests that bad banks can be effective institutional tools when traditional recovery mechanisms fail to resolve large, complex NPAs. Policymakers should therefore view NARCL not as a substitute for existing mechanisms but as a system-level complement designed to address coordination failures and legacy stress.

The explicit government support provided to NARCL through security receipt guarantees highlights the importance of state backing in restoring confidence during periods of financial stress. However, such support also necessitates careful monitoring to mitigate fiscal risks and moral hazards. Policymakers must strike a balance between enabling effective resolution and ensuring that banks and borrowers do not perceive bad banks as permanent exit routes for poor credit decisions.

The Indian experience further demonstrates that institutional design matters more than short-term recovery metrics. Centralised ownership, professional resolution management, and risk-sharing structures can significantly improve the resolution environment even when recoveries are back-loaded. These insights are particularly relevant for emerging economies facing rising NPAs and limited legal enforcement capacity.

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