What are Asset Reconstruction Companies (ARCs)?

An Asset Reconstruction Company is a specialized financial institution that buys the NPAs or bad assets from banks and financial institutions so that the latter can clean up their balance sheets. In other words, ARCs are in the business of buying bad loans from banks.

In the Union Budget 2021-22, Finance Minister Nirmala Sitharaman announced the setting up of Asset Reconstruction Companies in India to take care of Non-Performing Assets (NPAs) of stressed banks. ARCs in India shall be set up by state-owned and private sector banks, as proposed. Also, there will be no equity contribution from the government.

About Asset Reconstruction Companies

- At the time of the Asian Financial Crisis, India's non-performing assets stood at a whopping 14.4 per cent. It was in this context that the Narasimham Committee (1998) recommended setting up an ARC specifically for purchasing NPAs from banks and financial institutions
- Following this, the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest **(SARFAESI) Act, 2002 was enacted in December 2002 which provides the legal basis for the setting up ARCs in India**
- The asset reconstruction companies or ARCs are registered under the RBI
- It helps the bank clear up its balance sheets and concentrate in normal banking activities
- The ARCs take over a portion of the debts of the bank that qualify to be recognised as Non-Performing Assets. Thus ARCs are engaged in the business of asset reconstruction or securitisation or both
- The ARC can take over only secured debts which have been classified as a non-performing asset (NPA)
- A few of the existing ARCs in India, which are being regulated by the Reserve Bank of India include:
  - Asset Reconstruction Company (India) Limited (ARCIL)
  - ASREC (India) Limited
  - Reliance Asset Reconstruction Company Limited
  - India SME Asset Reconstruction Company Limited (ISARC)
  - International Asset Reconstruction Company Private Limited; and more

What is the SARFAESI Act?
The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, more commonly known by its shorter name SARFAESI Act, is legislation that allows banks and other financial organizations to recover bad loans effectively.
The act can be utilized to tackle the problem of Non-Performing Assets (NPAs) through different procedures.
Basically, the SARFAESI Act empowers financial institutions to 'seize and desist'. The Act also

provides for the establishment of Asset Reconstruction Companies (ARCs) to acquire assets from banks and other financial institutions.

Asset Reconstruction Companies in the Union Budget 2021-22 - Key Points

- Bad loans of Indian lenders have increased in several years. The gross bad loans in the banks could increase to 13.5% by September 2021 (in the worst-case scenario, 14.8% – highest in two decades)
- Thus, ARCs can control this increase by setting up an Asset Management Company (AMC) which would manage and sell bad assets
- The bad bank would be transferring the NPAs to an entity (Asset Management or Asset Reconstruction Company) and dispose of the assets to Alternate Investment Funds (AIF)
- They would basically take over the bad loans in Public Sector Banks and manage the recoveries
- As of 2020, stressed assets of Rs. 2-2.5 lakh crore remain unsolved in approximately 70 large accounts

Capital Needs for Asset Reconstruction Companies

As per the amendment made in the SARFAESI Act in 2016, an ARC should have a minimum net owned fund of Rs. 2 crores. This was later increased to Rs.100 crores. The ARCs also have to maintain a capital adequacy ratio of 15% of their risk-weighted assets

How do ARCs work?

The banks will transfer the stressed assets to ARC at the net book value. The bank will in return receive 15% cash and 85% security receipts against the amount of bad loan from the Asset Management Company.

What is the need for new ARCs in India?

Many of the existing Asset Reconstruction Companies do not have sufficient capital to help the banks clear the debt and over the loss faced by NPAs. Thus, setting up new ARCs with proper capitalisation can benefit both the banks and the economic condition of the country.

If ARCs are set and start functioning well, the stressed assets in the banking sector may reduce drastically. This structure will reduce a load of stressed assets on the bank balance sheet and look to resolve these bad debts in a market-led way.