The Moratorium Case And The Increasing Helplessness Of Banks

written by Karishma | December 28, 2020

Loan Moratorium for Borrowers: Relief to the Borrowers and Anguish for Banks

The Reserve Bank of India came to the rescue of the borrowers struggling with liquidity amidst the financial jolt in the aftermath of the novel Coronavirus outbreak and announced a Loan Moratorium for Borrowers on all standard loans outstanding with the Commercial Banks and NBFCs for three months starting from March 1, 2020 to May 31, 2020[1] which was later extended to August 31, 2020[2].

The imposition of Loan Moratorium for Borrowers implies that the borrowers will not have to pay the instalments on loan EMI during the period of the moratorium. Though the repayment schedules are deferred, interest on loans continues to accrue and as a result of this 'interest on interest' factor, there will be a multiplier effect on the cost of capital until it is repaid. Since it was not mandatory for the borrowers to avail of the moratorium, resultantly those who have availed of it will suffer a higher financial crunch when it is time to repay at increased capital cost.

Another attempt to ease out the financial hardships of borrowers was made by the interim order of the Supreme Court on September 3, 2020 directing that "*accounts which were not declared NPA till August 31, 2020 shall not be declared NPA till further orders.*" In the wake of these measures being taken to reduce the financial distress, on one hand, borrowers started moving the apex court with petitions demanding for additional relief to waive off the difference in the compound and simple interest charged during the moratorium period, and on the other hand, the banks were rendered helpless in dealing with defaulters and bad debts.

Fundamentally, two major facts that determine the lending capacity and health of any lending institution are its liquidity and income. If the moratorium along with the interim order of the Apex Court with respect to NPAs results in high bad loans and low income, the health of lending institutions is definitely going to be adversely affected. Now, the question arises: is extending Loan Moratorium for Borrowers and waiving interest the right solution?

Does the Loan Moratorium for Borrowers come at a cost to the government?

The government in its affidavit submitted before the Apex Court had put the proposal to waive "interest on interest" on loans less than INR 2 crore for only the vulnerable category of borrowers limited only to the sectors of

education, consumer durables, housing, credit card, auto, consumption, personal loans, and MSMEs.

Assuming not more than 30-40% of banks and NBFCs will be eligible for the relief, the government should not exceed Rs 5,000-7,000 crore, as quoted by Mr. Anil Gupta, head, financial ratings at ICRA during one of his interviews. However, the government mentioned in its affidavit that if it were to consider the waiver scheme's applicability to all loans and advances corresponding to the moratorium period then the estimated cost to be borne by the government would reach an amount of INR 6 lakh crore.

Are these borrowers really affected by the disaster?

Amongst the petitioners who have filed pleas before the Apex Court for waiver of interest, are the stakeholders from the real estate sector claiming that their business has seen a downfall since the work came at a standstill at every project site due to lockdown and paucity of labours. But, during lockdown every industry was affected adversely. The real estate sector was already ailing and were experiencing dead market which was further worsened by the impact of the pandemic.

Hence, these sectors cannot be considered as the sectors which were directly affected by the pandemic; therefore they cannot claim relief under the disaster management. "Disaster-affected" is interpreted in law as directly affected by disaster and not subsequently affected or a situation where someone's conditions were worsened by the disaster.

It will be highly unjustified if the government looks uniformly at all the borrowers while applying the Loan Moratorium for Borrowers as there are few sectors like digital media and home delivery services that have without a doubt seen a boost in their business.

The government is burdened with the responsibility of providing relief to the borrowers and at the same time maintain the banks' balance sheet by not letting the banks to bear the cost of interest waiver scheme. However, the government's finances aren't in great shape either. With people paying no taxes because of reduced liquidity and zero income and with GST coming down due to closure of shops, is the provision of broader interest waiver within the scope of the government without crippling the economy?

Burden on banks

Banks pay interest on deposits to survive in business and they need interest income on their lendings. Thus, while giving relief to the borrowers affected by the pandemic, if banks are asked to waive off the interest, it is ultimately the depositor's money which they are lending and losing to borrowers. With across-the-board stay on the classification of non-performing asset (NPA) till further orders put forth by the Apex Court, the banks are suffering huge implications by being barred from adopting resolution frameworks tailored to meet the specific requirements of sector subject.

The classification of a loan account as NPA, based on the record of recovery, actually enables the lenders to follow the regulatory guidelines with regard to income recognition and provisioning and while dealing with the diverse nature of borrowers in various sectors, need of the hour is a sector-specific relief instead of a monolithic resolution framework.

The road ahead

With recent estimates of a rise in banks' gross NPA ratio and the increasing helplessness of banks to meet regulatory norms on capital, a one-time restructuring of loans to provide relief to retail, MSME and corporate

borrowers will help soften the Covid-19’s impact on borrowers. Banks are an intermediary between depositors and borrowers and providing cushion only to the borrowers would disrupt the intermediating function of the bank deterring the depositors from investing their credits into banks which would ultimately show its havoc in the next cycle of credit growth.

If banks are restricted from recognising bad assets and dragging commercial defaulters to bankruptcy courts, it would lead banks into an “extend and pretend” mode ending up the market into the cycle of mistakes of the previous years. In the absence of a dedicated resolution and restructuring mechanism for banks, we will be left with a handful of banks coming to the rescue of all other banks in trouble.

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[1] https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11835&Mode=0

[2]https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NT2455D86E6F80D9D4BC29C0DFAA43D76D9A4.PDF

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