

SC refrains from interfering in economic Policy decisions

The Supreme Court's (SC) judgement in 'interest on interest' waiver case is encouraging, especially in spirit as it limits scope for judicial review of economic policy decisions. Given that no rationale was submitted for restricting the relief of 'interest on interest' waiver to loans up to Rs20mn, the SC has ruled that it should be extended to all loans. Our reading suggests the verdict is applicable only to loans under moratorium as it states that any amount "already recovered" shall be refunded to the "concerned borrowers", or be credited/adjusted in the next instalment. However, we await clarity on whether the cost will be borne solely by financiers, or shared by the government. Waiving 'interest on interest' on loans >Rs20mn under moratorium will lead to a fresh burden of <4 bps for the industry.

Our view

- ▶ The SC verdict settles the uncertainty long lingering on the plea to waive the interest. Though delayed, the judgement is welcome in spirit as it limits scope for judicial review of economic Policy decisions, and probably sets a reference for such cases in the future.
- ▶ The words "amount already recovered" and refund to the "concerned borrowers" suggest that the relief will not be applicable to all loan accounts. Earlier the waiver was applicable to all loan accounts (whether under moratorium or not) up to Rs20mn. Rather, it seems applicable only to the portions of moratorium portfolio where 'interest on interest' has been charged.
- ▶ The interim relief of not declaring the accounts as NPAs, now stands vacated. In Q4FY21 banks would be disclosing actual NPAs and not proforma. Also, post tagging as NPA, banks can continue with recovery proceedings that were hitherto hampered due to non-tagging.

Impact: Incremental burden of <4bps of advances for the industry

- ▶ We have tried to quantify the impact of waiver of 'interest on interest' at an industry level using a few key publicly disclosed variables, viz. moratorium proportion, lending yield and proportion of >Rs2mn loans— for the purpose of our analysis.
- ▶ ***In our opinion, waiving 'interest on interest' on loans above Rs20mn under moratorium will lead to a fresh burden of Rs50bn for the industry; this would include ~Rs12bn for private banks/SFBs, ~Rs28bn for PSU banks, and Rs9bn for NBFCs/HFCs.*** The above means a drag of less than 4bps on RoAs. With respect to the lender-groups, this translates to RoAs (advances) of 3/4/5/4 bps for private banks, SFBs, PSUs and NBFCs/HFCs respectively. (refer table 1)
- ▶ For our assessment, we have used moratorium quantum based on RBI's Financial Stability Report that is much on the higher side compared to reported numbers for many of the leading private banks. ***Had we applied the same based on reported moratorium numbers for private banks, the burden would be significantly lower at less than Rs20bn (less than 2bps of advances).***
- ▶ Also, it is ***difficult to gauge bank-specific impact as granular details on moratorium between across credit segments and ticket-size for individual player is not available in public domain.***

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Judgement positive in spirit: Policy matters do not ordinarily attract the power of judicial review

- ▶ It is up to the government and regulator (in consultation with experts) to decide what is in the best interest of the economy, including the manner and extent to which relief packages are formulated, offered and implemented. ***Such matters do not ordinarily attract the power of judicial review.***
- ▶ ***Economic and fiscal regulatory measures are a field where judges should encroach upon very warily as they are not experts in these matters.***
- ▶ ***In assessing the propriety of government decision, the Court cannot interfere even if a second view by the government would be in order.***
- ▶ No direction can be given to the government and RBI to announce an additional relief of waiver of interest on moratorium. The judgement also rejects the plea for sector-wise relief to borrowers.
- ▶ To grant such a relief would have far-reaching implications on the economy as well as the lenders/banks. Therefore, when a conscious decision has been taken not to waive the interest during the moratorium period and to give relief to borrowers by inter alia deferring the payment of instalments (considering the Kamath Committee report), interference of the Court is not called for.

A point of contention: 'Interest on interest'

- ▶ Once the payment of instalment is deferred as per circular dated 27.03.2020, its non-payment during moratorium period cannot be said to be wilful, hence there is no justification to charge 'interest on interest'/compound interest/penal interest for the period.
- ▶ There shall not be any charge of 'interest on interest' / compound interest / penal interest for the moratorium period; further, ***any amount already recovered*** under the same head, shall be ***refunded to the "concerned borrowers"***, or credited/adjusted with the next instalment.

Petitioners shall not be entitled to any of the following reliefs:

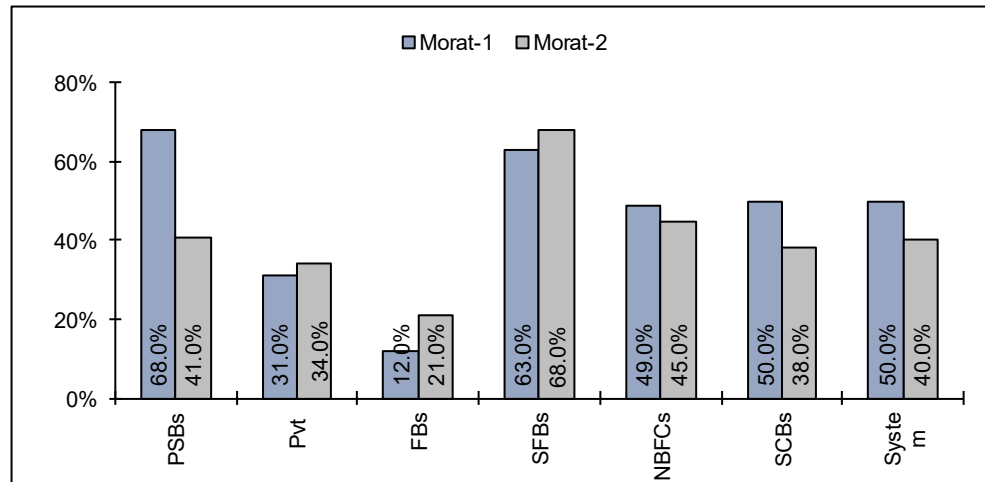
- Total waiver of interest during the moratorium period
- Extension of the period of moratorium
- Extension of the period for invocation of the resolution mechanism
- Sector-wise relief from the RBI
- Further reliefs (in addition to the packages already offered)

Table 1: Impact analysis of 'interest on interest' waiver for loans >Rs2mn (based on morat pool reported in RBI's FSR)

Corporate	PSBs	PVBs	FBs	SFBs	NBFCs	SCBs	System
Average Advances (Rs bn)	15,409	8,126	1,386	67	5,870	24,987	30,857
% of loans above Rs 20mn	89%	89%	89%	89%	89%	89%	89%
Portfolio in Morat 1.0 (%)	58%	20%	8%	44%	56%	39%	42%
Loans under Morat 1.0 (Rs bn)	7,954	1,417	95	26	2,936	8,695	11,507
Portfolio in Morat 2.0 (%)	37%	23%	15%	34%	37%	30%	34%
Loans under Morat 2.0 (Rs bn)	5,033	1,677	183	20	1,941	6,769	9,414
Total Interest on interest reversal (Rs bn)	13	4	0	0	5	16	22
Total Interest on interest reversal (% of Advances)	0.08%	0.04%	0.03%	0.07%	0.08%	0.07%	0.07%
MSME							
Average Advances (Rs bn)	9,546	5,911	662	194	2,497	16,313	18,810
% of loans above Rs 20mn	55%	55%	55%	55%	55%	55%	55%
Portfolio in Morat 1.0 (%)	82%	43%	50%	52%	61%	65%	65%
Loans under Morat 1.0 (Rs bn)	4,279	1,382	184	56	839	5,859	6,725
Portfolio in Morat 2.0 (%)	75%	63%	47%	67%	67%	68%	69%
Loans under Morat 2.0 (Rs bn)	3,960	2,048	173	71	920	6,107	7,169
Total Interest on interest reversal (Rs bn)	10	5	0	0	2	15	17
Total Interest on interest reversal (% of Advances)	0.10%	0.08%	0.06%	0.08%	0.09%	0.09%	0.09%
Retail							
Average Advances (Rs bn)	14,557	10,373	523	43	5,503	25,495	30,998
% of loans above Rs 20mn	5%	5%	5%	5%	5%	5%	5%
Portfolio in Morat 1.0 (%)	80%	34%	21%	73%	46%	56%	55%
Loans under Morat 1.0 (Rs bn)	582	174	6	2	126	716	857
Portfolio in Morat 2.0 (%)	35%	34%	28%	69%	57%	34%	41%
Loans under Morat 2.0 (Rs bn)	251	174	7	1	155	432	635
Total Interest on interest reversal (Rs bn)	1	0	0	0	0	1	2
Total Interest on interest reversal (% of Advances)	0.01%	0.00%	0.00%	0.01%	0.01%	0.00%	0.01%
Others							
Average Advances (Rs bn)	20,778	12,171	1,379	666	9,732	34,994	44,726
% of loans above Rs 20mn	20%	20%	20%	20%	20%	20%	20%
Portfolio in Morat 1.0 (%)	64%	41%	5%	12%	41%	56%	55%
Loans under Morat 1.0 (Rs bn)	2,647	996	13	16	806	3,898	4,884
Portfolio in Morat 2.0 (%)	39%	54%	9%	81%	33%	39%	42%
Loans under Morat 2.0 (Rs bn)	1,624	1,314	26	108	646	2,737	3,768
Total Interest on interest reversal (Rs bn)	5	3	0	0	2	7	10
Total Interest on interest reversal (% of Advances)	0.02%	0.02%	0.00%	0.03%	0.02%	0.02%	0.02%
Total							
Average Advances (Rs bn)	60,289	36,581	3,950	970	23,602	1,01,790	1,25,392
% of loans above Rs 20mn	40%	37%	48%	31%	37%	39%	39%
Portfolio in Morat 1.0 (%)	68%	31%	12%	63%	49%	50%	50%
Loans under Morat 1.0 (Rs bn)	15,462	3,969	297	100	4,707	19,169	23,973
Portfolio in Morat 2.0 (%)	41%	34%	21%	68%	45%	38%	40%
Loans under Morat 2.0 (Rs bn)	10,868	5,214	388	201	3,663	16,046	20,986
Total Interest on interest reversal (Rs bn)	28	12	1	0	9	40	51
Total Interest on interest reversal (% of Advances)	0.05%	0.03%	0.02%	0.04%	0.04%	0.04%	0.04%

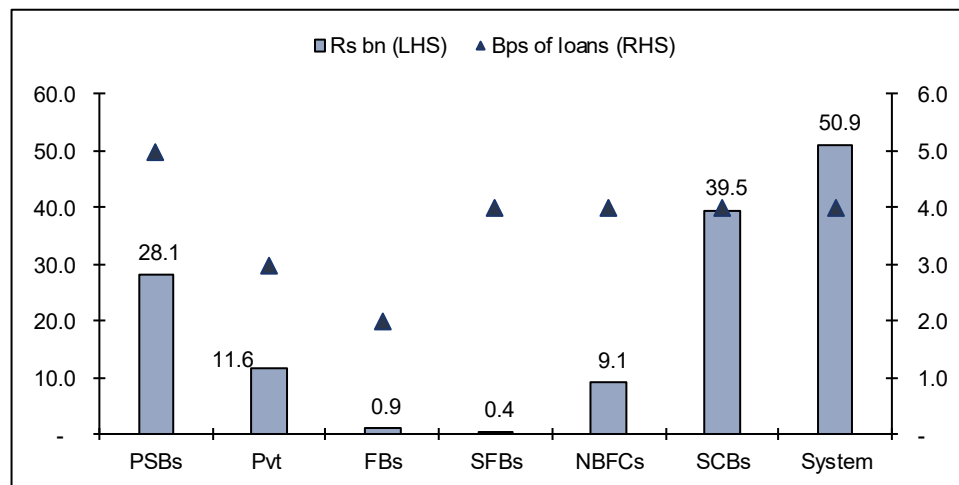
Source: RBI, I-Sec research

Chart 1: Moratorium pool across segments as per RBI's FSR



Source: RBI

Chart 2: Incremental burden of 'interest on interest' waiver across lender groups



Source: I-Sec research

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