Update on Supreme Court Judgment: Waiver of compound interest. NPA to increase as standstill lifted

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Introduction

RBI had announced a three-month moratorium which was extended by another three months i.e., till August 31, 2020 to provide borrowers relief during the COVID-19 pandemic. Further, in October 2020, the central government announced waiver of compound interest charged during the moratorium period on certain categories of loans of up to Rs 2 crore which was estimated to have cost the exchequer around Rs. 6,000 crores.

On September 03, 2020, the Supreme Court had ordered a standstill on NPA recognition due to a flurry of plea filed before it regarding issues such as extension of the loan moratorium, and interest charged.

In its judgement on March 23, 2021, the Supreme Court refused to either extend the moratorium or order a complete interest waiver. Further, it also declined to provide relief to specific sectors, however, it ruled that no "interest on interest" (compound interest) would be charged on borrowers during the moratorium period irrespective of the loan amount. The SC also lifted the temporary freeze on letting banks classify accounts as non-performing assets (NPAs) after the moratorium has ended.

GNPA to be recognised

As per the third quarter results reported by Indian banks, the GNPA ratio stood at 7.0%.

Around 22 SCBs have disclosed pro forma GNPAs during the quarter ended December 2020. If these SCBs had classified accounts as NPAs after August 31, 2020, the pro forma (total) GNPA (of 22 SCBs) would have been over Rs.8.0 lakh crore in December 2020. This indicates that around Rs.1.2 lakh crore (approximately **1.2% of advances** of these 22 SCBs) of **bad loans** exist in these 22 SCBs which are **yet to be recognised** by the banks. Of Rs.8.0 lakh crore pro forma GNPAs in these 22 SCBs, public banks alone (8 PSBs) have reported majority of the pro forma NPAs at over Rs.6.0 lakh crore, whereas the balance 14 PVBs reported pro forma GNPAs at over Rs.2 lakh crore. Amongst these 22 SCBs, SBI alone reported highest pro forma GNPA at over Rs.16,000 crore, followed by Punjab National Banks, Union Bank of India, and Canara Bank. On the other hand, Yes Bank, ICICI Bank, Axis Bank and HDFC Bank accounted for the highest pro forma GNPAs amongst PVBs.

Moratorium

By disallowing compound interest, the Supreme Court has proposed a middle path i.e., refraining from providing a complete interest waiver (which would have required significant capital) or permitting banks to maintain its path of interest charges.

The figure below tracks the movement in moratorium levels across categories. MSMEs and Corporates which would be affected by the Supreme Court judgement have shown a declining trend, however MSMEs levels have been significantly higher than the Corporate levels.

Loan Moratorium Availed as on April 30, 2020

Bank	Corporate		MSME		Individual		Others		Total	
	% of customer	% of total o/s	% of customer	% of total o/s	% of customer	% of total o/s	% of customer	% of total o/s	% of customer	% of total o/s
PSBs	28.8%	58.0%	73.9%	81.5%	80.3%	80.0%	48.8%	63.7%	66.6%	67.9%
PVBs	21.6%	19.6%	20.9%	42.5%	41.8%	33.6%	39.1%	40.9%	49.2%	31.1%
SCBs	24.7%	39.1%	43.1%	65.3%	52.1%	56.2%	45.7%	55.7%	55.1%	50.0%
NBFCs	39.7%	56.2%	60.7%	61.1%	32.5%	45.9%	37.3%	41.4%	29.0%	49.0%

Loan Moratorium Availed as on August 31, 2020

Bank	Corporate		MSME		Individual		Others		Total	
	% of customer	% of total o/s	% of customer	% of total o/s	% of customer	% of total o/s	% of customer	% of total o/s	% of customer	% of total o/s
PSBs	25.0%	36.7%	64.1%	75.4%	36.3%	34.5%	30.6%	39.1%	34.8%	41.3%
PVBs	16.4%	23.2%	83.4%	63.0%	50.3%	33.6%	47.9%	54.0%	54.9%	34.0%
SCBs	18.0%	30.4%	77.2%	68.1%	43.7%	33.9%	35.6%	39.1%	43.8%	37.9%
NBFCs	42.7%	37.2%	68.8%	67.0%	23.1%	56.5%	50.2%	33.2%	26.6%	44.9%

CARE View

The judgement looks attuned as charging compound interest would have diluted the relief provided by RBI. If we look to analyse the quantum of the compound interest that would be involved, personal and other loans up to Rs. 2 crores would be excluded as relief has already been provided for the same. Further, the WALR for these periods would have to be considered so that all the various interest rates charged on the advances by bank would be covered appropriately.

By extending the earlier interest relief package to all small borrowers up to Rs 2 crores, irrespective of the fact that they were under moratorium or not, expectations have been created that a similar approach would be followed for these classes of borrowers.

Considering these parameters, banks would face an impact of approximately Rs 6,500 – 7,000 crores (approximately 7-8 bps of the total advances of the banking system). Further, if the government refunds this amount to the banks, there would be no impact on the banks. However, the affected borrowers would receive significant relief.

An alternate view point

A major point to be considered here is that the benefit would be provided to only those who have been charged "interest on interest" and not the entire universe of advances. Consequently, for the impact analysis, we could exclude those borrowers who have not under been moratorium along with those borrowers who have been under moratorium but have been making interest payments as banks would not have charged interest on interest for such companies which have no unpaid interest dues. While RBI has published the quantum of overall moratorium, the collection efficiency been assumed at higher rates based on discussion with market sources.

Considering these parameters, overall banking system would face an impact of in the range of Rs. 2,000 – 2,500 crores, (approximately 2-3 bps of the total advances of the banking system).

In recent times, the bank credit growth has returned to the levels observed in the early months of the pandemic growing by around 6.6% in February 2021 (the bank credit growth ranged between 6.5% and 7.2% during April 2020) which can be ascribed to an increase in retail loans further led by falling weighted average lending rates (8.2% in January 2021 vs. 9.5% in January 2020). By end-March 2021, the bank credit growth is expected to increase owing to traditional year ending growth observed since last three to four years led by year-end transactions. However, slower to declining growth (as per the latest data available by RBI for the month of January 2021) in large industries, housing sector and NBFCs which account for around 27.0%, 14.0% and 7.0%, respectively, of the gross bank credit would restrict the further increase in bank credit growth in Q4FY21.

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