

SC directs lenders to refund penal interest on EMIs

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To ease the pain of borrowers during the COVID-19 crisis last year, the Reserve Bank of India (RBI) allowed banks and all other types of lenders to extend a moratorium on term loans. While the moratorium was only a deferral of EMIs and not a waiver, there were demands that banks should also waive off the interest amount during those six months. Banks, however, refused a total waiver saying the cost will be huge. There were also petitions seeking extension of the moratorium period beyond six months.

In news: Loan moratorium case: Refund penal interest on EMIs, Supreme Court tells lenders

Placing it in syllabus: Economy

Dimensions

- Highlights of the Ruling
- Importance of the Ruling

Content:

Highlights of the Ruling :

Waiver of compound interest and Penal Interest on EMI:

- The Supreme Court (SC) has directed **waiver of compound interest for all loans during the moratorium period**. Banks and financial institutions will have to **refund compound interest, interest on interest or penal interest collected on EMI** for loans during the period of moratorium from March 1 to August 31 in the year 2020.

Govt's restriction on interest waiver irrational:

- The court **questioned Centre's rationale to restrict compound interest relief only to loans upto Rs. 2 crores.**
- The judgment concluded that the **government's scheme to restrict the waiver of interest on interest to loans worth only up to ₹2 crore was irrational.** This scheme, introduced in October, was limited to debts in MSME, education, housing, consumer durables, credit card, auto, personal and consumption categories within the ₹2 crore limit.

Rejected extension of loan moratorium and RBI's Resolution Framework deadlines:

- The SC **rejected the requests to extend the loan moratorium** period beyond August 2020. It ruled that extension can't be granted to protect the interests of bank depositors and financial health of lending institutions.
- The court further **declined pleas to extend the deadline, from December 31, 2020, for the invocation of the Reserve Bank of India's resolution mechanism for "big borrowers"** like business and manufacturing sectors. The mechanism titled 'Resolution Framework for COVID-19-related Stress', issued in an August 6 circular, had informed that lending institutions, guided by their respective Board-approved policy, would prepare viable resolution plans for eligible borrowers under stress on account of COVID-19.

Covid-19 Reliefs do not Violate Article 14:

- The court **refused to entertain complaints from petitioners that the government did not do enough to ease the financial strain** during the pandemic.
- "Merely, since the reliefs announced by the Union of India/RBI may not suit the desires of the borrowers, the reliefs/policy decisions related to COVID-19 cannot be

said to be arbitrary or violative of Article 14 of the Constitution,” the court said.

Refused total interest waiver:

- The apex court further refused the insistent pleas of the borrowers for a total waiver of interest for EMIs falling within the moratorium period.
- The court said a total waiver of interest on loan EMIs would hit the banks and depositors hard.

Allowed RBI and banks to declare bad loan accounts as NPAs:

- It also **allowed RBI and banks to declare bad loan accounts as NPAs**.
- The apex court lifted the nearly six-month ban on them from declaring accounts of borrowers as non-performing assets (NPAs). In October last year, the apex court had stopped banks and lenders from declaring accounts of borrowers as NPAs.

Verdict on other issues:

- The court held that it won't pass any further orders to Centre and RBI, as **there is limited scope of judicial review on economic policy decisions** which are best left to the Union Government and the RBI to decide based on expert opinion.
- The court **refused to ask Centre to announce economic reliefs** after losing on revenue collection due to the lockdown, saying that **it is not an advisor to the Government on financial policy**.
- The court **dismissed arguments made by various industries which sought financial relief by the Centre under the Disaster Management Act**, observing that while the Union Government had already taken action under the Act, the functions of all ministries can't be done by the National Disaster Management Authority (NDMA) during a pandemic.

- The order **noted that judges can't be expected to have economic expertise, and shouldn't decide on economic policy** even if the petitioners contend that a better policy could be implemented.

Importance of the Ruling

The judgment was welcomed by banking sector experts who said it has offered much-needed clarity to the financial industry on interest waiver and bad loan classification.

Rejection of complete interest waiver has given breathing space for Government and Banks:

- According to government estimates, the burden of a complete interest waiver on the banking system could have been around Rs six lakh crore.
- Waiving off the total interest amount would hurt the banking system as banks need to pay interest to depositors.
- This would have been a shocker for a fiscally constrained government or a capital-starved banking system to absorb.
- Luckily, SC rejected the demand for a total waiver.

Relief for borrowers

- the compound interest waiver has provided relief to all borrowers especially big borrowers (Rs 2 Crore and Above) who were earlier excluded from the loan moratorium scheme
- Once the payment of instalment is deferred as per March 27, 2020 circular, non-payment of the instalment during the moratorium period cannot be said to be wilful

Eases Asset Classification

- SC had, on September 3, put a stop on the classifying loans as NPA to help COVID-hit borrowers. It has asked banks not to tag accounts that were standard as on

August 31, as NPAs.

- This created difficulties for industry in terms of asset classification.
- The RBI had said that a failure to lift the interim stay could undermine the central bank's regulatory mandate.
- Around the same time, the Indian banks association (IBA), too, raised a similar demand saying the stay has made banks helpless to do proper monitoring of the asset quality.
- Later, in December 2020, the finance ministry also said it was finding it difficult to make a proper assessment of the recapitalisation needs of the PSU banks due to the SC stay.
- Lifting of interim stay on banks' asset classification will ease the asset classification.

Return to Normalcy:

- The lenders can now recognise their NPAs and start taking appropriate corrective action for recoveries.
- This will allow regular functioning of the banking system and ensure the economy continues its course to normalcy.

Mould your thought: Recent ruling of the Supreme Court on loan moratorium has offered much-needed clarity to the financial industry on interest waiver and bad loan classification. Evaluate

Approach to the answer:

- Introduction
- Discuss the order of the SC
- Discuss the importance of the order
- Conclusion