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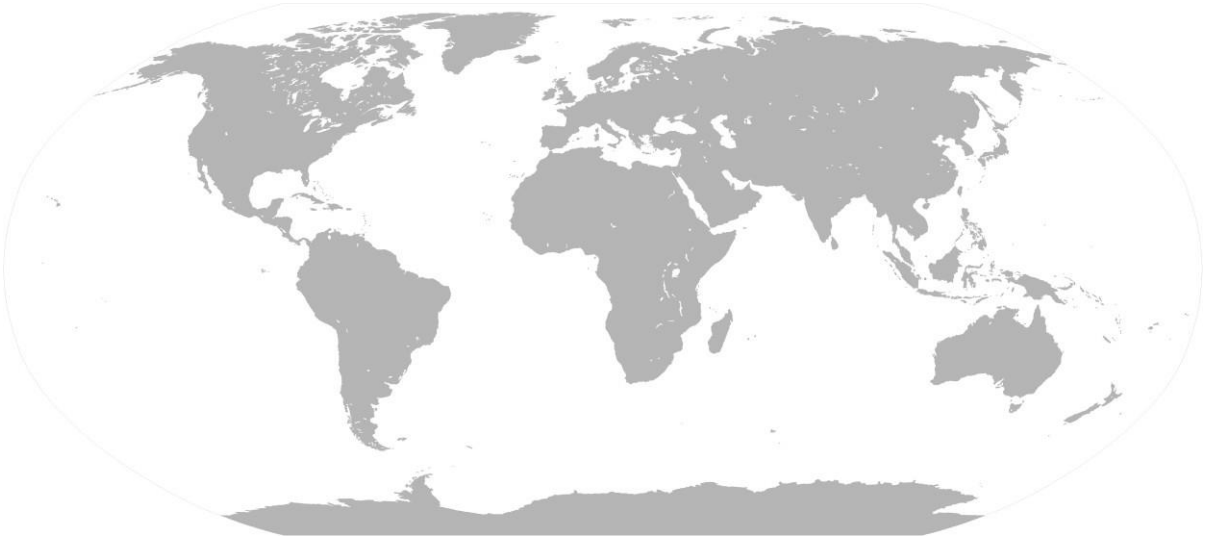

COVID 19- Regulatory Package – Interpretation on Applicability of Asset Classification

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COVID 19- Regulatory Package – Interpretation on Applicability of Asset Classification

The COVID 19- Regulatory Package was issued by Reserve Bank of India on 27th March, 2020 ("**Regulatory Package**") to ameliorate some of the financial suffering induced by COVID-19. It did so by allowing regulated lending institutions (banks/ NBFCs/ HFCs/MFIs) to grant a moratorium of three months on payment of all instalments falling due between March 1, 2020 and May 31, 2020 ("**Moratorium Period**") in respect of term loans ("**Moratorium**"). Lending institutions were allowed to provide such relief by easing the asset classification norms to be applied to loans which availed the benefit of the Moratorium.

RBI Rejects Applicability to Overdue Instalments

It is absolutely clear that the concession provided in the Regulatory Package will apply to asset classification of instalments which were scheduled to be paid in the Moratorium Period. However, there was lack of clarity on applicability of Regulatory Package to instalments which were already overdue on March 1, 2020. Does the Regulatory Package allow regulated lending institutions to freeze the asset classification for such dues from March 1, 2020 till Mar 31, 2020? Such an interpretation would mean that an account which was SMA -1 or SMA-2 as on February 29, 2020 would not deteriorate further during the Moratorium Period.

The Regulatory Package stated that Moratorium could be made applicable to instalments "falling due" in the Moratorium Period. Arguably, an instalment which had already become due earlier cannot be deemed to be falling due again during the Moratorium Period. This was also clarified by the RBI in its response sent to Indian Bank Association on this issue. In the response RBI clarified that the purpose of the Regulatory Package was to mitigate the burden of debt servicing brought about by disruptions on account of COVID -19 on borrowers who otherwise have been servicing their accounts regularly but would have defaulted on account of the temporary stress due to COVID-19. Hence, if a borrower has been in default even before March 01, 2020, such a default cannot be said to be as a result of the economic fallout of the pandemic. It clarified that the benefit of moratorium could be extended to such borrowers in respect of payments falling due during the period March 01 to May 31, 2020. However, payments overdue on or before February 29, 2020 will attract current income recognition and asset classification norms.

Delhi High Court Decides otherwise

It would have been apt to believe that such clear statement from the concerned regulator would have put quietus to the controversy.

However, a contrary interpretation of the Regulatory Package by the High Court of Delhi has again fuelled this confusion. The High Court in its order dated 06.04.2020 in the matter of Anant Raj Limited vs. Yes Bank Limited[1] held that the classification of a non-standard asset will not change during the Moratorium Period though interest and penal interest will continue to accrue. The court while coming to this conclusion relied on the fact that an overdue account has to make the journey from standard asset to SMA-1, then to SMA-2 and finally to NPA. Therefore, the court observed that the reference to NPA in the Regulatory Package means that the intention was to include already existing defaults. Otherwise the Regulatory Package should have only referred to Special Mention Account (for payment over due by 60 days) as there would be no situation where an account which was Standard Asset (as on March 1, 2020) would directly become NPA (payment over due by 90 days) during the Moratorium Period. The High Court, while coming to the conclusion that there will be no further downgrading of the asset during the Moratorium Period even if a borrower is already in default prior to start of the Moratorium Period, observed as below:

"*RBI has stipulated that the account which has been classified as SMA-2 cannot further be classified as a non-performing asset in case the instalment is not paid during the moratorium period i.e. between 01.03.2020 and 31.05.2020 and status quo qua the classification as SMA-2 shall have to be maintained*."

1. W.P.(C) URGENT 5/2020 titled Anant Raj Limited v. Yes Bank Limited

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The interpretation of the High Court will be a relief to lending institutions and borrowers and aligns with the demand of financial services industry that the regulator should mandate a general asset classification freeze to enable lenders and borrowers to cope with economic effects of COVID-19.

In our opinion, simply the use of the term NPA in the Regulatory Package is not sufficient to take such an interpretation. Even a purposive interpretation of the Regulatory Package could not have ignored the fact that the package was brought out to enable borrowers to deal with financial effects of the pandemic. The RBI letter also categorically referred to this as the reason for introducing the Regulatory Package. Interestingly, the default in the matter was pertaining to the payment due on 01.01.2020. The first case of COVID 19 in India was reported on 30.01.2020. Therefore, the default cannot logically be said to be a result of economic fallout of the pandemic, as was contended by the petitioner.

However, in the absence of any contrary decision by any other High Court or by the Supreme Court, the Delhi High Court's interpretation of the Regulator Framework will prevail for now. But it is open to other High Courts to take a different interpretation of the Regulatory package as the interpretation by the Delhi will only have persuasive value. It is entirely possible that other High Courts align their interpretation with that given by RBI in its letter to IBA. If that happens, it would lead to mayhem and regulatory uncertainty for lenders as well as borrowers. The issue could, however, be settled by the Reserve Bank of India issuing an addendum to the Regulatory Package to clarify the position on this aspect. That, in our view, would be within the RBI's authority as a regulator and would remove the scope of any interpretative ambiguity on this issue.

In the meantime, it should be noted that lending institutions, as regulated entities, will be reporting to the RBI. In view of the fact that the RBI wrote to IBA giving a diametrically opposite view to that pronounced by the Delhi High Court, any lending institution looking to freeze asset classification of all its accounts as of February 29, 2020 should consider intimating this to the RBI. It should highlight the fact that the court's attention was also drawn to the RBI letter to IBA. In our view, this will help avoid a regulatory conflict situation where RBI continues to go by its position as stated in the letter to IBA, while the lending institution abides by the principle set out in the Delhi High Court order.