

Interest Waiver

Why in news?

The Supreme Court (SC) has directed the government to implement the waiver of “interest on interest” for borrowers with an exposure of up to Rs 2 crore.

What does the SC decision mean?

- The SC wants the government to waive it by November 2, 2020.
- The hearings will continue and a final verdict is some time away.
- The SC seems to be comfortable with the idea of the government picking up the tab for the loss banks would incur by not charging the compound interest on exposures that were allowed a moratorium.
- The decision would come as a huge relief for both banks and the Reserve Bank of India (RBI).

Who would be eligible for waiver?

- The SC is not going to recommend a waiver of compound interest for bigger exposures—of more than Rs 2 crore.
- In other words, the government will reimburse banks for compound interest due only from smaller borrowers.

Is it a good practice?

- Waiving interest on loans can never be a good practice since it creates a moral hazard and vitiates the borrowing environment.
- Given the unprecedented pain caused by the pandemic, the SC’s view is understandable.

What is important?

- It is important that the SC has allowed the government to pay the bill, sparing the banks.
- Also, the waiver is restricted to just the smaller borrowers.

What did the government say?

- In its affidavit to the court, the government had pointed out that waiving the interest on all loans and advances, across all categories of borrowers, for a

period of six months would cost Rs 6 lakh crore.

- Clearly, banks are not financially strong enough to bear this burden.
- It would wipe out a substantial part of their net worth and make many of them unviable.
- As the government observed, lending institutions need to survive the current crisis, and promises made to depositors need to be honoured.
- If customers are to be paid interest on their deposits, borrowers need to pay interest on the loans.

What could be done?

- **Sub-limits** - Not all categories of borrowers are equal.
- It would only be fair if the government specifies different sub-limits for each segment of borrowers because taxpayers should not be subsidising those who can afford to pay the interest.
- **Declaring NPAs** - The RBI has been concerned, with the SC directive regarding non-performing assets (NPAs).
- The SC had directed the banks not to classify any loans as NPAs if they had not been declared as such on August 31.
- Hopefully, banks will soon be permitted to classify loans as per the rules because it is important that they provide for them immediately.
- **Setting aside capital** - Given how a big chunk of loans is expected to go bad, it is important banks set aside enough capital for these losses.

Source: Financial Express