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Moratorium and its Effect on Indian Banks during Covid-19 Pandemic

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Abstract

Moratoriums are suspensions during crisis imposed by regulators. During the last 20 years, the Indian banking sector has experienced it in multiple instances. Recently the Reserve Bank of India offered a six-month moratorium on all loan equated monthly installments, to lessen the troubles faced by borrowers during the covid-19 pandemic. India, with a roadmap targeted for growth, suddenly realized the urge to work under new reality with unprepared procedures of action. The front-runners who had digital acquaintance kept the business rolling through e-commerce prior to the tragic hit. As against it, banks became the rescue during covid-19 attacks. The new systems and processes were developed with digital solutions which helped the banks continue with its operations helping economy thereby complying with hygiene requisites. It's a call for banks to gear up for new normal, where customers, employees and regulatory bodies all show less of resistance and more of acceptance to explore new opportunities to combat low interest rates, cyber security and credit score during times of loan moratorium. The paper studies the merits and demerits of loan moratorium.

Keywords – Low interest rates, digital solutions, credit score, loan moratorium

Introduction

Despite short term response generated by banks, and the growth process with full swing implemented, came the Pandemic, Covid-19. The banks faced the challenge to revisit the reforms as post crisis work culture exerts thrust for digital transformation of this sector. It's the time to replace outdated working models with new digital platforms. Along with new normal reforms to set, came the loan moratorium, mandated low interest rates and need for cyber security.

The Indian Banking sector, being huge in size, comprises of public sector banks (12), private sector banks (22), foreign banks (44), RRB's (43), urban cooperative banks (1,484) and 96,000 rural cooperative banks (96000) in addition to cooperative credit institutions. The focus of Indian banks is to adopt integrated approach to risk management which led to a recovery of Non-Performing assets amounting to US$ 57.23 billion in FY19, which is highest recorded in last four years. According to the RBI, as of April 23, 2021, India experienced good scores in terms of it foreign exchange reserves which stretched to US$ 582.41 billion, bank credit which mounted to US$ 1.48 trillion and deposits which mounted US$ 2.06 trillion. At the outset, the banks and financial institutions were affected least and witnessed immediate implementation of government subsidy programs and increase in volume of trading.

Literature Review

Dr. Meera Mehta (2020) in her research on "Loan moratorium 2020-Its impact on Indian Banks" analyzed the pros and corns of moratorium with context to NPA levels of banking institutions in India.

Dr Uttam Kumar Purbey in his research work titled "A study on analysis of non-performing assets and its impact on profitability: In the context of Indian banking system" suggested that at the threshold where 2019 pandemic forced technological changes, Indian banks can deliver innovative and cost effective products to satisfy the aspirations of young Indian consumers who rely more on financing their assets. Thus the scope for retail banking will mark a shift from physical banking to technology driven efforts. There is an urgent need to introduce new competitive services when there is life style change post covid. E cheques, real time gross settlement, electronic fund transfer and electronic clearing service is what the new generations looks forward to during lockdown times.

Jaafar M Alghazo et al in their paper on "Cyber security analysis of internet banking in emerging countries: User and bank perspectives" have analyzed the cyber security related to Internet Banking and have proposed a new model to lessen the cyber security risk and enhance customer satisfaction. The proposed model is proposed for Saudi Arabia, Pakistan, and India.

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Bikker and Vervliet in their research article titled “Bank profitability and risk taking under low interest rates”, have attempted to calculate ratios like return on assets, return on equity, total capital ratio, credit loss provision to credit ratio and net interest margin for banks of United States under the low interest environment. The general supposition is that, in the long term, falling interest rates have a negative effect on bank profits. But the extent of harm is bank solvency.

Objective of Study

The main objective of this study is to discuss the challenges faced by Indian banking sector during corona crisis. There is always a need for banks to monitor Non performing assets, abide by RBI regulations and keep the customers interest intact. In the process of struggling to maintain with all the three requisites, the new normal calls for proper understanding and discussion to fulfill the following objectives -

- To review the low interest rates and high cost for banks post Covid 19
- To review the digital solutions and flexible working models offered by banks
- To review loan moratorium and loan restructuring

Research Questions -

- How are banks addressing the low interest issue?
- What challenges Covid-19 has offered for working of banks?
- Is Loan moratorium and restructuring beneficial for borrowers?

Research Methodology – Like every piece of research, this paper has also built research methodology. The research is descriptive in nature and hence secondary data available for review has been widely used. The discussion is presented with the use of tables as and where required.

Discussion – India being a nation where banking industry can be viewed from various perspectives. On one hand there are still untapped customers and markets and on the other hand with the addition of foreign banks to the sector, there are numerous challenges to sustain in the

market. Covid-19 has added fuel to the problems. The following are the challenges for Indian banks to strive for new normal.

1. Low Interest Rates and Elevated Risk Costs Are The New Normal For Banks

Many marketplace performers anticipated rise in interest in the wake of progress post covid-19, this was ruined by the emergency- County wide Lockdown announced in March 2020 for 21 days at a stretch.

During the pandemic times, the banks have been compelled to reduce the interest rates. The impact of which is enormous. At the initial, the low interest rate on lending will be compensated by low interest rate on deposits as well. Gradually, banks loose customers due to negative interest rate, hitting its profitability and finally leading to insolvency.

SBI, being considered the largest lender of India initiated the lending rate cut from 7.80 per cent to 7.05 percent, effective from April 1,2020, the announcement extended on repo rate-linked lending rate to 6.65 per cent from 7.40 per cent, followed by reducing fixed deposits rate by 20-100 bps. In addition, the Retail FD's were lowered by 20-50 bps; while majority term deposit rates by 50-100 bps. As mandated by the Apex bank, RBI in March 2020, Bank of Baroda also lowered the interest rate to 7.25 percent on loans for retail, personal and Micro, Small and Medium Enterprises (MSMEs. It also condensed the Repo Linked Lending Rate by 75 basis points to 7.25 per cent; pertinent as a floating rate for all types of loans –personal, retail and to MSMEs. In spite of the measures undertaken, the new normal had increase in default loans. The diligently low interest rate situation followed by default borrowers, forced banks to increase cost-effectiveness in other ways like increase their locker rents, service request charges, digital transaction charges and penal charges. Be that as it may, more and more people are expected to revisit their bank accounts that were largely dormant as government grants and support will be disbursed through this channel.

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2. Greater Customer Demand for Digital, Cross-Channel Solutions That Enable Banks To Offer Their Clients Holistic Advice To Suit Individual Needs

The new normal demands customer interactions across all channels ie first interaction to closing the deal and processing all back office operations. In the new normal, customers expect higher security and demand holistic advises on all of their banking interactions. This has surfaced trust issues and banks have emerged as dependable partners. Moreover the physical interaction is not subdued, in case of arising needs; the banks are mandated to address customers amid the complexity of covid-19 protocols.

Banks are geared up to offer integrated solutions to their customers by collaborating with third party providers. They intend to develop the products to meet liquidity and accounting issues which are beyond banking. The digitalized working demands systematic use of internal data base supported by the external data available through social media platforms. All the data analytics tool to be resorted to provide need based, individual solution for customers.

3. A More Digital and Crisis-Proof Operating Model with Greater Flexibility.

The crisis hardly affected the banks during first half of the year in spite of first lockdown announced On March 21, 2020. With the intensive introduction to digital banking, the customers have become more accustomed which will impose changes in physical spaces significantly than before – branch numbers and office spaces. The virtual agile way facilitates greater collaboration with employees and customers.

The crisis has revealed that there is always another way. The first half of the year, witnessed hardly any losses by banks in spite of the lockdown. In the new normal, the banks will work with fewer branches, flexible working models and less physical interactions.

Customers have already grown habituated to digital banking facilitated by employees for virtual collaboration with customers and coworkers. To increase the efficiency, banks will have to identify activities in terms of value and shift the ones having less value to third party to reduce cost drastically.

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Digital transformation has led to higher security risks. Cybercriminals are exploiting digital footprint to steal data and to draw off money. They are alluring customers through emails leading to fraud. The risk gets extended to the bank employees as well. The attackers target the digital platforms of employees who are novice to the technological shift. The need of the hour is to increase the intensity and frequency of cyber security protection by banks. One of the recent cyber-attacks took place in Cosmos Bank located in Pune, in 2018. The hackers managed to wipe Rs.94.42 cores. During the same year 2018, 20 Lakhs were siphoned from around 300 ATM users details of Canara Bank. Also one of the huge data breaches that took place in 2018 was leaking of 1.1 Billion Indians Adhar Card Details. During the emergency, Banks have enabled staff to work from remote location as they have established IT systems. But huge staff opting for remote access has created challenge for banks. Due to the lack of software/hardware needed to access Virtual Private Network by staff has enhanced, IT control issues. What COVID-19 has created is effectively a huge monitoring challenge.

4. Covid-19 Emi Moratorium and Loan Restructuring -

The term moratorium is defined as a momentary break on loan EMI. The intention behind introducing moratorium is to support customers by having no impact on their credit scores as well as banks by not increasing their NPA level.

An extension to RBI Relief Package, the lending institutions, NBFCs (including Housing Finance Companies) were allowed to award a moratorium of three months on payment of all installments due between March 1, 2020 and May 31, 2020. The announcement gathered attention and was understood to waive loan EMIs and credit card dues for three months. On May 23, 2020, RBI announced its extension to another three months- from June 1, 2020 to Ausust 31,2020. As a consequence, the loan period inevitably prolonged to three months, leading to extra interest charges. The direct impact was on the customers, who were at first stage of loan tenure. With bane came the boon of relief to the customers availing it with its no impact on their credit scores and preventing their loan to be classified under NPA category.

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In general, default leads to escalation of interest and penalties and reduces the credit scores of borrower leading to his inability to generate loans in future, which worked opposite in case of moratorium.

In spite of the fact that it was worthwhile, many borrowers did not opt for this loan moratorium faced difficulties in repaying their loans. On May 5, 2021 came the huge relief when RBI announced second moratorium, but with conditions. To be eligible, there should not have been any loan default till March 31, 2021.

The former loan moratorium framework allowed borrowers to opt for a moratorium of 3 months, which could be extended up to a total period of 2 years with discussion with the creditor. With the announcement of new moratorium, the remaining tenure can be extended to utilize it up to two years..According to Anil Pinapala, Founder & CEO of Vivifi India Finance, a non-banking finance company, the focus is on those retail loan borrowers who have been regular with repayment and have so far not accessed any loan restructure mode. The resolution framework 2.0, announced by RBI on 5 May,2021 classifies borrowers account as 'standard' subject to condition that they are the ones who have not availed Resolution Framework 1.0 as announced on 6 August,2020. Gaurav Chopra, CEO Indialends defines standard and substandard loan account.The definition of 'standard account' rests on repayment without default of not more than 90 days, which in simpler terms mean a continuous default of 3 months switches the category from standard to substandard.

"In case of term loans, with or without postponement of remaining term and extending to the maximum stipulated period in the scheme, the moratorium of interest and /or Principal is offered" – Babu K A, Federal Bank, Senior vice president and Head, Loan Collection & Recovery Department. This means that a borrower can apply for a complete holiday for repayment of Principal or interest up to a total period of two years ie moratorium period. The choice to pay interest only during moratorium period is allowed. One can stick to original period with enhanced repayment with higher EMIs or can apply for period extension after moratorium to address affordability.

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Moratorium in direct sense does not affect the credit score of a borrower, but in practice 'borrowers with moratorium' are subject to rejection for loan application. Also, failure to make payments after the moratorium, is likely to hit the credit score drastically. On the contrary, for the customers not opting for moratorim, the payments are to be paid in time to prevent its ill effect on credit score. Thus for the customers, either ways, maintaining credit score turns out to be the major concern.

The purpose of introducing repayment holiday was to address hardships due to pandemic, covid-19. Those unaffected can continue with regular payments. On availing moratorium, one enjoys the holiday benefit but at the cost of paying higher interest post-holiday. How it happens can be interpreted with following example.

Impact of EMI holiday on a Rs 2.50 lakh auto loan outstanding Interest Rate 10% p.a. on monthly balance

Table :1 – EMI holiday and Interest

Current remaining tenure	5years	5	5	5
EMI EXISTING	5,312	5,312	5,312	5,312
HOLIDAY PERIOD OF NOT PAYING EM ATALL	1 YEAR	1 YEAR	2 YEAR	2 YEAR
ACCRUED INTEREST AFTER MORATORIUM	26,179	26,179	55,098	55,098
OUTSTANDING PRINCIPAL AFTER	RS 2.765 LAKH	2.765 Lakh	3.05 Lakh	3.05 Lakh

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MORATORIUM				
ORIGINAL TENURE EXTENDED	NO	1 YEAR	NO	2 YEARS
REMAINING TENURE AFTER MORATORIUM	4	5	3	5
REVISED EMI	7,005	5,868	9,845	6,483
TOTAL ADDITIONAL REPAYMENT	17,515	33,373	35,702	70,240

Source – www.economictimes.indiatimes.com

The same holds true for home loan as well. Impact of principal repayment holiday on a Rs 15 lakh home loan outstanding with Interest rate at 8% p.a. on monthly balance.

Current remaining tenure	10 years	10 years	10 years	10 years
Existing EMI	18,199	18,199	18,199	18,199
HOLIDAY PERIOD FOR ONLY INTEREST PAYMENT	1 YEAR	1 YEAR	2 YEARS	2 YEARS
MONTHLY INTEREST PAYMENT	10,000	10,000	10,000	10,000

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DURING HOLIDAY				
ORIGINAL TENURE EXTENDED	NO	1 YEAR	NO	2 YEARS
REMAINING TENURE AFTER MORATORIUM	9	10	8	10
REVISED EMI	19,528	NO CHANGE	21,205	NO CHANGE
TOTAL ADDITIONAL INTEREST PAYMENT	45135	1.2 LAKH	92,000	2.4 LAKH

Source – www.economictimes.indiatimes.com

There is always a higher interest outgo whether the borrower opts for on any extension or moratorium on EMI or principal. The obvious reason being for a longer period, lesser or no principal repayment during moratorium will add to outstanding amount. This in turn will lead to higher interest on the amount which is already higher outstanding. The only method to lessen the additional interest payment is that the borrower keeps serving the interest during the short moratorium and restructure the loan to make payment repaid within the original period, as evident from above example.

RBI has authorized all lenders in India, in all domains ie public, private, foreign, state co-operative, urban co-operative, regional rural, district co-operative, housing finance companies and NBFCs to use this facility with forbearance. This is the first time that RBI has announced a restructuring framework for personal loan segments. The term ‘personal loan’ here includes education, home, gold, unsecured personal, car, and consumer durable loans, apart from credit

card dues and loan against securities (other than those sanctioned for business and commercial purposes).

There has been great argument over credit worthiness of borrowers, off late. The borrowers are concerned about their credit history and credit score. There is a thin line of demarcation drawn between these borrowers being not placed in default category but will be marked in books as credit restructurers.

Their accounts will bear the tag – account restructured under covid 19. They will be placed in between standard account without arrears and more than standard account with long arrears or NPA. Hence they need to take a call on restructuring than getting termed as NPA. In spite of the fact that these borrowers are victims of opposing financial condition, but the impact on credit score cannot be diminished.

In order to get quick sanction of loan, the borrower should have impressive credit score. The RBI has licensed four companies to act as credit information companies. They are CIBIL, Experian, HIGHMARK, and Equifax. The most popular one, being CIBIL, Credit Information Bureau India Limited. It produces, three-digit report ranging from 300 to 900. The higher the score, the greater the creditworthiness.

Under the announcements made, Loan restructuring will not influence CIBIL score but the lending bank has to report such restructured loan to CIBIL Bureau. So, if not directly, but indirectly further loans may get rejected when entered as restructured in the database.

In case of multiple loan enquiries, without corresponding approvals denote that the borrower is trying to maximize the chance of securing it without knowing that such multiple inquiries will have a great bearing on will the CIBIL score.

Conclusion

The analysis concludes that the Indian Banking Sector is well capitalized, properly regulated and can be treated far more superior to other developing countries. It has executed innovative banking models and stand among top 25 banks in the world with immediate payment service

system (IMPS) at its fifth level in Faster payments innovation system (FPII). From the above discussion, it is clear that RBI, through moratorium has tried to help those borrowers who have been prey to Corona pandemic through Moratorium. However the borrowers should understand that how much they can risk their credit profile. One can always check CIBIL score for free and keep track of his records. The pace of growth for the Indian banking industry has been noteworthy even during crisis times. It has taken measures for credit extension, escalating profitability, performance efficiency; maintain lower levels of non- performing assets and emphasis on financial inclusion. They have been the strong pillars of growth to keep the economy rolling in spite of numerous challenges posed by the Pandemic since 2020.

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