Introduction

The recent coronavirus (COVID-19) outbreak has posed a significant and an unprecedented challenge to the Indian economy. To prevent the economic shocks from becoming more severe, it is crucial that the governments intervene with timely policy responses. The Reserve Bank of India (RBI) has continuously assessed the macroeconomic situation and financial market conditions in India. Based on this, it has issued an array of economic measures in the form of various developmental and regulatory policies to ease the functioning of financial markets. These policies aim to:

- Expand and maintain adequate liquidity in the system and its constituents
- Facilitate and incentivise bank credit flows
- Relax repayment pressures, improving access to working capital to ease financial stress, and
- Improving the functioning of financial markets.

The article aims to enunciate the regulatory and developmental measures introduced by RBI which aim to mitigate the burden of debt servicing brought about by disruptions on account of COVID-19 and to ensure continuity of viable businesses.

Regulatory and developmental measures

The measures taken by RBI are consistent with the globally coordinated action committed to by the Basel Committee on Banking Supervision (BCBS) to alleviate the impact of COVID-19 on the global banking system.

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<tr>
<th>Moratorium on term loans/deferment of interest on working capital loans</th>
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Source: KPMG in India’s analysis, 2020 read with RBI press releases dated 27 March 2020 and 17 April 2020

Moratorium on term loans/deferment of interest on working capital loans and its impact on asset classification and provisioning

Moratorium on term loans

The RBI vide its notification dated 27 March 2020 permitted all lending institutions to grant a moratorium of three months from 1 March 2020 to 31 May 2020 on payment of instalments of principal/interest components, bullet repayments and Equated Monthly Instalments (EMIs) pertaining to term loans, as well as on credit card dues. Thus, eligible borrowers having any such payments falling due between 1 March 2020 and 31 May 2020 have an option to avail of this moratorium.

1. Through press releases dated 27 March 2020 (Statement on Developmental and Regulatory Policies), 1 April 2020 and 17 April 2020 (Governor’s Statement).
2. Including agricultural term loans, retail and crop loans.
4. Lending institutions includes all commercial banks (including regional rural banks, small finance banks and local area banks), co-operative banks, all-India Financial Institutions, and Non-Banking Financial Companies (NBFCs) (including housing finance companies).
5. Lending institutions are required to frame board approved policies, which inter alia includes the borrowers who would be eligible for such moratorium (for example, all loan accounts classified as standard assets as on 1 March 2020).
The repayment schedules and the residual tenor for all such loans would be shifted across the board by three months (or the period of moratorium availed) after the moratorium period. However, interest would continue to accrue on the outstanding portion of the loans during the moratorium period. Thus, for example, where an eligible borrower had a loan outstanding of INR50 crore as on 1 March 2020, and had to make payments of INR5 crore on 1 April 2020, he/she has an option to avail the moratorium, and pay INR5 crore post 31 May 2020. However, the interest would continue to accrue on INR50 crore for the period from 1 April 2020 to 31 May 2020.

**Impact on asset classification**

Banks are required to adopt the Prudential norms on Income Recognition, Assets Classification and Provisioning for Advances (IRAC norms) for the purpose of asset classification and provisioning. As per these norms, loans would be classified as a standard asset or a Non-Performing Asset (NPA) based on the number of days past due. A term loan would be classified as NPA if interest and/or instalment of principal remain overdue for a period of 90 days.

Resultantly, the RBI has notified that in respect of all accounts classified as standard as on 29 February 2020, even if overdue, the moratorium period, would be excluded by the lending institutions from the number of days past due for the purpose of asset classification under the IRAC norms. Accordingly, the asset classification for such advances would remain standstill for the stipulated period.

**Deferral of interest on certain working capital facilities**

The notification permits lending institutions to defer the recovery of interest applied on cash credit/overdraft facilities (CC/OD) during the period from 1 March 2020 to 31 May 2020 (deferment period). The accumulated interest would be recovered immediately after the completion of this period.

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6. Standard assets are advances on which recoveries are fine and account is normal (these assets are less than 90 days past due). NPAs are further classified as sub-standard, doubtful and loss assets.

7. The FAQs issued by the Indian Bank Association on 1 April 2020 have clarified that the accumulated interest would be recovered along with interest applied on 30 June 2020 and in cases, where monthly interest is not applied, along with next interest date.

8. Advances would be classified as Special Mention Accounts (SMA) if they have defaulted but are not 90 days past due.
or a change in terms and conditions of loan agreements due to financial difficulty of borrower. Consequently, such a measure by itself would not result in asset classification downgrade.

**Impact on asset classification**
Special Mention Accounts (SMA) and out of order status of CCs/ODs would be evaluated considering the application of accumulated interest immediately after the completion of the deferment period as well as the revised terms (revised drawing power).

**Reporting to Credit Information Companies (CICs)**
The rescheduling of payments, including interest, will not qualify as a default for the purposes of supervisory reporting and reporting to Credit Information Companies (CICs) by the lending institutions. CICs should ensure that the actions taken by lending institutions pursuant to the above announcements do not adversely impact the credit history of the borrowers.

**Other conditions**
For the purpose of providing the above-mentioned reliefs to eligible borrowers:

- Lending institutions should frame Board approved policies, which inter alia include the objective criteria for considering borrowers for whom the ‘drawing powers’ can be recalculated. These policies should be disclosed in public domain.
- Where exposure of a lending institution to a borrower is INR5 crore or above as on 1 March 2020, it should develop an MIS on reliefs provided to its borrowers. These *inter alia*, include borrower-wise and credit-facility wise information regarding the nature and amount of relief granted.

**Impact on asset classification and provisioning**
The RBI acknowledged the risk that would build-up in the banks’ and NBFCs’ balance sheet on account of firm-level stress and delays in recoveries due to the reliefs granted. With the objective of ensuring that banks and NBFCs maintain sufficient buffers and remain adequately provisioned to meet future challenges, they are required to maintain a higher provision of 10 per cent on all such accounts under standstill and where asset classification benefit is extended.

This provision would be phased over two quarters-i.e. quarter ended 31 March 2020 (five per cent) and quarter ending 30 June 2020 (five per cent).

This additional provision can be adjusted later on against the provisioning requirements for actual slippages in such accounts, and may be written back at year end. However, till such adjustment, it would not be considered to be part of net NPAs, and would be disclosed separately in the balance sheet (and not adjusted against gross advances).

The RBI further clarified, that the provisioning on other accounts (already classified as NPAs as on 29 February 2020) has to be maintained, and the subsequent ageing in these accounts would continue in the usual manner.

**Disclosure in financial statements**
With regard to the asset classification benefits and the additional provisioning required, lending institutions are required to provide the following disclosures in the ‘Notes to Accounts’ in their financial statements for FY2019-20, 2020-21 as well as for half-year ending 30 September 2020:

- Amounts in SMA/overdue categories, where the moratorium/deferral was extended
- Respective amount where asset classification benefits is extended
- Additional provisions made during the quarters ended 31 March 2020 and 30 June 2020
- Additional provisions adjusted during the respective accounting periods against slippages and the residual provisions.

**Extension of resolution time**
As per the prudential framework, once a borrower is reported to be in default in repayment of dues to any financial institution, all lenders are required to undertake a prima facie review of the borrower account within 30 days from such default (review period). The resolution plan agreed upon by the lenders for such default is required to be implemented within 180 days of the end of the review period.

The RBI recognised the challenges posed under the COVID-19 situation, and has thus decided to exclude the stipulated period of 1 March 2020 to 31 May 2020 from the review and resolution period as explained further on the next page:

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9. Minimum of 10 per cent
The RBI further clarified that the other provisions of the prudential framework would be in force without any modifications. Further, lending institutions are required to make relevant disclosures in respect of accounts where the resolution period was extended. This disclosure is required to be given in the notes to accounts section of financial statements for FY2019-20, 2020-21 and for the half year ending 30 September 2020.

**Freeze on dividend distribution**
COVID-19 has negatively affected the cash flows of many businesses and could lead to a cascading effect on the economy. In this environment of heightened uncertainty, it is important that banks conserve capital to retain their capacity to support the economy and absorb losses. Accordingly, RBI notified\(^{10}\) that all banks would not make any further dividend payouts from the profits pertaining to the financial year ended 31 March 2020 until further instructions. This restriction would be reassessed by RBI based on the financial results of banks for the quarter ending 30 September 2020.

**Extension of realisation of export proceeds\(^{11}\)**
Currently, exporters are required to realise and fully repatriate the proceeds of exports to the country within a period of 9 months from the date of exports. In view of the disruption caused by the COVID-19 pandemic, the time period for realisation and repatriation of export proceeds for exports made up to or on 31 July 2020 is extended to 15 months from the date of export. This measure will enable the exporters to realise their receipts, especially from COVID-19 affected countries within the extended period and also provide greater flexibility to the exporters to negotiate future export contracts with buyers abroad.

### Scenario and Analysis

<table>
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<tr>
<th>Scenario</th>
<th>Analysis</th>
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<tbody>
<tr>
<td>30-day review period started on 25 February 2020 (i.e. account is in the review period as on 1 March 2020)</td>
<td>The period from 1 March 2020 to 31 May 2020 would be excluded from the calculation of the 30-day timeline for the review period. In respect of all such accounts, the residual review period would be resumed from 1 June 2020, upon expiry of which the lenders would have the usual 180 days for resolution.</td>
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<tr>
<td>30-day review period expired on 25 February 2020 (i.e. 180-day resolution period has not expired as on 1 March 2020)</td>
<td>The timeline for resolution would get extended by 90 days from the date on which the 180-day period was originally set to expire. Consequently, the requirement of making additional provisions (of 20 per cent as per the prudential framework) would be triggered when the extended resolution period expires.</td>
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**Other measures**
The RBI has issued a slew of monetary and regulatory measures to proactively respond to the COVID-19 situation through both conventional and unconventional measures. This includes reducing the liquidity coverage ratio requirement from 100 per cent to 80 per cent with immediate effect\(^{12}\), and extending the relief with regard to the extension of the date for commencement for commercial operations to NBFCs\(^{13}\).

**Consider this**

- Whilst the bank’s need to follow an RBI prescribed approach on NPA recognition and measurement, they will need to assess whether the current COVID-19 situation has resulted in a higher inherent risk in the portfolio/counterparty, requiring a need for a provision.
- For NBFCs, the impairment model in Ind AS 109, Financial Instruments, is an expected loss model, which means that it is not necessary for a loss event to occur before an impairment loss is recognised. As a result, all financial assets generally carry a loss allowance. While assessing impairment on loan assets, lending institutions\(^{14}\) should consider the economic downturn caused by COVID-19. Thus, while assessing ECL, lending institutions may need to assess the appropriateness of their current criteria of staging as well as critically evaluate whether there has been a Significant Increase in Credit Risk (SICR) in any of their underlying portfolios/loan exposures. Further, emphasis should be given to entities who have faced difficulty in obtaining working capital funding, for whom the drawing powers were reassessed by these lending institutions.

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11. Through communication dated 1 April 2020
12. This would be restored gradually in the second half of the year.
13. This was initially available only to banks’.
14. NBFCs/HFCs

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• The RBI notification clarifies that the moratorium
granted on payment of term loan instalments, the
deferral of interest and recalculation of drawing
powers of working capital facilities do not necessarily
indicate a financial difficulty for the borrower.
Where the modification does not result in a
derecognition, these changes in terms of the
instrument, would be accounted for as changes in the
timing of estimated cash flows. Accordingly, the gross
carrying amount of the financial asset (the amortised
cost of the financial liability) would be adjusted in
the period of change to reflect the revised actual and
estimated cash flows, with a corresponding income or
expense being recognised in profit or loss. The revised
gross carrying amount of the financial asset (or
amortised cost of the financial liability) is recalculated
by discounting the revised estimated future cash
flows at the instrument’s original effective interest
rate or, when applicable, the revised effective interest
rate.
• Implementing each of the above moratorium
requirements will require significant system changes/
enhancements and lending institutions would be
well advised to critically evaluate and address the
operational risks associated with this implementation.
• Having received representations from industry
associations seeking moratorium on repayment of
term loans sanctioned by insurers, the Insurance
Regulatory and Development Authority of India
(IRDAI) issued a circular dated 8 April 202016
providing similar relief to borrowers of term loans. Accordingly,
in respect of term loans:
  - The insurers are permitted to grant a moratorium
    of three months towards payment of instalments
    falling due between 1 March 2020 and 31 May
    2020. The repayment schedule as well as the
    residual tenor for such loans would be shifted
    across the board by three months from the
    moratorium period
  - Interest would continue to accrue on the
    outstanding loans during such moratorium period
  - Asset classification of term loans would be
determined on the basis of revised due dates and
  revised repayment schedule
  - Insurers would be required to frame board
approved policies to extend such reliefs to all
eligible borrowers, further concurrent auditors
would be required to confirm in their reports for
the quarter ending June 2020 that the insurers
have complied with the board approved policies in
granting moratorium.
Further, through a circular dated 24 April 202016,
IRDAI urged insurers to refrain from making dividend
payouts for profits pertaining to financial year ended
31 March 2020 till further instructions. This position
would be reassessed by IRDAI based on financial
results of insurers for quarter ending 30 September
2020.

15. Circular number IRDA/F&I/CIR/INV/085/04/2020
16. Circular number IRDA/F&A/CIR/MISC/099/04/2020