A SAFE HARBOUR FOR BORROWERS DURING COVID-19 PANDEMIC - DISCUSSION ON RBI MORATORIUM VIS-À-VIS ASSET CLASSIFICATION

I. INTRODUCTION

The Coronavirus or COVID-19 pandemic danse macabre is not only taking catastrophic toll on human lives but also causing severe economic dislocation and market turmoil. The outbreak of the pandemic has necessitated imposition of extraordinary measures such as lockdowns in most countries keeping in mind the larger interests of public health.

While India remains under a lockdown and a state of siege prevails, the Reserve Bank of India **("RBI")** has, in an attempt to mitigate the adverse impact of the pandemic on the economy and with a view to revive growth and mitigate the burden of debt servicing, released Circulars termed as 'Statement of Development and Regulatory Policies' dated March 27, 2020[1] and 'COVID-19 – Regulatory Package' dated March 27, 2020[2] (**"RBI Circulars"**) which *inter alia* permitted all the lending institutions[3] to allow a moratorium of 3 months on instalments in respect of all term loans falling due between March 1, 2020 and May 31, 2020 (**"Moratorium Period"**).

The RBI Circulars further state that repayment schedule and all subsequent due dates, as also the tenor for such loans, may be commensurately shifted across the board by three months. Similarly, in case of Working Capital facilities, the lenders are permitted to allow a deferment of 3 months on payment of interest in respect of all such facilities outstanding as on 1st March 2020, whilst the interest can continue to accrue and will be payable after the expiry of the said period.

II. THE SCOPE AND EXTENT OF SAFE HARBOUR PROVIDED IN THE RBI CIRCULARS:

The objective of this safe harbour of moratorium/deferment is to specifically enable the borrowers to tide over the economic fallout from COVID-19 and hence, a default will not result in asset classification downgrade. The RBI was however mindful to caveat this by providing that this will not be treated as change in terms and conditions of loan agreements due to financial difficulty of the borrowers.

It is pertinent to understand here as to what the stages of asset classification are. Asset classification is primarily governed by the Master Circular on Prudential norms on Income

[1] https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/PR21302E204AFFBB614305B56DD6B843A520DB.PDF
[2] https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NOTI186B27003E9DB3D4FB49BDDF955F4289D68.PDF
[3] Lending institutions being all commercial banks (including regional rural banks, small finance banks and local area banks), co-operative banks, all-India Financial Institutions, and NBFCs (including housing finance companies)

Recognition, Asset Classification and Provisioning pertaining to Advances dated 1st July 2015 (as amended from time to time) (colloquially referred to as **"IRAC norms"**). As per the IRAC norms, an asset it classified as a Non-Performing Asset (**NPA**) when the interest and/or instalment of principal remains overdue for a period of more than 90 days. IRAC norms further state that, prior to classifying an account as an NPA, an account shall be first classified as Special Mention Account – 1 (**SMA-1**) when the account remains overdue between 31-60 days and Special Mention Account – 2 (**SMA-2**) when the account is overdue between 61-90 days. While this is the basic parameter for declaring an asset as an NPA, the RBI has released various other circulars and guidelines on the classification standards from time to time, which may not be essential for discussions here.

While the RBI Circulars provide a safe harbour to the borrowers so as to not trigger any 'default' during the Moratorium Period, the Borrowers are also protected from any downgrade in classification of their account as per the IRAC norms, during the Moratorium Period. The Circular clearly provides that the asset classification of term loans which are granted relief shall be determined based on revised due dates and revised repayment schedule.

The borrowers have however, knocked the doors of the Courts in respect of issues concerning the interpretation of the said RBI Circulars. Few issues which came up for consideration before the Courts till now are (1) whether the safe harbour under the RBI Circulars apply to Assets which were in default prior to 1st March 2020; (2) whether the time period for Asset Classification/down-gradation continue to run during the Moratorium Period; (3) whether moratorium has any effect on enforcement of security interest for a default occurred prior to 1st March 2020; and (4) whether the Moratorium Period also applies in respect of facilities availed by NBFCs.

1. ***Whether the safe harbour under the RBI Circulars applies to Assets which were in default prior to 1st March 2020:***

This issue came up for consideration in the case of *Anant Raj Limited v. Yes Bank Ltd.*[4] before the Hon'ble High Court of Delhi. In this case, Anant Raj Ltd., the borrower, which is engaged in the business of real estate, had availed credit facilities to the tune of Rs. 1570 crores from YES Bank Ltd. The Borrower filed a writ petition challenging YES Bank's action of classifying the Borrower's account as NPA on 31st March 2020. The Borrower contended that it is squarely covered under the aforesaid RBI Circular to avail moratorium on instalments from 1st March 2020 and that, in this intervening period, status quo *qua* classification of the account should be maintained. YES Bank contended that the RBI Circulars apply to instalments which fall due after 1st March 2020 and in the present case, as the default had occurred on January 1,2020 and the interest instalment remained overdue for a period of 90 days, the account is to be classified as NPA as per the IRAC norms.

[4] W.P. (C) (Urgent) No. 5 / 2020, delivered on 6th April 2020. Accessible at: *http://delhihighcourt.nic.in/writereaddata/OrderSAN_PDF/URGENT/wpcurgent5202006042020.pdf*

The Delhi High Court, after analysing the RBI Circulars held that, *prima facie* it appeared that the RBI intended to maintain status quo as on 1st March 2020 with regard to the instalment payments which are to be made between 1st March 2020 and 31st May 2020 as well as the classification of accounts of the borrowers as on 1st March 2020. The Court reasoned by observing that if the RBI Circulars were intended to apply only to Standard Asset accounts, there would be no need for the RBI to even refer to classification of NPA in the said Circulars, and reference to SMA-1 and SMA-2 would have sufficed. In other words, an account which was otherwise a Standard Asset as on 29th February 2020, cannot become an NPA post 1st March 2020 unless it goes through the process of SMA-1 and SMA-2. As the account cannot be classified as SMA for instalments falling due post 1st March 2020, there is no question of stipulating a moratorium for classification as NPA.

With the aforesaid observation and reasoning, the Delhi High Court ordered *status quo ante* and restored the account classification as it stood on 1st March 2020. In our view, the Delhi High Court rightly observed that the RBI Circulars clearly provide for status quo on asset classification as it existed on 1st March 2020. Whilst the Delhi High Court may have arrived at correct interpretation, the maintainability of the petition itself is required to be examined, as no state instrumentality appears to have been made a party to the writ petition filed.

The issue of maintainability of the writ petition came up for consideration before the Hon'ble Bombay High Court in the matter of *Transcon Skycity Pvt. Ltd. & Ors. v. ICICI Bank and Ors.*[5], when the Court was seized with the question of whether the Moratorium Period is to be excluded from the computation of time period for classification of an account as NPA. However, the Bombay High Court, while passing interim orders under the extraordinary circumstances, is yet to pass any final observation and order on the issue of maintainability of such writ petitions, which is dealt in detail below.

2. ***Whether the time period for Asset Classification/down-gradation continue to run during the Moratorium Period:***

In the case of *Transcon Skycity Pvt. Ltd. & Ors. v. ICICI Bank and Ors.*(supra), the borrowers *viz.* Transcon Skycity Pvt Ltd. and Transcon Iconica Pvt Ltd. (**"Transcon"**) approached the Bombay High Court in similar facts as that of the *Anant Raj*'s case, however, the issue which was examined by the Court was whether the countdown for computation of asset classification be suspended during the Moratorium Period. Like in the *Anant Raj*'s case, in the present case Transcon availed credit facilities from ICICI Bank and had committed defaults in payment on 15th January 2020 and 15th February 2020 thereby exposing Transcon to be classified as NPA on 15th April and 15th May 2020 respectively. The Borrowers therefore approached the Court against ICICI Bank and RBI seeking safe harbour under the RBI Circulars along with an injunction against ICICI Bank from taking any coercive steps, including downgrading asset classification of Transcon.

[5] Writ Petition LD-VC No. 28 of2020. Accessible at: https://drive.google.com/file/d/1mLqXrpqr4bdDaV6jhqgp28i2TLzDNshE/view?usp=sharing

Transcon placed reliance on the judgement of Delhi High Court in *Anant Raj's* case and contended that from the reading of the said judgment, the duration of the lockdown period is required to be excluded from 90-day countdown, failing which, such moratorium granted by RBI would be rendered meaningless in a situation akin to that of Transcon. On the other hand, ICICI Bank had contended that the writ petition itself was not maintainable as it is a private bank and not a state instrumentality to be amenable to writ jurisdiction. It was also contended by ICICI Bank that at the ad-interim stage, the Court shall proceed cautiously so as to not open the floodgates to the borrowers during these extraordinary circumstances.

The Bombay High Court limiting itself to a *prima facie* enquiry, attempted to preserve the parties' status quo and ensure minimal prejudice to both sides in these unprecedented and exceptionally difficult times. In an attempt to fashion a workable order limited to the facts of this particular case ensuring that it sets no precedent in other cases, held that the period of the moratorium during which there is a lockdown will not be reckoned by ICICI Bank for the purposes of computation of the 90-day countdown for NPA declaration.

On the issue of maintainability of the petition itself, which was never challenged before the Delhi High Court, the Court observed that the challenge was to the directive or set of directives issued by an instrumentality of the State, *viz.* the RBI and what the Borrower seeks is an interpretation of those directives and circulars to bring them into accord with their avowed objective. It was therefore satisfied that, *prima facie*, the Petition was maintainable to grant ad-interim reliefs, although keeping the issue of maintainability open for contention, at a later date.

It was clarified by the Court that the period of moratorium shall not cease to exist, as on 31st May 2020, as currently advised by the RBI but would extend till complete lifting of the lockdown. Likewise, if the complete lifting of lockdown is lifted before 31st May 2020, the period of moratorium must be construed to end on such day.

3. *Whether the asset classification position be altered during the Moratorium Period on account of non-payment of installment due before 1st March 2020.*

A similar proposition as above, once again came for consideration before the Delhi High Court in the matter of *Shakuntla Education and Welfare Society v. Punjab and Sind Bank*[6], wherein the Petitioner, Shakuntla Education and Welfare Society (**"Society"**) had failed to pay a quarterly installment that became due on December 31, 2019 to the Punjab and Sind Bank (**"Bank"**). The Society was liable to make payments on or before March 31, 2019. Directions were sought to restrain the Bank from declaring its pending loan accounts, installment of which was payable by March 31, 2020, as NPA.

The Society argued that although the debt became due as on December 31, 2019, the same is payable anytime on or before March 31, 2020. However, owing to the nation-wide lockdown and increased financial burden due to such lockdown, it was necessary that a safe harbor be provided

[6] W.P. (C) No. 2959 of 2020. Accessible at: http://delhihighcourt.nic.in/dhcqrydisp_o.asp?pn=70481&yr=2020

to the Society and the asset downward classification be stayed. The Society placed reliance on the judgements by Delhi High Court in *Anant Raj's* case and that of Bombay High Court in *Transcon's* case. The Society stated that the payment would have been made by March 31, 2020 if the lockdown was not imposed and further undertook to make pending payment to the Bank within a week of the aforesaid directions of the Government of Uttar Pradesh are vacated.

The Bank, on the other hand, contended that the moratorium only applies to installments which shall become due and payable on or after March 1, 2020. Since, the debt due by the Society is prior to that, therefore, the Moratorium Period has no application on the accounts of the Society. It was also stated that RBI Circulars are silent on asset classification for the debts due and payable on or before March 1, 2020.

The Court, by its Order dated April 13, 2020, accepted that the applicability of RBI Circulars on the Society are questions which have to be determined only post completion of pleadings and after looking at the view by the RBI (which was impleaded as a party later). However, to limit itself to the interim relief, the Court whilst agreeing with the decision in *Anant Raj's case* held that since the Society did have time to make payment till March 31, 2020 and *prima facie* it appears that the intention of the RBI Circulars was to maintain *status quo* since March 1, 2020, the Bank cannot be allowed to alter the position in which the Society stood as on March 1, 2020. The Bank was, accordingly, restrained from taking any coercive action against the Society, till one week from the date on which the directions of the Government of Uttar Pradesh (restraining educational institutions from collecting fees) is vacated.

Interestingly, the RBI was not made a party to the present Writ Petition, however, upon an oral request by the Society, the RBI was added as Respondent party, therefore, the issue of maintainability of the present Writ Petition did not come up before the Delhi High Court.

4. ***Asset classification standstill announced by the RBI Governor***

More recently, the RBI Governor, *vide* his statement dated April 17, 2020[7] (**"Governor's Statement"**), recognized the challenges faced by the borrowers to even honour their installment payment commitments which fell due on or before February 29, 2020. Accordingly, the Governor has announced that for all such accounts for which the lending institutions have allowed a moratorium or deferment in view of the RBI Circulars, and if such accounts which were standard as on March 1, 2020, the lending institutions are allowed to exclude the Moratorium Period from the 90-days NPA norm. Therefore, in the case of such accounts where the borrower has failed to honour its commitment which accrued on or before February 29, 2020, the accounts shall be allowed an asset classification standstill, if the following conditions are satisfied, which are:

- for which the lending institutions have allowed a moratorium or deferment in view of the RBI Circulars; and
- if such accounts which were standard as on March 1, 2020.

[7] https://www.rbi.org.in/Scripts/bs_viewcontent.aspx?Id=3853

The RBI Governor has further granted Non-Banking Financial Company (**"NBFC"**) flexibility under the prescribed accounting standards, that are required to be mandatorily complied by the NBFC and has directed the NBFCs to be guided by the accounting standards (**"AS"**) guidelines as may be duly approved by their board as per the advisories issued by the Institute of Chartered Accountants of India (**"ICAI"**).

The RBI Governor, being conscious of the fact of risk build up in the balance sheets of the lending institutions on account of delay in recoveries and possible slippage, has directed all the Banks to maintain higher provision of ten percent on all such accounts which are offered a standstill.

5. ***Whether the Moratorium Period restrains enforcement of security interest:***

Whilst the possibility to invoke/enforce security interest by the lenders may be next to impossible in the present extraordinary circumstances, the RBI Circulars do not provide for any such restriction. Unlike the moratorium under Insolvency and Bankruptcy Code, 2016 which squarely restricts the lenders from enforcing security interest, the safe harbour provided by RBI in view of the pandemic, does not place such express restriction. However, Courts have granted equitable reliefs of injunction to protect the true market value of secures assets such as shares, which have plummeted due to the COVID-19 pandemic.

Interestingly, the Supreme Court[8] has recently on April 17, 2020, upheld an *ad-interim* order of injunction granted by the Bombay High Court against invocation of pledge against shares of Future Retail Ltd., owing to plummeting of share prices because of the COVID-19 pandemic. The Bombay High Court had, in the case of *Rural Fairprice Wholesale Limited & Anr. v. IDBI Trusteeship Services Limited & Ors.*[9], observed that while the share prices of pledged shares were around Rs. 350/- at the time of execution of the Debenture Trust Deeds, the same fell to nearly Rs. 100/- at the time of issuance of notice of sale. Considering these extraordinary circumstances, an injunction was granted to protect the market value of pledged shares, although a debt of nearly Rs. 610 crores was owed to UBS Bank on whose instance pledge was sought to be invoked.

In contrast to this, the legality of invocation of pledge after the issuance of the RBI Circulars came up for consideration in another case before the Bombay High Court, which was in fact referred by the Court while deciding the *Transcon's* case. The Bombay High Court in the recent case of *Ideal Toll & Infrastructure Pvt. Ltd., Mumbai and Anr. v. ICICI Home Finance Co. Ltd., Mumbai & Anr.*[10] decided on 7th April 2020, examined the issue of invocation of pledge during the Moratorium Period, for a default which occurred prior to 1st March 2020. In that case, the default had occurred in January 2020 and whereas the lender, i.e., ICICI Home Finance Co. Ltd. sold pledged shared on 31st March 2020. When it was contended that the safe harbour under the said RBI Circulars clearly applies to the case, the High Court disagreed and held that while the account cannot be downgraded as NPA after 1st March 2020, the moratorium cannot come to the rescue

[8] *UBS AG London Branch v. Rural Enterprise Wholesale Ltd. & Ors.*, SLP (Diary) No. 10943 of 2020
[9] Interim Application No. 1 of 2020 in Commercial Suit No. (L) 307 OF 2020, order dated March 30, 2020
[10] Commercial Suit No. LD-VC-7 of 20-20, along with IA No.LD-VC-7(IA) of 2020. Accessible at: https://drive.google.com/file/d/1BCb-fPxKgoysj-FE-4Cg8k1NajDvAxzD/view?usp=sharing

to restrain sale of pledged shared for a default which occurred much prior to 1st March 2020. It is pertinent to note that the sale of pledged shares had already taken place before the borrower had approached the Court seeking reliefs. In another companion matter of *Mrs. Anuya Jayant Mhaiskar v. ICICI Home Finance Co. Ltd. & Anr.*[11], however, where the default occurred on 25th March 2020, the Court granted an injunction on invocation of pledge, subject to payment of amounts falling due after 1st March 2020, as undertaken to be paid by the Borrower before the Court.

Therefore, the Courts are dynamically approaching the issue of financial distress in the times of a pandemic by granting equitable reliefs after assessing the situation. In the long run, this would protect the actual market value of secured assets, which may have come into distress because of such extraordinary circumstances.

6. Charging of interest during moratorium period due to lockdown. Unjust enrichment in times of Pandemic? Plea filed before the Hon'ble Supreme Court.

Rather interestingly, a Petition was filed before the Apex Court with a plea that the State cannot enrich itself nor can it permit others to enrich themselves by charging continued interest during the lockdown period, in the times of a global pandemic.

As discussed above, while the RBI deferred the payment obligations, the RBI clearly stated in the said RBI Circulars that the interest shall continue to accrue even during the Moratorium Period. This accumulated accrued interest shall be recovered immediately by the lending institutions after the completion of the lockdown period, presently, till 31st May 2020 (end of Moratorium), subject to commensurate extension of the tenor of the loans.

It was contended in this Petition that, in wake of such health emergency, the state must act as a 'welfare state' and waive off all interest that may accrue during the lockdown period. The Petition is still sub-judice before the Apex Court. In our view, however, this could in fact be counter-productive and have a negative impact on the economy, as it can cause drastic effects on the liquidity of the lending institutions. Moreover, it is entirely in the wisdom of the Executive and the Legislative bodies to decide such policy decision and it is unlikely that the Supreme Court would adjudicate/express its views on such a plea.

7. Application of RBI Circular to a Non-Banking Financial Company ("NBFC")? RBI to clarify.

Indiabulls Commercial Credit Limited (**"Indiabulls"**), a NBFC approached Delhi High Court seeking directions for SIDBI to comply with the directions of the RBI Circulars. Indiabulls contended that despite the moratorium granted by the RBI, the SIDBI, on April 3, 2020 raised a demand towards payment of installment due and payable in the month of April 2020.

SIDBI contended that such demand as made on April 3, 2020 is being done as a regular process since it is unclear that such moratorium as granted by the RBI Circulars are applicable when the

[11] Commercial Suit No. LD-VC-8 of 20-20, along with IA No.LD-VC-8(IA) of 2020. Accessible at: https://drive.google.com/file/d/18pOc8BflSOLF0w8O1gO-dwfnd_gAmO5B/view?usp=sharing

borrower itself is NBFC. SIDBI informed that the necessary clarification in this regard is already being sought from the RBI.

However, since the clarification was pending and the installment due and payable in the month of April 2020 is already serviced, the Petition was dismissed as infructuous by Delhi High Court.[12]

On perusal of the RBI Circulars, it is clear that the attempt of the RBI is to enable the borrowers to tide over the economic fallout from COVID-19. The term 'borrowers' as per the Reserve Bank of India Act, 1934 "*is any person to whom any credit limit has been sanctioned by any banking company, whether availed of or not.*"

Interestingly, the RBI Act, unlike the IBC, does not exclude the NBFC from the definition of Debtor. Therefore, in our view, Indiabulls or any company (including NBFCs) shall, on plain reading of the definition of 'borrower' above, may be construed to be a Borrower for the purpose of the RBI Circulars. The RBI Circulars, in no-way explicitly restrict or limit this definition. Therefore, presently it does not seem that NBFC is beyond the ambit of the safe harbour granted by the RBI. However, the clarification from RBI is still awaited.

III. INDUSLAW VIEW

We are of the view that the Courts have attempted to decipher the true intention of the RBI in releasing the aforesaid Circulars and applied to the practical scenarios which unfolded before them. A liberal reading of the RBI Circulars does point out that the RBI intended for the status quo as on 1st March 2020 to be maintained *qua* classification of account and payment obligations of the borrowers. The objective behind issuance of the said RBI Circulars is certainly to provide a safe breathing space for the borrowers to recoup and defray the financial distress caused by the COVID-19 pandemic.

While the aforesaid orders have been passed at ad-interim/interim stage taking into account only the *prima facie* case, the Courts, by grant of injunctions, did leave a room for unintended consequences which may arise in a similarly placed situations. Although the RBI and the Judiciary have given an umbrella protection, the concerning factor is the misuse of this protection by a regular/ordinary defaulter (one who would have defaulted even without the lockdown being in place) in contrast to a genuine defaulter who may not be in default but for the pandemic/lockdown. Thus, extending this safety net to an ordinary/regular defaulter, may be uncalled for and be counter-productive to the already crippling lending sector. However, the umbrella protection could be the only way to deal looking at the current pandemic situation and the economic distress arising out of such unprecedented times.

There are other issues such as whether the moratorium provided in the aforesaid Circulars would also apply to declaration of borrowers as 'wilful defaulter' which is governed by Master Circular on Wilful Defaulters dated 1st July 2014 (as amended).[13] We can expect more judicial precedents

[12] Writ Petition (C) No. 2955 of 2020. Accessible at: https://drive.google.com/file/d/16p9D_TsAdHcBtNvExlA4EyGWnvVhQWyJ/view?usp=sharing
[13] https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=9044&Mode=0#21

covering wide array of issues concerning the financial and regulatory packages being implemented in view of COVID-19 pandemic, in the coming days.

However, this may have a highly beneficial impact on small and medium scale industries and provide them a relief from challenges thrown by not just the lockdown but also from already distressed economy. Such measures coupled with changes in IBC regime[14], such as, increasing the threshold limit of default to Rs. 1 Crore from existing threshold of Rs. 1 Lakh, and a possible suspension of Sections 7, 9 and 10 of the IBC (which is under consideration) may just give the necessary breather to the India Inc.

Authors: Amit Jajoo| Sushmita Gandhi | Bhargav Kosuru | Darpan Bhatia

Practice Areas: Dispute Resolution

Date: 14th April 2020 (updated on 19th April 2020)

DISCLAIMER

[14] As announced by Minister of Finance and Corporate Affairs on March 24, 2020.