

Banking and Finance – Legal Milestones Financial Year 2020-21 and a Look Ahead

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1 The Year that Was

In the first half of 2020, the Indian economy witnessed an unprecedented slowdown owing to the global impact of the COVID-19 pandemic and enforcement of one of the world's strictest lockdowns. With a deep contraction in its economic activity, India moved into a technical recession for the first time in its history and the Government of India (GoI) undertook a series of measures to alleviate the strain on stakeholders and provide temporary flexibility and relief.

Some of the notable developments included amendments to the Insolvency and Bankruptcy Code, 2016 (IBC) to protect corporate entities defaulting on payment obligations during the COVID-19 pandemic from being dragged into insolvency process. On its part, the Reserve Bank of India (RBI) issued circulars permitting banks, NBFCs and other lending institutions to grant a loan moratorium for payments on term loans. The period of moratorium was initially three months and, thereafter, extended by a period of another three months i.e., from 1 March 2020 to 31 August 2020.

A majority of the developments in the banking and finance sector in 2020 were centered around relief to stakeholders from the economic stress caused by the COVID-19 pandemic and the consequent disruption of the global economy. This update summarises some of the key developments and also highlights our expectations for the year ahead.

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The year also marked the resolution of distress under the IBC for the first-ever Non-banking Finance Company (NBFC), Dewan Housing Finance Limited (DHFL). In 2019, DHFL was referred by the RBI (using its special powers under the IBC), to the National Company Law Tribunal (NCLT) for initiation of the corporate insolvency resolution process. The year 2020 saw this process unfold with a host of bidders, with the final round of the bidding being submitted in December 2020 and the committee of creditors of DHFL evaluating the bids received. The process was finally concluded in January 2021, with the committee of creditors finally approving the resolution plan submitted by Piramal Capital and Housing Finance Limited.

2 Major Developments in the Financial Year 2020-2021

2.1 Supreme Court directs waiver of interest-on-interest during the loan moratorium period declared by the RBI on term loans

With the onset of the pandemic, the RBI issued circulars permitting banks, NBFCs and other lending institutions to grant a moratorium for payments from term loan borrowers due to COVID-19 (Loan Moratorium Circulars). The period of moratorium was initially three months and, thereafter, extended by a period of another three months, i.e., from 1 March 2020 to 31 August 2020. However, during the moratorium period, interest-on-interest would accrue.

Aggrieved by the Loan Moratorium Circulars, several stakeholders filed writ petitions seeking directions from the Supreme Court on whether the loan moratorium period could be extended further and if a complete waiver of interest and interest-on-interest during the loan moratorium period could be granted. The Supreme Court also considered whether the government can be directed to grant additional sector-wise relief packages. Interestingly, the government had announced an ex-gratia scheme waiving interest-on-interest on loan moratorium for borrowers who have borrowed up to INR two crores / up to INR twenty million.

The Supreme Court reasoned that interest-on-interest in term loans can be charged only in cases of wilful default and not in cases of non-payment during moratorium. Based on this, the Supreme Court directed that interest-on-interest on all loans covered by the Loan Moratorium Circulars should be waived. It further directed all lending institutions to refund or adjust in subsequent installments, any interest-on-interest collected for the moratorium period. Separately, the Central government's waiver of interest-on-interest on loans up to INR two crores / up to INR twenty million was held to be arbitrary. Lastly, the Supreme Court rejected pleas for extension of the moratorium period, total waiver of interest for the moratorium period and sector-wise relief, observing that these are matters of government policy.

The judgement provided clarity on and substantial relief to term loan borrowers. More importantly, it also balanced the interests of the banking industry that feared a collapse if complete interest amounts were directed to be waived.

2.2 Resolution Framework for COVID-19 related Stress

Concerned that the financial stress caused by the COVID-19 pandemic would affect the long-term viability of several borrowers that otherwise had a good track record, the RBI on 6 August 2020 issued the 'Resolution Framework for COVID-19 Related Stress' (Resolution Framework).

The Resolution Framework provides a window under the existing RBI (Prudential Framework for Resolution of Stressed Assets) Directions, 2019 dated 7 June 2019 enabling lending institutions (Lenders) to implement a resolution plan for personal loans and corporate exposures, without requiring a change in ownership, while

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continuing to classify such exposures as standard assets. It also broadens the ambit of Lenders to include all NBFCs and housing finance companies. The measures under the Resolution Framework reflect the RBI's intent to provide longer-term relief to affected borrowers.

Please [click here](#) for a more detailed analysis.

2.3 Liquidity measures for the NBFC sector

In March 2020, the RBI had introduced the Targeted Long -Term Repo Operations scheme for NBFCs, but its benefits reached only the big players. Therefore, to further ease financial stress, increase liquidity in the market and facilitate funds flow to small and mid-sized corporates, including NBFCs and micro finance institutions (MFIs), the RBI in April 2020 introduced a second set of targeted long-term repo operations for an initial aggregate amount of INR 50,000 Crore (TLTRO 2.0 Scheme).

Under the TLTRO 2.0, funds availed by the banks were required to be invested in investment-grade bonds, commercial paper, and non-convertible debentures of NBFCs, with at least 50% of the total amount availed going to small and mid-sized NBFCs and MFIs.

However, under the TLTRO 2.0 Scheme, smaller NBFCs and MFIs received limited relief. While some interest was shown by State-run banks, private banks remained largely silent due to the liquidity crunch and larger chances of delinquencies in small and mid-sized NBFCs and MFIs.

2.4 Amendments to the IBC

With the advance of COVID-19, several corporates and businesses were hit hard by the pandemic and consequent lockdowns, leading to severe losses. This caused a domino effect where many corporates found themselves reeling under mounting debts with the threat of insolvency looming large over them. To provide some relief to corporates and protect them from facing insolvency proceedings and eventual closure, several amendments were introduced to the IBC through 2020. The amendments included the following:

- Increase in threshold

By a notification of the Ministry of Corporate Affairs, the pecuniary threshold for default in payment of debt pursuant to which a creditor or a corporate applicant could initiate corporate insolvency resolution process (CIRP) was increased to INR 1 crore from INR 1 lakh under the IBC.

- Moratorium on CIRP initiation

A moratorium was imposed on operational, financial creditors and corporate applicants from initiating CIRP for any default arising on or after 25 March 2020. Initially, the moratorium was only for the first six months till 24 September 2020, however, it was extended thereafter and is presently operational till 31 March 2021. For any defaults during the moratorium period, a CIRP can never be initiated.

Please [click here](#) for a more detailed analysis.

- Extensions of timelines for actions during CIRP and liquidation

The IBC regulations were amended to provide extensions for various actions under CIRP and liquidation process during the lockdown imposed by the Central government from 25 March 2020 to 29 May 2020 and further extended by some of the State governments.

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2.5 Applicability of SARFAESI Act to Co-operative Banks

A constitutional bench of the Supreme Court, in the judgement of *Pandurang Ganpati Chaugule vs. Vishwasrao Patil Murgud Sahakari Bank Limited* (Pandurang case), held that cooperative banks may seek remedies available under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) for recovery of their dues.

In 2003, the Central government had issued a notification making the SARFAESI Act applicable to multi-state co-operative banks. Subsequently, by way of Section 2 of the Enforcement of Security Interest and Recovery of Debt Laws (Amendment) Act, 2012, the definition of 'bank' under the SARFAESI Act was amended to include multi-state co-operative banks. The addition of multi-state co-operative bank to the definition of banks was heavily disputed on the ground that co-operative banks fall under Entry 32 of List II (State List) of the Seventh Schedule of the Constitution of India and therefore the Parliament does not have the jurisdiction under Entry 45 of List I (Union List) of Seventh Schedule of the Constitution of India to legislate on co-operative banks. This view was supported by a three-judge bench of the Supreme Court in *Greater Bombay Co-op Bank Limited vs. United Yarn Textiles Private Limited* (Greater Bombay Judgement), while holding that co-operative banks cannot approach debt recovery tribunals under the Recovery of Debts and Bankruptcy Act, 1993 for recovery of their dues.

In 2020, in the Pandurang case, the Supreme Court had an opportunity to consider this issue while deciding on the applicability of the SARFAESI Act to co-operative banks. Overruling the Greater Bombay Judgement, the Supreme Court held that co-operative banks are covered under the framework of the SARFAESI Act. The Court observed that the Greater Bombay Judgement required 'reconsideration and clarification'. It held that while the 'regulation' and 'winding up' of co-operative societies are covered under Entry 32 of List II, banking activities of such co-operative societies fall under Entry 45 of List I. The Court also observed that co-operative banks are registered and regulated under the Banking Regulation Act, 1949 which is a legislation enacted under Entry 45 of List I itself.

The Supreme Court's judgement in the Pandurang case has brought much-awaited clarity by finally settling the issue on the applicability of the SARFAESI Act to co-operative banks.

3 Looking Ahead

With the pandemic resulting in a deep contraction of the Indian economy, the year 2020 saw the government taking several steps to provide relief to the banking sector. While these reliefs may have temporarily addressed some of the problems, it will be interesting to see how the government decides to roll these back with the gradual stabilisation of the economy. The RBI recently reported that the health of banks may be dented and the extent of the gross non-performing assets of the banks will only be reflected once normalcy of banking operations is resumed.

Due to stringent lockdowns, consumers in the banking sector were heavily reliant on digital platforms in 2020. We expect this higher dependence on information technology and digital banking to continue in 2021, accelerating further growth in the fintech industry.

While India's GDP had shrunk in the first two quarters of the Financial Year 2020-21 amid the COVID-19 pandemic and lockdowns, marking a technical recession, the third quarter of the fiscal year clocked a rise in the GDP. Global rating agencies have predicted that the recent vaccination drive will allow many sectors like hospitality, aviation, and tourism to gradually open up and recover. The International Monetary Fund in its

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World Economic Outlook report for January has projected an 11.5% growth rate for India's economy in 2021. Economists believe that the correct economic policies and proper implementation can lead to a strong resurgence of the Indian economy.

The second wave of the COVID-19 pandemic has not yet destabilised the economy's recovery but localised lockdowns, may impact growth in the April-June 2021 financial quarter, with current data indicating significant signs of incipient stress.

For a round -up of some of the key legal developments in the financial year 2020-2021 across other practices and a brief insight on what to expect in the year ahead, please read our practice-wise updates, which can be accessed [here](#).

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