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Market Watch

View: If interest on loans is waived, banks or depositors can't be told to pick up the bill

BY TOI CONTRIBUTOR | JUN 11, 2020, 10.41 AM IST

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By **Duvvuri Subbarao**

During the lockdown, firms and businesses had no revenue stream to service their debts to banks. To soften the pressure on them, the RBI, in exercise of its regulatory power, permitted banks to defer repayments on term loans till the end of August 2020. This was not a mandate; it was just regulatory forbearance. The RBI, in fact, left the final decision to banks. It however asked banks to charge interest on the outstanding portion of the loans during the moratorium period.

A borrower approached [the Supreme Court](#) praying that the court should order RBI to ask banks to waive the interest during the moratorium period as they had no income during the lockdown. My endeavour here is to weigh in on the issue drawing from my experience as a past governor of RBI.

At the heart of this case is a simple question: Who bears the cost? Banks are financial intermediaries between savers and borrowers. They take deposits from savers and lend out the money to borrowers at a slightly higher interest rate. From the interest they collect, they keep a margin to cover their costs and some profit, and use the rest to pay interest on deposits. If banks are asked to waive the interest during the moratorium period, can they absorb it all in their profits? At Rs 2.1 trillion, the estimated waiver amount is far too large for banks to absorb in their profits. They will be forced to pass on most, if not all, of the burden to savers.

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people – pensioners, for example – to whom the interest on their deposits is a significant source of income. Besides, they too were impacted by the lockdown. Is it they who should be forced to bear the burden of supporting another affected group? What is worse, they are not even represented in the case before the SC.

There are other important issues in this case. Banks are commercial institutions and bankers are expected to make decisions on commercial considerations. Magnanimity is not, and cannot be, a factor in a commercial decision. For sure, banks do reschedule loans and fund interest. But that is done in specific cases and on commercial considerations, not out of sympathy. Besides, banks are accountable to their shareholders for the conduct of their business. How do they justify privileging one set of stakeholders over another?

There are similar issues from the RBI's perspective. Note that what the RBI asked banks in its regulatory order is only to defer repayment of instalments till beyond the lockdown, not to waive it. That entailed no loss of income to banks. What is being sought now is total waiver of interest. It is not clear RBI's regulatory authority extends to issuing a fiat to banks to forego income.



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authority, but will in fact run the risk of acting in contravention of its regulatory mandate. The Banking Regulation Act, from which the RBI derives its regulatory authority, enjoins it “to prevent the affairs of any banking company being conducted in a manner detrimental to the interest of its depositors or in a manner prejudicial to the banking company”.

Now consider what might happen if the RBI directed waiver of interest. Small savers to whom the rate of interest is a very material consideration will pull their monies out of banks and take them to saving options in the informal market in search of higher returns, exposing themselves to the risk of total loss. The [Saradha](#) scam which blew up spectacularly in our face during my tenure at the RBI is a high profile example, but it was by no means the only one.

There were several episodes of gullible, low income households being lured by fly-by-night operators with attractive returns, only for everyone of them to end in tears. If something like that were to happen again, won't the RBI be in the dock? Will it not be charged of acting against the interest of depositors which it is enjoined by law to protect?

There is another dimension to this. If small savers pull their money out of banks, won't the erosion of this low cost source of funds make banks more vulnerable and threaten their viability? Won't the RBI then be charged of acting in a manner prejudicial to financial stability which it is enjoined to protect?

Importantly, waiving of interest is an issue in distributive policy, beyond the purview of banks, and clearly in the domain of the government. Note that when the government decided to waive farm loans, it bore the burden by itself, did not pass it on to banks. Similarly in this case too, if some concession has to be accorded to borrowers, the cost has to be borne by the government.

Whether the government should take on this burden is a complex political economy issue. Government resources come from taxes and borrowing – that is from current and future taxpayers. Should a group of today's stakeholders be bailed out at the cost of current and future taxpayers? The safeguard is that whichever way the government decides, it will be held to account in the [Parliament](#).

(The writer is a former governor of [the Reserve Bank of India](#))

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