Conference on Bank Branch Statutory Audit

Prudential Norms on Income Recognition, Asset Classification and Provisioning

Organised & Hosted by
Bengaluru branch of SIRC of ICAI

CA Dhananjay J. Gokhale

1

1

Coverage

- Objective
- Identification of Account as NPA
- Exceptions / Clarifications
- Relief to MSME borrowers
- Covid 19 related Circulars
- Projects under Implementation
- Asset Classification and Provisioning
- Guidelines on Restructuring of Advances
- Prudential Framework for Resolution of Stressed Assets (RBI Circular dated 07.Jun.2019)
- Points to ponder

CA Dhananjay J. Gokhale 2

2

RBI Circulars Reference

- Master Circular dated October 01, 2021 on IRAC Norms & clarificatory circulars dated November 12, 2021 and February 15, 2022
- Master Direction – RBI (Relief Measures by Banks in Areas affected by natural calamities) Directions, 2018 dated October 17, 2018
- Prudential Framework for Resolution of Stressed Asset –Circular dated June 07, 2019
- Relief for MSME Borrowers: 07.Feb.18, 08.Jun.18, 01.Jan.19, 11.Feb.20, 06.Aug.20 & 05.May.2021

Covid19 related RBI Circulars

Date	Circular
27.Mar.2020	Covid-19 Regulatory Package
17.Apr.2020	Covid-19 Regulatory Package – Asset Classification & Provisioning
17.Apr.2020	Covid-19 Regulatory Package – Review of Resolution Timelines under Prudential Framework on Resolution of Stressed Assets
23.May,2020	Covid-19 Regulatory Package
23.May.2020	Covid-19 Regulatory Package – Review of Resolution Timelines under Prudential Framework on Resolution of Stressed Assets
06.Aug.2020	Resolution Framework for Covid-19 related stress
17.Sep.2020	Resolution Framework for Covid-19 related stress – Financial Parameters
13.Oct.2020	FAQs

Covid19 related RBI Circulars

Date	Circular
05.May.2021	Resolution Framework 2.0 for Covid-19 related stress of Individuals and Small Businesses
05.May.2021	Resolution Framework 2.0 for Covid-19 related stress of MSMEs
04.Jun.2021	Resolution Framework 2.0 for Covid-19 related stress of Individuals and Small Businesses – Revision in threshold for aggregate exposure from Rs. 25 Cr to Rs. 50 Cr
04.Jun.2021	Resolution Framework 2.0 for Covid-19 related stress of MSMEs – Revision in threshold for aggregate exposure from Rs. 25 Cr to Rs. 50 Cr
07.Jul.2021	New definition of MSME – Addition of Retail and Wholesale Trade
06.Aug.2021	Resolution Framework for Covid19 relate stress – Financial Parameters – Revised timelines for compliance

Objective

- The classification of assets of banks has to be done on the basis of objective criteria, which would ensure a uniform and consistent application of the norms.
- The provisioning should be made on the basis of the classification of assets based on the period for which the asset has remained non-performing and the availability of security and the realisable value thereof.

Asset Types

Standard Assets Performing Assets (PA)	Non-Performing Assets (NPAs)
Not Non-Performing	Ceases to generate income
Do not carry risk more than normal banking risk	Higher risk than normal banking risk
Exempted categories to retain status as PA	NPA as per various criteria defined

Criteria for NPA

Loans or Advance	▪ Interest and/or installment remains overdue for a period of more than 90 days in respect of a term loan. ▪ *Concession of para 2.1.3 – an account is classified as NPA only if interest due and charged during any quarter is not serviced fully within 90 days from the end of the quarter : Removed vide circular dated 12.Nov.2021 w.e.f. 31.Mar.2022*
Exceptions	▪ Loans with moratorium for payment of interest ▪ Housing Loan or similar advance to staff

Criteria for NPA

Bills Purchased and discounted	Bill remains overdue for a Discounted period of more than 90 days.
Agricultural Advances	Interest or installment remains overdue for two crop seasons for short duration crop, one crop season for long duration crop.
	**Definitions* *crop season – 'period up to harvesting of crops raised' as determined by SLBC* *Long duration crop – Crops wherein crop season is more than 12 months*

9

Criteria for NPA

Agricultural Advances	Banks have discretion of rescheduling the agricultural advances in case of natural calamities, which impair repaying capacity
Reference Circulars of Reserve Bank of India	FIDD.CO.Plan.BC.54/04.09.01/ 2014-15 dated April 23, 2015 FIDD.No.FSD.BC.52/ 05.10.001/2014-15 dated March 25, 2015 Master Direction dated July 01, 2016, July 03, 2017, October 17, 2018
FIDD.CO.Plan.BC.54/04.09.01/ 2014-15 dated April 23, 2015	Defines 'Farm Credit'

10

Criteria for NPA

FIDD.No.FSD.BC.52/ 05.10.001/2014-15 dated March 25, 2015 Guidelines for relief measures by banks in areas affected by natural calamity	
Natural Calamity	12 types of natural calamities are defined
Institutional framework	The Banks to have blueprint of action plan with adequate delegation of powers with discretionary powers granted to Divisional / Zonal Managers, to ensure assistance provided without loss of time.

Criteria for NPA

Guidelines for relief measures by banks in areas affected by natural calamity	
Meeting of SLBC / District Consultative Committee	*Immediate conveying of meeting by:* If calamity covers entire state …. SLBC If small part of the state …. District Consultative Committee
Declaration of natural calamity	Domain of Sovereign (Central / State Government) <u>Assessed Crop loss should be 33% or more</u>
Restructuring / rescheduling of existing loans	Agricultural Loans - Short Term - Long Term Other Loans

Criteria for NPA

Guidelines for relief measures by banks in areas affected by natural calamity

Short Term Agricultural Loans

Eligibility: Loan should not be overdue at the time of occurrence of natural calamity

Crop Loss	*Maximum repayment period extension* *(incl. of moratorium period)*
33% to 50%	*2 Years*
50% or more	*5 Years*

- Moratorium period – at least 1 year
- Principal and interest due in the year of natural calamity to be converted into Term Loan
- Additional collateral security not to be insisted upon

Criteria for NPA

Guidelines for relief measures by banks in areas affected by natural calamity

Long Term Agricultural Loans

Only Crop for that year is damaged and not the productive assets

- Reschedule installment during the year of natural calamity and extension of loan period by one year
- Willful defaulted installments not eligible for rescheduling
- Payment of interest may be postponed

Productive Assets are damaged (partially / totally)

Repayment period can be restructured provided generally it shouldn't exceed 5 years

Criteria for NPA

Guidelines for relief measures by banks in areas affected by natural calamity	
Asset Classification	- Restructured portion to be considered as current dues - Un-restructured portion to be governed by original terms and conditions - Additional finance to be treated as 'Standard Asset' - Second restructuring would not considered as 'repeated restructuring'
Insurance Proceeds	To be adjusted against restructured loans wherein fresh loans are granted

15

Criteria for NPA

Derivative Transaction	Overdue receivables representing positive mark to market value of a derivative contract remaining unpaid for a period of 90 days from specified due date.
Liquidity facility	Remains outstanding for more than 90 days in respect of Securitisation transaction.
Credit Card dues	The minimum amount payable is not paid within 90 days from the next statement date. *The reporting to Credit Information Companies (CICs) & levying of penal charges only after 3 days from due date.*

16

Criteria for NPA

Cash Credit Accounts	If the account is 'out of order'

Conditions for out of order status

- Outstanding Balance remains continuously in excess of sanctioned limit / drawing power for more than 90 days
- No credit continuously for 90 days as on the date of Balance Sheet (for 90 days as on EoD w.e.f. 12.Nov.21)
- Credits in the account are not sufficient to cover interest debited during the same period

Criteria for NPA

What is 'Overdue'?

If an amount due to bank under any credit facility is not paid on the due date fixed by the bank.

IRAC Master Circular dated October 01, 2021

Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances
A] Para 4.2.2: Appropriate internal systems for proper and timely identification of NPAs (Ref. Circular dated 14.Sep.2020 on automation of IRAC and provisioning process) B] Para 4.2.19.3: Credit card charges like penal charges, reporting to Credit Information Companies (CICs) only if credit card account remains 'past due' for more than three days

IRAC Master Circular dated October 01, 2021

Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances
C] Para 5.6.2.3: Utilisation of floating provision held as on 31.Dec.2020 permitted upto 31.Mar.2022 D] Para 6.2.2: Technical write-offs: *Banks to extinguish all available means of recovery before writing off any account full or partially;* *Need to disclose in FS.* E] Para 7: NPA Management – Requirement of Effective mechanism & Granular Data

IRAC Master Circular dated October 01, 2021

Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances
F] Para 21.6 – Unrealised income represented by FITL: Corresponding provision as 'Sundry Liabilities Account (Interest Capitalisation) G] Para 30 – Bank Loans for financing Promotors' Contribution: Permitted only to extend finance to 'specialized' entities (which are formed for taking over and turning around troubled entities)

IRAC Circular dated November 12, 2021

Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances - Clarifications
A] Specification of due dates / Repayment date B] Classification of SMA and NPA *Accounts to be flagged as a part of day-end process* C] Definition of 'out of order' *Changed criteria from 'quarter-end' to '(moving) 90 days'* D] NPA classification in case of interest payments *Para 2.1.3 concession removed and usual 90 days norms to apply*

IRAC Circular dated November 12, 2021

Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances - Clarifications

E] Upgradation of accounts classified as NPA
Only when 'entire arrears on interest and principal' are paid by borrower.
Clarity about 'partial recoveries' and 'subsequent recoveries'

F] Income recognition policy for loans with moratorium on payment of interest
Recognition of interest when moratorium of repayment of interest is granted
Sanctioned interest capitalization thus wont affect reversal of interest after NPA as its nature is considered as capital portion

IRAC Circular dated February 15, 2022

Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances - Clarifications

A] Applicability of 'out of order' to all loan products offered as Overdraft including those not meant for business

B] Concept of 'previous 90 days' for determination of 'out of order' status to include the day on which EoD process is run

C] Loan can be upgraded only when entire arrears pertaining to all credit facilities are repaid

Criteria for NPA

Accounts with Temporary Deficiencies
Outstanding Balance in account based on the drawing power calculated from stock statements older than 3 months would be deemed as irregular & if such irregular drawing are permitted for a period of 90 days, account needs to be classified as NPA *Note: The leverage is applicable only for large borrowers*
Non-renewal/ Non-regularisation of regular / adhoc limit within 180 days from the due date

Criteria for NPA

Exceptions / Clarifications
▪ Advances against term deposits, NSCs, IVPs, KVPs and Life Insurance Policies need not be treated as NPAs, till security cover is sufficient to cover outstanding balance. ▪ Income to be recognised subject to availability of margin
Advance against Gold Ornaments / Government Securities not exempt
Central Government guaranteed advance to be classified as NPA only if Government repudiates the guarantee when invoked.

Criteria for NPA

Exceptions / Clarifications
Classification Qua Borrower All facilities granted to a borrower shall be treated as NPA & not only that facility which has become irregular
Exception (i) Credit facility to Primary Agricultural Credit Society (PACS) and Farmers Service Societies (FSS) under on lending arrangement; (ii) Bill Discounted against accepted LC

Criteria for NPA

Exceptions / Clarifications
Consortium Advances ▪ Member banks shall classify the accounts according to their own record of recovery. ▪ Bank needs to arrange to get their share of recovery or obtain an express consent from the Lead Bank otherwise the account in such deprived banks might be treated as NPA for non-servicing.

Criteria for NPA

Exceptions / Clarifications

Straightaway Classification (Potential threat of recovery)

- Erosion in Value ….. Where realisable value of security is less than 50% of the value assessed (*by bank or value accepted in last RBI Inspection)*, account to be straightaway classified as **Doubtful Asset**..
- Where realisable value (*as assessed by Bank / Valuator / RBI Inspector*) of security is less than 10% of outstanding balance, account to be straightaway classified as **Loss Asset**.

29

Criteria for NPA

Exceptions / Clarifications

Straightaway Classification (Potential threat of recovery)

- Fraud …..
  - 100% to be provided irrespective of security spread over 4 quarters commencing from the quarter in which fraud has been detected, provided the unprovided provision is debited to 'Other Reserves'
  - If not reported to RBI within timeframe, 100% to be provided instantly

30

Criteria for NPA

Exceptions / Clarifications	
Solitary or few credit entries recorded before Balance Sheet to regularise the account Whether the account is having inherent weakness?	
Yes	No
Mark the account as NPA	The bank to evidence the auditors about manner of regularisation of account

31

Criteria for NPA

Mandatory Valuation of Securities
Applicable only if balance in NPA is Rs. 5 crores & above ▪ Annual Stock Audit by external agencies ▪ Immovable Properties – Valuation to be carried out once in three years by approve valuer

32

Criteria for NPA

Vital aspects of Asset Classification / Upgradation

- Automation of IRAC and provisioning process in banks (RBI Circular dated 14.Sep.2020) w.e.f. 30.Jun.2021
- Upgradation of NPAs – Criterias
- Upgradation of NPAs
  - Partial Recoveries at cust-id level
  - Subsequent recoveries (after date of Balance Sheet)

Relief for MSME Borrowers

Date of Circular	Details of Circular	PA cut-off date
07.Feb.2018	One time restructuring of MSME Advances	31.Aug.2017
06.Jun.2018	Encouraged formalisation of MSME Sector	
01.Jan.2019	Scheme extended (31.Mar.2020)	01.Jan.2019
11.Feb.2020	Scheme extended (31.Dec.2020)	01.Jan.2020
06.Aug.2020	Scheme extended (31.Mar.2021)	01.Mar.2020
05.May.2021	Scheme extended (30.Sep.2021)	31.Mar.2021

Relief for MSME Borrowers

Circular dated May 05, 2021
MSME Sector restructuring of advances (in continuation of 06.Aug.2020 circular)
One time relaxation given for restructuring of MSME standard accounts without downgrade subject to conditions

35

Relief for MSME Borrowers

Circular dated May 05, 2021
1. Aggregate exposures (FB + NFB) of banks and NBFCs should not exceed Rs. 25 crores as on 31.Mar.2021 (*later extended to Rs. 50 crores vide circular dated 04.Jun.21)*
Exposure need not be balance outstanding
2. Borrower account should be 'Standard Asset' as on 31.Mar.2021 and till date of implementation of restructuring
• *An account not marked as NPA but fulfilling NPA criteria to become ineligible* • *An account which is NPA as on 31.Mar.21 but upgraded subsequently ineligible*

36

Relief for MSME Borrowers

Circular dated May 05, 2021
3. Borrower entity should be registered on the date of implementation of restructuring (except for MSMEs exempt from GST Registration)
A borrower entity can opt for GST registration during the phase of implementation
4. Restructuring of borrower accounts to be implemented within 90 days from date of invocation (Invocation should be not later than 30.Sep.2021)
No apparent eligibility criteria defined for which accounts can be restructured besides no criteria defined as regards no. of years criteria for restructuring / reschedulement

Relief for MSME Borrowers

Circular dated May 05, 2021
5. Asset Classification to be retained even if the account slips into NPA category between 01.Apr.2021 and date of implementation
6. Additional provision of 5% to be made and retained till end of specified period or account demonstrating satisfactory performance *(no payment should be overdue for more than 30 days during the period of one year from the date when first interest / installment is due)*
7. Account restructured earlier under MSME Reliefs is ineligible.
8. Need to be registered in Udyam Registration Portal by before date of implementation.

Relief for MSME Borrowers

Circular dated May 05, 2021
9. Post restructuring usual NPA norms to apply
10. Disclosure in Notes on accounts required for MSME restructured accounts specifying no. of accounts and Amount
11. If restructured accounts is downgraded as NPA as per IRAC norms, the same would be eligible for upgradation only if it demonstrates satisfactory performance during the specified period

Covid19 related RBI Circulars

Date	Circular
27.Mar.2020	Covid-19 Regulatory Package
17.Apr.2020	Covid-19 Regulatory Package – Asset Classification & Provisioning
17.Apr.2020	Covid-19 Regulatory Package – Review of Resolution Timelines under Prudential Framework on Resolution of Stressed Assets
23.May,2020	Covid-19 Regulatory Package
23.May.2020	Covid-19 Regulatory Package – Review of Resolution Timelines under Prudential Framework on Resolution of Stressed Assets
06.Aug.2020	Resolution Framework for Covid-19 related stress
17.Sep.2020	Resolution Framework for Covid-19 related stress – Financial Parameters
13.Oct.2020	FAQs

Covid19 related RBI Circulars

Date	Circular
05.May.2021	Resolution Framework 2.0 for Covid-19 related stress of Individuals and Small Businesses
05.May.2021	Resolution Framework 2.0 for Covid-19 related stress of MSMEs
04.Jun.2021	Resolution Framework 2.0 for Covid-19 related stress of Individuals and Small Businesses – Revision in threshold for aggregate exposure from Rs. 25 Cr to Rs. 50 Cr
04.Jun.2021	Resolution Framework 2.0 for Covid-19 related stress of MSMEs – Revision in threshold for aggregate exposure from Rs. 25 Cr to Rs. 50 Cr
07.Jul.2021	New definition of MSME – Addition of Retail and Wholesale Trade
06.Aug.2021	Resolution Framework for Covid19 relate stress – Financial Parameters – Revised timelines for compliance

Resolution Framework for COVID-19 related stress
(RBI Circular dated 06.Aug.2020)

Ineligible Exposures
1. MSME borrowers with aggregate exposure upto Rs. 25 crores as at 01.Mar.2020 2. Farm credits (as Master Directions to apply) 3. Loan Primary Agricultural Credit Societies (PACs), Farmers' Service Providers (FSS), etc. for onward lending to agricultural 4. Exposure to lending institutions to financial service provider 5. Exposures to Central / State / Local Govt. Bodies 6. Exposure to housing finance companies 7. Staff Loans

Resolution Framework for COVID-19 related stress
(RBI Circular dated 06.Aug.2020)

Eligibility Criteria and other conditions – Personal Loans
1. Applicable only to pandemic affected borrowers 2. Board approved policy is required for implementation 3. Reference date for outstanding amount of debt for resolution shall be 01.Mar.2020 4. Account should be Standard and not in default for more than 30 days as at 01.Mar.2020

Resolution Framework for COVID-19 related stress
(RBI Circular dated 06.Aug.2020)

Eligibility Criteria and other conditions – Personal Loan
5. Borrower account is required to be standard as on date of invocation of resolution under this framework 6. Date of invocation = Date on which both borrower and lender agree to proceed with resolution plan 7. Last date of invocation is 31.Dec.2020 8. Resolution to be implemented within 90 days from date of invocation

Resolution Framework for COVID-19 related stress
(RBI Circular dated 06.Aug.2020)

What can be a resolution plan? (Personal Loan)
1. Re-schedulement of payment 2. Conversion of interest accrued or to be accrued into another credit facility 3. Moratorium period subject to maximum of upto 2 years 4. Moratorium if granted would be effected immediately upon implementation, thus, would be always prospective

45

Resolution Framework for COVID-19 related stress
(RBI Circular dated 06.Aug.2020)

When resolution plan can be said to be implemented? (Personal Loan)
1. All related documentation including execution of required agreements are completed 2. Change in terms & conditions of loan get duly reflected in books of lender 3. Borrower is not in default with lenders as per revised terms
If there is a breach of the conditions in implementation, usual NPA norms would apply

46

Resolution Framework for COVID-19 related stress
(RBI Circular dated 06.Aug.2020)

Other Exposures If there are multiple lending institutions
Resolution plan would be considered as invoked only if 1. 75% in value terms 2. 60% in number of lending institutions agree to invoke the same
For single lender exposures, Board approved policy would govern the implementation of resolution

CA Dhananjay J. Gokhale 47

47

Resolution Framework for COVID-19 related stress
(RBI Circular dated 06.Aug.2020)

Other Exposures
1. To be invoked upto 31.Dec.2020 2. To be implemented within **180 days** from date of invocation 3. Moratorium upto two years permitted 4. Sanction of additional credit facilities permitted
For multiple lending institutions, ICA to be signed by all lenders within 30 days from date of invocation or otherwise the invocation is considered as lapsed.

CA Dhananjay J. Gokhale 48

48

Resolution Framework for COVID-19 related stress
(RBI Circular dated 06.Aug.2020)

Other Exposures
Expert Committee (Report published vide circular dated 07.Sep.2020) *Provided list of financial parameters & sector-specific desirable ranges of parameters* Vetting required for aggregate exposures above Rs. 1500 crores
Independent Credit Evaluation (ICE) by independent credit rating agency required if exposure is above Rs. 100 crores

Resolution Framework for COVID-19 related stress
(RBI Circular dated 06.Aug.2020)

Asset Classification and Provisioning
Additional facilities sanction between invocation and implementation to be considered as 'Standard Asset' but if the implementation fails, same to be treated as 'qua-borrower'
Accounts which slip into NPA category in between invocation and implementation, can be upgraded to standard asset category on the date of implementation
Retention of class of asset benefit extended for covid19 resolution framework

Resolution Framework for COVID-19 related stress
(RBI Circular dated 06.Aug.2020)

Asset Classification and Provisioning
Personal Loan – Provision Provision held as on date of implementation or 10% whichever is higher
Other Exposure – Provision if ICA signed within 30 days Provision held as on date of implementation or 10% whichever is higher If ICA signed after 30 days – 20% provision

51

Resolution Framework for COVID-19 related stress
(RBI Circular dated 06.Aug.2020)

Reversal of Provision
Personal Loan Half to be reversed once 20% of residual debt is paid without slipping into NPA and balance after repayment of further 10%
Other Exposure For signatories to ICA – Same like Personal Loans For non-signatories to ICA – Same but IRAC provision to be continued

52

Resolution Framework for COVID-19 related stress
(RBI Circular dated 06.Aug.2020)

Post Implementation Performance
Personal Loan : Usual IRAC norms to apply
Other Exposure (during monitoring period) Monitoring Period: Period between implementation and repayment of 10% of residual period, subject of minimum of one year from commencement of first payment of Prin / Int. If there is a default during monitoring period, 30 days review period would be triggered and if the borrower is in default at the end of review period, downgraded to NPA from date of implementation or NPA date before implementation of plan

53

Resolution Framework for COVID-19 related stress
(RBI Circular dated 06.Aug.2020)

Disclosures and Credit Reporting
1. Disclosure as per format prescribed in quarterly and annual financials 2. Credit reporting to be made and ‘restructured’ status would be reflected

54

Resolution Framework 2.0: Resolution of COVID-19 related stress of Individual and Small Businesses (RBI Circular dated 05.May.2021)

Eligibility Criteria
1. Individuals availed of personal loans excluding staff loans, with aggregate exposures not more than Rs. 25 crores as on 31.Mar.2021
2. Small businesses including retailers / wholesale trades other than those classified as MSME as on 31.Mar.2021, with aggregate exposures not more than Rs. 25 crores as on 31.Mar.2021
3. Should not have availed any resolution in terms of Resolution Framework 1.0 except for special exemption

55

Resolution Framework 2.0: Resolution of COVID-19 related stress of Individual and Small Businesses (RBI Circular dated 05.May.2021)

Invocation of Resolution Process
1. Board to approve policies within four weeks
2. Facility is provided only to borrower having stress on account of Covid-19
3. Considered as invoked when Bank and borrower agree to proceed with efforts towards finalisation of resolution plan
4. Decision to be communicated to borrower within 30 days of receipt of application
5. Last date of invocation of resolution permitted is 30.Sep.21

56

Resolution Framework 2.0: Resolution of COVID-19 related stress of Individual and Small Businesses (RBI Circular dated 05.May.2021)

Salient Features
1. Re-schedulement of payment 2. Conversion of interest into another credit facility 3. Revisions in working capital sanctions 4. Granting of Moratorium for maximum period of 2 years with extension to that extent 5. Resolution plan to be finalised & implemented within 90 days from date of invocation of resolution process 6. The account will be upgraded to PA as on date of implementation if it's slipped into NPA between invocation & implementation

Resolution Framework 2.0: Resolution of COVID-19 related stress of Individual and Small Businesses (RBI Circular dated 05.May.2021)

Eligibility for Loans resolved earlier under Framework 1.0
1. If moratorium is availed for less than 2 years, moratorium for balance period can be availed 2. Working Capital – Margins & limits to be restored by 31.Mar.2022

Few Important Circulars / Issues

Date	Circular
21.Aug.2020	Ad-hoc / Short Review / Renewal of credit Facilities
21.Aug.2020	New Definition of Micro, Small and Medium Enterprises – Clarifications
14.Sep.2020	Automation of Income Recognition, Asset Classification and Provisioning Process in banks (Cut-off date: 30.Jun.2021)
03.Sep.2020	Interim Order of Supreme Court *'the accounts which were not declared NPA till 31.08.2020 shall not be declared NPA till further orders.'*
07.Apr.2020	Asset Classification and Income Recognition following the expiry of Covid-19 regulatory package
07.Jul.2021	New definition of MSME – Addition of Retail & Wholesale Trade

Projects under Implementation

Essentials
Project loan means any term loan which has been extended for the purpose of setting up of an economic venture. The bank needs to clearly spell out 'Date of Completion' (DC) and 'Date of Commencement of Commercial Operations' (DCCO). Type of Project Loan: 1. Infrastructure Sector 2. Non-Infrastructure Sector

Projects under Implementation

When not considered as Restructuring?

If *change in repayment schedule* is caused due to increase in project outlay on account of increase in scope and size of the project & following conditions are fulfilled:

1. The increase in scope and size of the project takes place before commencement of commercial operations of the existing project;
2. The rise in cost excluding any cost-overrun in respect of the original project is 25% or more of the original outlay;
3. The bank re-assesses the viability of the project before approving the enhancement of scope and fixing a fresh DCCO;
4. On re-rating, (if already rated) the new rating is not below the previous rating by more than one notch.

Projects under Implementation

Deferment of DCCO

If deferent and consequential shift in repayment schedule is for equal or shorter duration, not considered as restructuring if:

Particulars	Infrastructure	Non-Infrastructure
Revised DCCO is within	Two years from original DCCO	One year from original DCCO
Revision due to Court Case	2 + 2 Years from original DCCO	1 + 1 Years from original DCCO
Revision due to any other reason	2 + 1 Years from original DCCO	

Projects under Implementation

Deferment of DCCO & Retention of Class – Conditions
1. Benefit of asset classification now available to CRE with extension by 1 year as per circular dated 07.Feb.2020
2. Application for restructuring (deferment of DCCO) is received upto to two years from date of original DCCO for Infrastructure and one year w.r.t. non-infrastructure
3. Account needs to be standard
4. If moratorium given for interest, income on accrual can be booked till two years from date of original DCCO for Infrastructure and one year w.r.t. non-infrastructure
5. Additional provision of 5% if extended beyond two years from date of original DCCO for Infrastructure and one year w.r.t. non-infrastructure

Projects under Implementation

Deferment of DCCO & Retention of Class – Conditions
6. Additional provision of sacrifice (diminishing in fair value) for standard assets is required to be made for extension of DCCO
7. In case of Infrastructure projects under implementation, appointed date is shifted due to inability of concession authority to comply requisite conditions, the loan need not be treated as 'restructuring' provided: i. Project should be Public Private Partnership model ii. <u>Loan is not yet disbursed</u> iii. Revised date is documented by way of supplementary agreement iv. Viability to be re-assed and sanctioned

Projects under Implementation

Retention of Class – Change of Ownership (2+2+2)

Additional extension of DCCO permitted upto 2 years with retention of class subject to:

1. Project is stalled due to inadequacies of the promoters;
2. Change of ownership resulting in high probability of commencement of commercial operations;
3. New promoters need to have sufficient expertise
4. New promoters should own at least 51% of paid up equity
5. Viability of the project to be established
6. Intra-group company take over not eligible

65

Projects under Implementation

Retention of Class – Change of Ownership (2+2+2)

Additional extension of DCCO permitted upto 2 years with retention of class subject to:

7. Asset classification would be as of reference date (date on which preliminary binding agreement is executed)
8. Take over to be completed within 90 days
9. New promoters to demonstrate commitment by bringing in substantial portion of additional funds
10. Repayment schedule not to exceed beyond 85% of economic life
11. Facility available only once

66

Projects under Implementation

Retention of Class – Financing of Cost Over-runs

Standby Credit Facility:

1. Sanctioned at the time of initial financial closure
2. Purpose is to fund cost overruns, if required
3. To be disbursed only if cost overruns and not otherwise
4. Subsequent Standby Credit facility permitted if DCCO extended upto 2 / 1 year for infra and non-infra
5. Exemption from definition of restructuring provided:
   i. Interest during construction due to delay can be funded
   ii. Other cost overruns limited to 10% of original cost

Projects under Implementation

Retention of Class – Financing of Cost Over-runs

Standby Credit Facility:

5. Exemption from definition of restructuring provided:
   iii. Debt / Equity Ratio need to be unchanged (promoters to infuse funds)
   iv. Disbursement only after promoter's contribution
   v. No other change in terms and conditions
   vi. 10% cost-over run ceiling is excluding interest but including currency fluctuations

Income Recognition

For NPA accounts income should be recognised on realisation basis.
When an account becomes non-performing, unrealised interest / fees / commission of the previous periods should be reversed or provided.
Interest income on additional finance in NPA account should be recognised on cash basis.
In project loan, funding of interest in respect of NPA if recognised as income, should be fully provided.
If interest due is converted into (unlisted) equity or any other instrument, income recognised should be fully provided (if listed, income recognised to the extent of MV)

69

Income Recognition

Order of Recovery
Suggested though not mandatory Unrealised Expenses Unrealised Interest Principal Outstanding
Clarification vide Master Circular - in the absence of clear agreement between the Bank and the Borrower, an appropriate policy to be followed in uniform and consistent manner.

70

Classification Norms

- Standard Asset

  The account is not non-performing.

- Sub-Standard Asset

  A sub-standard Asset is one which has remained NPA for a period of less than or equal to 12 months.

- Loss Assets

  These are accounts, identified by the bank or internal or external auditors or by RBI Inspectors as wholly irrecoverable but the amount for which has not been written off.

71

Classification Norms

- Doubtful Asset - Three Categories

Category	Period
Doubtful - I	Up to One Year
Doubtful – II	One to Three Years
Doubtful - III	More than Three Years

72

Provisioning Norms

Primary Responsibility is of the Bank Management and Auditors

Standard Asset

▪Agricultural and SMEs Sectors	0.25%
▪Commercial Real Estate (CRE) Section	1.00%
▪CRE – Residential Housing Project	0.75%
▪Others	0.40%
▪Housing Loan during teaser rate period	2.00%

Provisioning Norms

Sub-standard Asset

- 15% of total outstanding
- 25% of total outstanding if loan is unsecured
- 20% of total outstanding if infrastructure loan provided its backed by escrow facility with first charge

Definition of Secured Loan:

If security is not less than 10% of exposure (funded & non-funded) ab initio

Provisioning Norms

Doubtful Assets:

Period Provision	(Secured	+	Unsecured)
Up to 1 year	25%	+	100%
1to 3 years	40%	+	100%
More than 3 years	100%	+	100%

Loss Asset 100% should be provided for

**Intangible Security: Considered only if backed by legally enforceable and recoverable right over collection and rest of intangibles like rights, licenses, etc. are considered as 'Unsecured'*

Provisioning Norms

Provisioning for Country Risk

In respect of a country where its net funded exposure is ≥ 1% of its total assets

Risk Category	ECGC Classification	Provision % age*
Insignificant	A1	0.25
Low	A2	0.25
Moderate	B1	5
High	B2	20
Very High	C1	25
Restricted	C2	100
Off-Credit	D	100

*Lower Provision @ 25% w.r.t. short term (180 d) exposures

Provisioning Norms

Provisions under Special Circumstances
Advances guaranteed by CGTMSE / CRGFTLIH / ECGC, Provision should be made only for balance in excess of the amount guaranteed by these corporations *CGTMSE: Credit Guarantee Fund Trust for Micro and Small Enterprises* *CRGFTLIH: Credit Risk Guarantee Fund Trust for Low Income Housing*
Take Out Finance Transactions that involve prior commitments shall be governed by the circular DBOD.No.BP.BC.144/21.04.048-2000 dated February 29, 2000 on "Income Recognition, Asset Classification, Provisioning and other related matters and Capital Adequacy Standards – Takeout Finance".

Other Aspects

Post Shipment Suppliers' Credit
Exim Bank has introduced Guarantee-cum-Refinance Scheme (Guarantee to settle claim within period of 30 days)
Export Project Finance
The lending bank needs establish through documentary evidence that importer has cleared the dues in full in the bank abroad when its PA

Guidelines on Restructuring of Advances

Categories of Loan which can be restructured

79

Guidelines on Restructuring of Advances

Eligibility

- Any account classified as standard, sub standard or doubtful.
- Restructuring cannot be done retrospectively and usual asset classification norms would continue to apply.
- Restructuring should be subject to customer agreeing to terms and conditions.
- Financial viability should be established.
- Borrowers indulging in frauds and malfeasance are ineligible.
- BIFR cases eligible for restructuring subject to approval from BIFR.

80

Guidelines on Restructuring of Advances

Stage at which restructuring can take place

- Before Commencement of Commercial Production
- After commencement of commercial production but Asset is classified as NPA
- After commencement of commercial production but Asset is PA

81

Guidelines on Restructuring of Advances

Asset Classification Norms

- Standard Asset to be reclassified as SSA
- NPA will further slip to lower category as per pre-restructured repayment schedule
- All accounts eligible for upgradation after satisfactory performance
- Additional finance to be treated as Standard for one year

82

Guidelines on Restructuring of Advances

Satisfactory Performance

MSME with exposure less than Rs. 25 crores
No payment to remain overdrawn / overdue for period of more than 30 days , during one year from commencement of first payment

Others
No defaults during period from date of implementation of RP upto date of payment of at least 10% of outstanding principal debt

For exposures above Rs. 100 crores (Additional criteria)
Should be at least rated as investment grade (BBB- or better)

83

Guidelines on Restructuring of Advances

Provisioning Requirements

Normal provision as per Asset Classification

Provision for diminution in fair value, recomputed at each Balance Sheet date (Sacrifice)
(If loan exposure is less than 1 crore, provision can be made @ 5% notionally)

Part D – Annexes denotes the requirement of Sacrifice calculation though methodology is not defined in Circular

84

Guidelines on Restructuring of Advances

Calculation of Sacrifice

Discounting Rate = BPLR / Base Rate + appropriate Term and Credit Risk premium on the date of restructuring **applicable to borrower category**

Apply Discounting Rate to future Cash Inflows of principal and interest and calculate NPV as per original and revised repayment schedules

Total provision not to exceed 100%

Working Capital Finance
Tenure to be presumed at One Year for calculation of Sacrifice

Early identification and reporting of stress

SMA Sub-category	TL - Basis for classification Principal / Interest or any other payment overdue partially or wholly for
SMA-0	1 to 30 days
SMA-1	31 to 60 days
SMA-2	61 to 90 days
SMA Sub-category	CC / OD - Basis for classification Outstanding Balance remains continuously in excess of the sanction limit / drawing power, whichever is lower for a period of
SMA-1	31 to 60 days
SMA-2	61 to 90 days

Early identification and reporting of stress

Reporting Requirements to CRILC (Central Repository of Information on Large Credits) Reporting
1. Applicability: Coverage for Fund and Non-Fund based exposures above Rs. 5 crores excluding crop loans, Inter-Bank / SIDBI / EXIM / NHB / NABARD exposures 2. CRILC Main report – Monthly Basis 3. CRILC Weekly Reporting (Every Friday) – Defaults by all borrowers above Rs. 5 Crores of exposure

Applicability of Prudential Framework for Resolution of Stressed Assets

(Ref.: RBI Circular dated June 07, 2019)
(Ref.: Para 9 of RBI Master Circular dated October 01, 2021)

Aggregate Exposure of Borrowers to the lenders	Reference Date
Rs. 2,000 crores and above	Date of these directions
Above Rs. 1,500 crores but below Rs. 2,000 crores	01.Jan.2020
Less than Rs. 1,500 crores	To be announced in due course

Circular dated June 07, 2019

Prudential Framework for Resolution of Stressed Assets
Applicability of guidelines & its purpose
1. Applicable with immediate effect 2. Providing framework for early recognition, reporting and time bound resolution of stressed assets 3. These directions are issued without prejudice to issuance of specific directions, from time to time, by the Reserve Bank to banks, in terms of the provisions of Section 35AA of the Banking Regulation Act, 1949, for initiation of insolvency proceedings against specific borrowers under the Insolvency and Bankruptcy Code, 2016 (IBC)

Circular dated June 07, 2019

Prudential Framework for Resolution of Stressed Assets
Framework
1. Early identification and reporting of stress 2. Implementation of resolution plan 3. Implementation of conditions for RP 4. Delayed implementation of Resolution Plan 5. Prudential Norms a) Supervisory Review b) Disclosures

Early identification and reporting of stress

SMA Sub-category	TL - Basis for classification Principal / Interest or any other payment overdue partially or wholly for
SMA-0	1 to 30 days
SMA-1	31 to 60 days
SMA-2	61 to 90 days
SMA Sub-category	CC / OD - Basis for classification Outstanding Balance remains continuously in excess of the sanction limit / drawing power, whichever is lower for a period of
SMA-1	31 to 60 days
SMA-2	61 to 90 days

Circular dated June 07, 2019

Reporting Requirements
1. CRILC Reporting for borrower accounts above Rs. 5 crores 2. CRILC Main report – Monthly Basis 3. CRILC Weekly Reporting (Every Friday) – Defaults by all borrowers above Rs. 5 Crores of exposure

Circular dated June 07, 2019

Implementation of Resolution Plan
1. All lenders must put Board Approved Policy 2. Expected that the lenders initiate the process of implementing Resolution Plan even before a default 3. Once default is reported, "Review Period" of 30 days, wherein lenders may decide on resolution strategy, may choose to initiate legal proceedings for insolvency or recovery.

93

Circular dated June 07, 2019

Implementation of Resolution Plan
4. If RP is to be implemented, all lenders to sign inter creditor agreement (ICA) during Review Period. Decision to be taken as agreed by lenders representing 75% by value of total outstanding credit facilities (FB+NFB) and 60%of lenders by number. 5. On or after the reference date, resolution plan must be implemented within 180 days from end of review period

94

Circular dated June 07, 2019

Aggregate Exposure of Borrowers to the lenders	Reference Date
Rs. 2,000 crores and above	Date of these directions
Above Rs. 1,500 crores but below Rs. 2,000 crores	01.Jan.2020
Less than Rs. 1,500 crores	To be announced in due course

Circular dated June 07, 2019

Implementation Conditions for Resolution Plan

1. 1 billion (100 Cr) and above exposure – Independent Credit Evaluation (ICE) of the residual debt by Credit Rating Agencies (CRAs) specifically authorised by RBI for this purpose.

2. 5 billion (500 Cr) and above exposure – Two such Independent Credit Evaluation (ICE) of the residual debt by Credit Rating Agencies (CRAs) specifically authorised by RBI for this purpose.

3. RP is implemented if following conditions are met.

Circular dated June 07, 2019

Conditions for Implementation of Resolution Plan

1. RP Not involving Restructuring / Change in Ownership shall be deemed to be implemented only if the borrower is not in default with any of the lenders as on 180th day from the end of Review Period

2. RP involving Restructuring / Change in Ownership shall be deemed to be implemented only if following conditions are met:

3. All related documentation, creation of security/charge / perfection of security are completed by the lenders

Circular dated June 07, 2019

Conditions for Implementation of Resolution Plan

4. New Capital Structure and changes in terms of conditions of the existing loans gets duly reflected in the books of the lenders and borrower

5. Borrower is not in default with any of the lenders.

Circular dated June 07, 2019

Delayed Implementation of Resolution Plan
Additional Provision Requirement 1. 180 days from end of review period – 20% 2. 365 days from end of commencement of review period: 15% Overall provision should not exceed 100%

99

Circular dated June 07, 2019

Prudential Norms
Restructuring is an act in which a lender, for economic or legal reasons relating to the borrower's financial difficulty, grants concessions to the borrower. Restructuring may involve modification of terms of the advances / securities, which would generally include, among others, alteration of payment period / payable amount / the amount of instalments / rate of interest; roll over of credit facilities; sanction of additional credit facility/ release of additional funds for an account in default to aid curing of default / enhancement of existing credit limits; compromise settlements where time for payment of settlement amount exceeds three months.

100

Circular dated June 07, 2019

Few examples of Financial Difficulty
1. A default or Borrowers credit facilities are NPA 2. Borrower not in default, but is probable that the borrower will default on any of its exposures in foreseeable future without the concession, 3. Borrowers outstanding securities have been delisted 4. Actual performance vs estimates, cash flows to be assessed insufficient to service all of its loans or debt securities 5. Borrowers existing exposures are catagorised as exposures that have already evidenced difficulty in borrowers ability to repay in accordance with banks internal credit rating system

101

Circular dated June 07, 2019

Asset Classification
On restructuring account will be downgraded from Standard to Substandard. NPAs will remain in same category

102

Circular dated June 07, 2019

Asset Upgradation
Only when all the outstanding loan / facilities in the account demonstrate 'satisfactory performance' during the period from the date of implementation of RP up to the date by which at least 10% of the sum of outstanding principal debt as per RP and interest capitalisation sanctioned as a part of the restructuring, if any is repaid (provided that account can not be upgraded before one year from the commencement of the first payment of interest or principal, whichever is later, on the credit facility with longest period of moratorium under the terms of RP)

Circular dated June 07, 2019

Asset Upgradation – Additional conditions
In case of aggregate exposure of Rs. 1 Billion and above External credit rating of investment grade BBB- or better In case of aggregate exposure of Rs. 5 Billion and above Two such external credit ratings of investment grade BBB- or better On failure to demonstrate satisfactory performance during monitoring period, asset classification upgrade is subjected to fresh restructuring / change of ownership framework as per IBC and additional provision of 15% for such accounts should be made at the end of review period.

Circular dated June 07, 2019

Provisioning Norms
Accounts restructured under the revised framework shall attract provisioning as per the asset classification category as laid out in the Master Circular on Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances dated July 1, 2015, as amended from time to time

105

Master Direction on Transfer of Loan Exposures dated September 24, 2021

Master Direction – Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021
A] Directions to come into immediate effect replacing existing instructions B] NBV: Funded outstanding in a loan exposure as reduced by specific provision made against such exposure C] Chapter IV – Transfer of Stressed Loans C: Transfer of loans to ARCs

106

Master Direction on Transfer of Loan Exposures dated September 24, 2021

Master Direction – Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021
Para 73: Stressed Loans which are in default for more than 60 days can be transferred Stressed Loan: Loan exposure that is classified as NPA or SMA Para 75: If stressed loan is transferred to ARC at price below NBV … *permitted to use countercyclical or floating provisions*

107

Master Direction on Transfer of Loan Exposures dated September 24, 2021

Master Direction – Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021
Para 76: If stressed loan is transferred to ARC at price above NBV – reverse excess provision to PL only to the extent of cash received as initial consideration Para 77: SRs / PTCs to be M2M periodically at NAV Proviso to Para 77: (i) Accounting at lower of NBV or NAV

108

Master Direction on Transfer of Loan Exposures dated September 24, 2021

Master Direction – Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021
Proviso to Para 77: (ii) when the investment by a transferor in SRs backed by stressed loans transferred by it, is more than 10 percent of all SRs backed by its transferred loans and issued under that securitisation, the valuation of such SRs by the transferor will be additionally subject to a floor of face value of the SRs reduced by the provisioning rate as applicable to the underlying loans, had the loans continued in the books of the transferor.

109

Master Direction on Transfer of Loan Exposures dated September 24, 2021

Master Direction – Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021
Para 78: SRs/PTCs which are not redeemed as at the end of the resolution period (i.e., five years or eight years as the case may be) shall be treated as loss asset in books of the lenders and fully provided for. Para 79: Valuation, classification and other norms applicable to Non-SLR instruments applicable

110

Points to Ponder

Divergences in NPA observed by RBI AFI
Verification Parameters in CBS vis-à-vis RBI Circular
Purity of Master Data in CBS
Reversal of un-serviced Interest of NPA
Availability of valuation of security for advances below 5 crores
Authenticity and regularity of stock statements
Date of NPA – current and prior year of newly identified NPAs
Unique Customer-id of borrower accounts
Accounts upgraded during the year
Regularisation of account subsequent to balance sheet date

111

Points to Ponder

Accounts other than Advances accounts including Sundries / Suspense Accounts
Accounts transferred to other branches – control over identification / classification of accounts
Income leakages identified and resulting in overdrawing of accounts
Recalculation of Drawing Power
Early Mortality Cases
Ever-greening of accounts
MOCs vis-à-vis Main Audit Report vis-à-vis LFAR

112

113

Thank you!

Dhananjay J. Gokhale

9820047669 / 9322229740

dhan_gokhale@hotmail.com

114