CHAPTER III
RESERVE BANK OF INDIA NORMS FOR
CLASSIFICATION OF ASSETS

3.1. INTRODUCTION

In the liberalized economy, financial and banking sector reforms assume high priority. Economic reforms have given a new thrust to the banking sector as a whole and private sector in particular. Nearly 85 per cent of commercial banking operations in the country are in the hands of public sector at present. One of the important indicators of banks is the quality of their assets. The idea of quality of assets on the books of accounts of banks came into prominence when Reserve Bank of India (RBI) introduced prudential norms in 1992-93 with regard to income recognition, asset classification, provisioning and capital adequacy based on the recommendations of the Narasimham Committee on financial sector reforms.

Non-Performing Assets (NPAs) refer to advances where payment of interest or repayment of installments of principal or both remains unpaid for a period of more than 180 days. However, with effect from March 2004, default status is given to a borrower account if the dues are not paid for 90 days. The level of NPAs is recognized as a critical indicator for assessing bank’s credit risk, asset quality and efficiency in the allocation of resources to productive sectors.

3.2. DEFINITION OF NON-PERFORMING ASSETS

3.2.1. Non-Performing Assets

A non-performing Assets shall be a loan or advance where:

- Interest and or installment of principal remain overdue for a period of more than 90 days in respect of a Term Loan.

- The account remains ‘out of order’ in respect of an Overdraft / Cash Credit (OD/CC).

- The bill remains overdue for a period of more than 90 days in the case of Bills Purchased and Discounted.

In case of advance granted for agricultural purposes, interest and or installment of principal remains overdue for two crop seasons (in case of short duration crops) and or one crop season (in case of long duration crops).

- Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

- If the interest charged during any quarter is not serviced fully within 90 days from the end of the quarter.

3.2.2. Due Date

Due data refers to the date on which interest / installment is payable by the borrower, Interest has to be collected at monthly rests in respect of Working Capital and
Term Loans, except Agricultural Advances. Normally interest falls due for payment immediately on the date of debit.

In respect of certain category of advances such as Project Finance, Agricultural Advances(including Gold Loans), Loans granted to Staff, Educational Loan and so on, where repayment holiday is granted, the due date should fall only after the expiry of the said specified period.

The installment of principal falls due for payment as per the terms of sanction. In case of Emi Loans, due date refers to the due date for the stipulated installment which comprises both principal and interest.

3.2.3. Overdue

Any amount due to the Bank under any credit facility is ‘overdue’ if it is not paid on the due date specified as per the terms of sanction.

3.2.4. 90 Days Norms

With a view to moving towards international best practices and to ensure greater transparency, the ‘90 days’ overdue norm for identification of NPAs has been adopted from the year ended March 31, 2004.

The 90 days norm would continue to be applicable for the Balance Sheet as at 31-03-2009.

3.2.5. Agricultural Advances

In respect of Agricultural Advances, the following norms are applicable with effect from September 30, 2004.

a) A loan granted for short duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for two crop seasons.

b) A loan granted for long duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for one crop season.

“Long duration” crops would be crops with crop season longer than one year.

Crops which are not “long duration” crops, would be treated as “short duration” crops.

The crop season for each crop, which means the period of harvesting of the crops rose would be determined by the State Level Banker’s Committee in each State.

Depending upon the duration of crops, the NPA norms would also be made applicable to all District Agricultural Advances.

In respect of agricultural advances, other than direct agricultural advances and term loans given to non agriculturists, identification of NPAs would be done on the same basis as non-agricultural advances, which, at, present, is the 90 days delinquency norm.

In case of Sugar Mills account that becomes irregular due to delay in receipt of claim of interest subsidy from Department of Food and Public Distribution, Government of India, banks can continue to treat the account as “Standard Asset”.

Since, the Central Government is to bear interest subvention up to 12% on loans extended by lending Branches to concerned sugar mills, there is a commitment on the part of the Central Government to pay the interest subvention amount.
However, it would be necessary to reverse the interest income recognized by the Bank, if the receipt of interest subsidy from Government of India is delayed beyond 90 days.

3.2.6. Gold Loans

Gold Loans are normally granted for agricultural purposes. Interest and principal are to be cleared within 12 months. However, in respect of GL-OD, the tenability is retained at 24 months.

Accounts where interest and principal have become overdue for two crop seasons (in case of short duration crops) or one crop season (in case of long duration crops), such accounts are to be classified as NPAs.

In this regard, Branches may also refer Gold Loan Manual wherein it is advised that immediately after completion of the repayment period, the repayment period of loan can be extended by 6 months by the Branch provided interest debited till such time is recovered.

3.2.7. RUNNING ACCOUNTS

Out of Order Accounts

An account should be treated as ‘out of order’ if the outstanding balance remains continuously in excess of the sanctioned limit / drawing power /

In case where the outstanding balance in the principal operating account is less than the sanctioned limit / drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, such accounts should be treated as out of order.

Non Submission / Delayed Submission of Stock Statements

Stock statements are relied upon for determining Drawing Powers should not be older than three months.

The outstandings in the account based on Drawing Power calculated from stick statements older than three months shall be deemed as irregular.

The Working Capital limits will become Non-Performing Assets if such irregular drawings are permitted in the account for a continuous period of 90 days even through the unit is working or the borrower’s financial position is satisfactory.

Delay in Renewal / Regularization of a Adhoc Limits

Regular and adhoc credit limits should be renewed / regularized within three months from the due date / date of adhoc sanction.

If the renewal/ review are delayed for want of financial statements and other data from the borrowers, branch should furnish evidence to show that renewal / review of credit limits is already on and would be completed soon.

An account where the regular / adhoc credit limits have not been reviewed / renewed within a period of 180 days from the due date / date of adhoc sanction, will be treated as Non-Perforating Assets.

However, on review / renewal of limits, the asset classification may be brought to performing assets.
However, an account where the liability is in excess of sanctioned limit / drawing power on account of exercising emergency power or temporary enhancement has been permitted for a given period can be classified as Standard Asset till such time.

Regularization of Accounts just Before the Date of Balance Sheet

In respect of borrowal accounts where a solitary or a few credits are recorded before the Balance Sheet date, satisfactory evidence should be available about the manner of regularization of the account to eliminate doubts on their performing status.

Where the account shows inherent weakness on the basis of the data available, it should be deemed as non-performing Asset.

Advances which have been regularized by repayment of interest / installment before Balance Sheet Date need not be classified as NPA, even though the account might have been out of order / in default for more than 90 days or major part of the year provided such regularization was through genuine sources.

Sanctioning of additional limits should not be resorted to just to avoid slipping of an account into NPA.

Transfer of funds from one account to another with the only intention of avoiding slipping into NPA, should not be resorted. This however does not prohibit genuine transfer of funds between one account to another.

Bills Liability

The bills liability will become NPA if it remains overdue for a period of more than 90 days.

Term Loans

A term loan account will become NPA if interest and / or installment of principal remain overdue for a period of more than 90 days. Term loans are those where the terms of repayment are for a period of more than 36 months.

Other Advances

Any amount to be received remains overdue for a period of more than 90 days in respect of other advances, such accounts will become NPA.

3.3. ASSET CLASSIFICATION

Advances are broadly classified into Performing and Non-Performing Assets. Performing Assets are Standard Assets and Non-Performing Assets are further classified into Sub-standard, Doubtful and Loss Assets.

An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank.

The above Asset Classification intends to provide basis for Income Recognition and determining the Provisioning requirement for Non-Performing Assets.

In order to ensure scrupulous compliance with the guidelines on Prudential Norms in a uniform manner, the Asset Classification and Valuation of Securities should be confirmed by the branch-in-charge.
Further, such asset classification and valuation of securities should be vetted by the appropriate authority in respect of accounts falling under their powers and by the circle office in respect of accounts falling under their and HO powers in the given format.

3.3.1. Borrowerwise Classification

The Asset Classification into performing and non-performing is borrowerwise and not account / facilitywise.

All the facilities granted to a borrower will have to be treated as NPA and not the particular facility or part thereof which has become irregular.

Accordingly, if one account of the borrower is NPA, the other accounts which are otherwise performing, should also be classified as NPA of the same category.

Since, the Asset Classification is borrowerwise, the total liability of the borrower in all the facilities and the total value of securities available thereof should be aggregated for Asset Classification and Provisioning.

In branches, the crystallized liability on account of development of LCs / Guarantees is kept in a separate account without debiting to the operating accounts of the borrowers. In such cases, the devolved liability should be determined taking into account all the liabilities / facilities of the borrower including Devolved LCs / Guarantees.

3.3.2. Performing Assets- Standard Assets

Performing Assets are Standard Assets which do not disclose any problem and which do not carry more than the normal risk attached to the business. The performing asset is one, which generates income for the bank.

An account is considered to be Standard Asset when it is in order or where the overdue amount is within a period of 90 days and in respect Direct Agricultural Advances if the amount overdue is less than two crop seasons in case of short duration and one crop season in case of long duration crops.

3.3.3. Non-Performing Assets

An account is to be treated as Non-Performing Asset (NPA) when it ceases to generate income for the bank. Such Non-Performing Assets should have well defined credit weakness, which jeopardize the liquidation of the debt and are characterized by distinct possibility, that the bank would sustain some loss, if the deficiencies are not corrected. Non-Performing Assets are further classified into three categories viz., Sub-standard, Doubtful and Loss Assets.

3.3.4. Sub-Standard Assets

In respect of loan account if any amount is overdue for a period of more than 90 days from the due date, the account should be classified as sub-standard asset. With effect from 31-03-2005, a sub-standard asset would be one, which has remained NPA for a period less than or equal to 12 months. In cases where the loan was sanctioned as a clear / unsecured loan, the account on becoming NPA for the first time should be treated as sub-standard only.

3.3.5. Doubtful Assets

The following accounts should be classified as Doubtful Assets.
1. With effect from 31-03-2005, an account would be classified as doubtful if it had remained in the sub-standard category continuously for 12 months.

2. A Non-Performing Asset where the erosion in the value of securities is more than 50% of value as assessed by the bank/accepted by Reserve Bank of India previously at the time of last inspection and where the value of securities available is more than 10% of the outstanding liability should be straightaway classified under doubtful category and provisioning should be made as applicable to Doubtful Assets.

3.3.6. Loss Assets

A loss asset is one where the loss has been identified by the bank or internal/external auditors or the Reserve Bank of India Inspectors, but the amount has not been written off wholly or partly.

In other words, such asset is considered uncollectible with little salvage or recovery value.

Further, in cases of exposures, where the realizable value of security, while sanctioning of the facility is more than 10% of the outstanding exposure and has subsequently eroded to 10% or less of the outstanding, then the account should be straightaway classified as Loss Asset.

Further accounts where there is a potential threat of recovery on account of erosion in the value of security or non-availability of security and existence of other factors such as fraud, bills discounted with fake documents should be classified as doubtful asset(where the realizable value of securities is more than 10% of the outstanding liability) or loss assets(where realizable value of securities is less than 10% of outstanding liability), irrespective of the period it has remained as Non-Performing Asset.

Also, a NPA need not go through the various stages of classification in cases of serious credit impairment and such assets should be straightaway classified as doubtful(where the realizable value of securities is more than 10% of the outstanding liability) or loss asset(where realizable value of securities is less than 10% of outstanding liability) as appropriate.

3.3.7. Date of NPA

In view of the necessity to determine the overdue period from the due date, the date of NPA assumes more significance and absolutely necessary to ascertain as to whether a Non-Performing Asset has completed 12 months in sub-standard category to be classified as Doubtful Asset. Further, calculation of date of NPA is more relevant as due date for payment of installments / bills purchased and discounted will fall on any date during a month. Date of NPA and year of doubtful debt should be carefully updated in the system so that advances supporting sheets are generated correctly.

3.3.8. Certain Specific Category of Advance

Government Guaranteed Advances

Central Government Guaranteed Accounts

Credit facilities though overdue, backed by Central Government Guarantee should be treated as Standard Asset, to the extent of the Guarantee Cover available.
Liability over and above the Guarantee Cover available is to be classified as NPA depending on the overdue position. However, income should not be recognized in such accounts if the same has not been realized.

If the Government repudiates its Guarantee when invoked, such facilities in toto should be treated as NPA and provision is to be made depending on the asset classification.

**State Government Guaranteed Accounts**

Credit facilities backed by State Government Guarantee should be classified as ‘Sub-Standard’ or ‘Doubtful or Loss’ asset, if interest and / or principal or any other amount due to the bank remains overdue for more than 90 days and attract appropriate provisioning as per norms.

Advances guaranteed by Public Sector Undertakings/ Banks/ Financial Institutions/ Corporations / Other bodies should not be treated as guaranteed by Government and asset classification / income recognition as in the case of normal advances is to be followed.

**Consortium Advances**

In respect of consortium advances, individual banks can classify the borrowal accounts according to its own record of recovery and other aspects having a bearing on recoverability of advances. Accordingly, depending upon the performance and overdue position with the bank alone, the account should get classified as Performing or Non-Performing Asset.

Where the remittances by the borrower under consortium lending arrangements are pooled with bank and / or where the bank receiving remittances is not parting with the share of other member banks, the account will be treated as not serviced in the books of other member banks and the account is to be treated as Non-Performing Asset. Hence, it should get the share of recovery from the Lead bank or get an express consent form the Lead bank for transfer of share of recovery to ensure proper asset classification in books.

**Apportioned Limit**

In respect of apportioned limits, the Asset Classification adopted by the Main Branch should be adopted by all other branches. If a branch has got apportioned limit, they have to get asset classification from the main branch. If the branch has apportioned limit to other branches, asset classification has to be done taking into consideration the overall overdue position in the account with all the branches. The main branch has to inform the asset classification to the respective branches well in advance so as to enable them to classify the account correctly as on balance sheet date.

**Agricultural Advances through Primary Agricultural Credit Societies (PACS / Farmers Service Societies (FSS))**

In respect of agricultural advances as well as advances for other purpose granted by the banks to ceded PACS / FSS under the on-lending system, only that particular credit facility granted to PACS/FSS which is in default for a period of two crop seasons incase of short duration crops and one crop season in case of long duration crops, as the case may be, after it has become due will be classified as NPA and not all the credit facilities sanctioned to a PACS /FSS.
The other direct loans and advances, if any, granted by bank to the member borrower of a PACS/ FSS outside the on-lending arrangement will become NPA even if one of the credit facilities granted to the same borrower becomes NPA.

**Advances to Staff**

The interest/ installments on loans granted to staff members are generally recovered regularly from the salary. Hence, staff loans are treated as Standard Assets.

If for reasons such as loss of pay and suspension, no recovery is forthcoming, then the account should be classified accordingly taking into consideration the overdue position.

In the case of housing loan or similar advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards.

Such loans / advances should be classified as NPA only when there is default in repayment of installment of principal or payment of interest on the respective due dates.

**Advances against Own Deposits / NSCs / IVPs/ Life Insurance Policies**

Loans / advances granted against own term deposits, NSCs eligible for surrender, IVPs, KVPs, life insurance policies are to be treated as Standard Assets. However, advances against gold ornaments, government securities and all other securities are not covered by this exemption.

Further, interest on advances against term deposits, NSCs, KVPs and life insurance policies may be taken to income account on the due date, provided adequate margin is available in the accounts.

**Loans Granted under Government Sponsored Schemes**

For loans granted under Government sponsored schemes such as SGSY, PMRY etc, assets created out of finance and the subsidy received from the Government which is kept under deposit / sundry liabilities should also be taken as security.

**Loans with Moratorium for Payment of Interest**

In the case of finance given for industrial projects or for agricultural plantations etc., where moratorium is available for payment of interest, payment of interest becomes ‘due’ only after the moratorium or gestation period is over. Therefore, such amounts of interest do not become overdue and hence not NPA, with reference to the date of debit of interest. They become overdue after due date for payment of interest if uncollected.

**TOD in Savings Bank / Current Account**

The temporary over drawings allowed in current/ savings bank account (including over drawings on account of Cancard FTV debits) fall due for payment within 15 days and become overdue thereafter. Depending on the overdue position, the account would get classified as performing or otherwise. Further, for NPAs depending upon the degree of credit risk and the chances of realisability of dues, they should be classified as Sub-Standard or Loss Asset.

**Restructuring / Rescheduling of Loans**

Subsequently Reserve Bank of India has issued guidelines governing restructuring of different types of advances and the revised guidelines of the same are covered in Circular No. 4 / 2009 dated 03-01-2009 and 67/2009 dated 28-02-2009. The guidelines
issued by Reserve Bank of India in this regard provide certain special regulatory treatment on asset classification and income recognition. The Reserve Bank of India also provides for special regulatory treatment for assets classification for a restricted period.

Restructuring of Advances are classified into the four categories as under:

a) Restructuring of advances extended to industrial units
b) Restructuring of advances extended to industrial units under CDR mechanism
c) Restructuring of advances extended to SME
d) Restructuring of all other advances

Income Recognition Norms

Interest income is respect of restructured accounts classified as standard assets will be recognized on accrual basis and in respect of the accounts classified as non-performing will be recognized on cash basis.

Rehabilitation / Nursing Package

The norms for accounts under rehabilitation / nursing package are:

a. The existing facilities shall continue to be classified under the same category of Asset Classification before sanctioning of the package.
b. Additional limits sanctioned as per the package should be classified as Standard Package for a period of one year and hence there is no need for making any provision for a period of one year from the date of disbursement of the additional facilities.
c. After one year from the date of disbursement under the package, all the accounts including the additional limits are to be reviewed. If the account has been conducted in accordance with the terms of the package, then it can be upgraded as Standard Asset. If not, should be classified as NPA including the additional facilities, depending upon the overdue status.

Upgradation of Accounts

Accounts classified as Non-Performing Asset for the previous balance sheet are to be reviewed and based on the performance / recovery during the period, they may either have upward or downward movement as on the subsequent balance sheet.

Upward movement is only on account of recovery of overdue amounts or satisfactory conduct of the running account. Upgradation within the NPA category is not permitted except in respect of Loss Assets, where fresh securities are acquired covering more than 10% of the liability outstanding, in which case, the account would be classified as Doubtful Asset.

It is brought to the notice of Reserve Bank of India, that in case of NPAs, some banks consider upgradation to standard only after year of satisfactory performance. It has been clarified by Reserve Bank of India that if arrears of interest and principal are paid by the borrower, as per original repayment schedule, in case of loan accounts classified as NPAs, the account should no longer be treated as Non-Performing and should be classified as Standard Account; However, extent instructions in respect of re-classification of loan accounts subjected to restructuring would be remain unchanged.
Interest Suspense

Interest should not be debited to NPA accounts from the date on which account is identified as NPA. In respect of accounts classified as NPA for the first time, interest neither debited to the extent nor recovered is to be reversed to respective advances accounts as per the guidelines of the recovery wing.

Interest suspense sub-head has been discounted w.e.f. 01-01-2006. However, in respect of FITL accounts, where unrealized / undebited portion of interest is kept in interest suspense, the same should not be credited to the FITL account. In other words, for such category of accounts, the interest suspense account will continue till the interest is recognized.

For the balance sheet as at 31-03-2009, in respect of accounts classified as NPA for the first tie, interest debited in the previous year, as well as in the current year, which have not yet been realized, should be reversed to respective loan account by debiting interest collected account as per the guidelines of recovery wing.

In view of the above guidelines, there would not be any interest suspense account (except FITL). In all cases, other than past due loan accounts, recoveries made should be first adjusted towards interest debits. On further recovery, unrecognized interest income should be accounted by debiting interest due in the NPA account to the extent of recovery.

3.4. INCOME RECOGNITION POLICY

The policy of income recognition has to be objective based on the Record of recovery. Internationally income from nonperforming assets (NPA) is not recognized on accrual basis but is booked as income only when it is actually Received. Therefore, the banks should not charge and take to income account interest On any NPA. However, interest on advances against term deposits, NSCs, IVPs, KVPs and Life Policies may be taken to income account on the due date, provided adequate margin is there.

3.4.1. Available in the Accounts

Fees and commissions earned by the banks as a result of renegotiations or rescheduling of outstanding debts should be recognized on an accrual basis over the period of time covered by the renegotiated or rescheduled extension of credit. If Government guaranteed advances become NPA, the interest on such advances should not be taken to income account unless the interest has been realized.

3.4.2. Reversal of Income

If any advance, including bills purchased and discounted, becomes NPA, the entire interest accrued and credited to income account in the past periods, should be reversed if the same is not realized. This will apply to Government guaranteed accounts also. In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed with respect to past periods, if uncollected.

3.4.3. Leased Assets

The finance charge component of finance income (as defined in “AS 19-Leases”) issued by the Council of the Institute of Chartered Accountants of India (ICAI) on the leased assets which has accrued and was credited to income account before the asset
became nonperforming, and remaining unrealized, should be reversed or provided for in the current accounting period.

3.4.4. Appropriation of Recovery in NPAs

Interest realized on NPAs may be taken to income account provided the credits in the accounts towards interest are not out of fresh/additional credit facilities sanctioned to the borrower concerned.

In the absence of a clear agreement between the banks and the borrower for the purpose of appropriation of recoveries in NPAs (i.e. towards principal or interest due), banks should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner.

3.4.5. Interest Application

On an account turning NPA, banks should reverse the interest already charged and not collected by debiting Profit and Loss account, and stop further application of interest. However, banks may continue to record such accrued interest in a Memorandum account in their books. For the purpose of computing Gross Advances, interest recorded in the Memorandum account should not be taken into account.

3.4.6. Computation of NPA Levels

Banks are advised to compute their Gross Advances, Net Advances, Gross NPAs and Net NPAs, as per the format.

3.4.7. Guidelines for Classification of Assets

Broadly speaking, classification of assets into above categories should be done taking into account the degree of well-defined credit weaknesses and the extent of dependence on collateral security for realization of dues.

Banks should establish appropriate internal systems to eliminate the tendency to delay or postpone the identification of NPAs, especially in respect of high value accounts. The banks may fix a minimum cut off point to decide what would constitute a high value account depending upon their respective business levels. The cutoff point should be valid for the entire accounting year, Responsibility and validation levels for ensuring proper asset classification may be fixed by the banks. The system should ensure that doubts in asset classification due to any reason are settled through specified internal channels within one month from the date on which the account would have been classified as NPA as per extent guidelines.

3.4.8. Availability of Security/Net Work of Borrower/Guarantor

The availability of security or net worth of borrower/guarantor should not be taken into account for the purpose of treating an advance as NPA or otherwise, except to the extent provided in Para 4.2.9, as income recognition is based on record of recovery.

3.4.9. Accounts with Temporary Deficiencies

The classification of an asset as NPA should be based on the record of recovery, Bank should not classify an advance account as NPA merely due to the existence of some deficiencies which are temporary in nature such as non availability of adequate drawing power based on the latest available stock statement, balance outstanding exceeding the limit temporarily, non submission of stock statements and non renewal of the limits on the
due date, etc. In the matter of classification of accounts with such deficiencies banks may follow guidelines:

i. Banks should ensure that drawing in the working capital accounts are covered by the adequacy of current assets, since current assets are first appropriated in times of distress. Drawing power is required to be arrived at based on the stock statement which is current. However, considering the difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than three months. The outstanding in the account based on drawing power calculated from stock statements older than three months, would be deemed as irregular. A working capital borrower account will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days even though the unit may be working or the borrower’s financial position is satisfactory.

ii. Regular and adhoc credit limits need to be reviewed/regularized not later than three months from the due date/date of adhoc sanction. In case of constraints such as non-availability of financial statements and other data from the borrowers, the branch should furnish evidence to show that renewal/review of credit limits is already on and would be completed soon. In any case, delay beyond six months is not considered desirable as a general discipline. Hence, an account where the regular/adhoc credit limits have not been reviewed/renewed within 180 days from the due date/date of adhoc sanction will be treated as NPA.

3.4.10. Up Gradation of Loan Accounts Classified as NPAS

If arrears of interest and principal are paid by the borrower in the case of loan accounts classified as NPAs, the account should no longer be treated as nonperforming and may be classified as ‘standard’ accounts. With regard to up gradation of a restructured/rescheduled account classified as NPA contents of paragraphs 11.2 and 14.2 in the Part B of this circular will be applicable.

3.4.11. Assets Classification to Be Borrowerwise and Not Facilitywise

i. It is difficult to envisage a situation when only one facility to a borrower/one investment in any of the securities issued by the borrower becomes a problem credit/investment and not others. Therefore, all the facilities granted by a bank to a borrower and investment in all the securities issued by the borrower will have to be treated as NPA/NPI and not the particular facility/investment or part thereof which has become irregular.

ii. If the debits arising out of development of letters of credit or invoked guarantees are placed in a separate account, the balance outstanding in that account also should be treated as a part of the borrower’s principal operating account for the purpose of application of prudential norms on income recognition, asset classification and provisioning.

iii. The bills discounted under LC favoring a borrower may not be classified as a Non-performing advance (NPA), when any other facility granted to the borrower is classified as NPA. However, in case documents under LC are not accepted on presentation or the payment under the LC is not made on the due date by the LC
issuing bank for any reason and the borrower does not immediately make good the amount disbursed as a result of discounting of concerned bills, the outstanding bills discounted will immediately be classified as NPA with effect from the date when the other facilities had been classified as NPA.

iv. The overdue receivables representing positive mark-to-market value of a derivative contract will be treated as a non-performing asset, if these remain unpaid for 90 days or more.

In case the over dues arising from forward contracts and plain vanilla swaps and options become NPAs, all other funded facilities granted to the client shall also be classified as non-performing asset following the principle of borrowerwise classification as per the existing asset classification norms. Accordingly, any amount, representing positive mark-to-market value of the foreign exchange derivative contracts (other than forward contract and plain vanilla swaps and options) that was entered into during the period April 2007 to June 2008, which has already crystallized or might crystallize in future and is/becomes receivable from the client, should be posted in a separate account maintained in the name of the client/counterparty. This amount, even if overdue for a period of 90 days or more, will not make other funded facilities provided to the client. NPA on account of the principle of borrowerwise asset classification, though such receivable over due for 90 days or more shall itself be classified as NPA, as per the extant IRAC norms. The classification of all other assets of such clients will, however, continue to the governed by the extant IRAC norms.

v. If the client concerned is also a borrower of the bank enjoying a Cash Credit or Overdraft facility from the bank, the receivables mentioned in item (iv) above may be debited to that account on due date and the impact of its non-payment would be reflected in the cash credit/overdraft facility account. The Principle of borrowerwise asset classification would be applicable here also, as per extant norms.

vi. In cases where the contract provides for settlement of the current mark-to-market value of a derivative contract before its maturity, only the current credit exposure (not the potential future exposure) will be classified as a non-performing asset after an overdue period of 90 days.

vii. As the overdue receivables mentioned above would represent unrealized income already booked by the bank on accrual basis, after 90 days of overdue period, the amount already taken to ‘Profit and Loss a/c’ should be reversed.

3.4.12. Projects under Implementation

For all project financed by the FIs/banks after 28th May, 2002, the date of completion of the project should be clearly spelt out at the time of financial closure of the project.

3.4.13. Project Loans

There are occasions when the completion of projects is delayed for legal and other extraneous reasons like delays in Government approvals etc. All these factors, which are beyond the control of promoters, may lead to delay in project implementation and involve restructuring/re schedulement of loans by banks. Accordingly, the following asset
classification norms would apply to the project loans before commencement of commercial operations. These guidelines will, however, not be applicable to restructuring of advances covered under the paragraph 14.1 of this Master Circular (Advances classified as Commercial Real Estate exposures, Advances classified as Capital Market exposure, and Consumer and Personal Advances) which will continue to be dealt with in terms of the extant provisions i.e. paragraph 14.1 of the circular.

For this purpose, all project loans have been divided into the following two categories:

a. Project Loans for infrastructure sector

b. Project Loans for non-infrastructure sector.

‘Project Loan’ would mean any term loan which has been extended for the purpose of setting up of an economic venture. Banks must fix a Date of Commencement of commercial operations (DCCO) for all project loans at the time of sanction of the loan/financial closure (in the case of multiple banking or consortium arrangements).

3.4.14. Project Loans for Infrastructure Sector

A loan for an infrastructure project will be classified as NPA during any time before commencement operations as per record of recovery (90 days overdue), unless it is restructured and becomes eligible for classification as standard asset in terms of paras (iii) to (v) below.

A loan for an infrastructure project will be classified as NPA if it fails to commence commercial operations within two years from the original DCCO, even if it is regular as per record of recovery, unless it is restructured and becomes eligible for classification as standard asset in terms of paras (iii) to (v) below.

If a project loan classified as standard asset is restructured any time during the period up to two years from the original date of commencement of operations (DCCO), in accordance with the provisions of Part B of this Master Circular, it can be retained as a standard asset if the fresh DCCO is fixed within the following limits, and further provided the account continues to be serviced as per the restructured terms.

Infrastructure Projects Involving Court Cases

Upto another 2 years (beyond the existing extended period of 2 years i.e. total extension of 4 years), in case the reason for extension of date of commencement of productions is arbitrations proceedings or a court case.

Infrastructure Project Delayed for Other Reasons Beyond the Control of Promoters

Up to another 1 year (beyond the existing extended period of 2 years i.e. total extension of 3 years), in other than court cases.

(iv) it is re-iterated that dispensation in para 4.2.15.3 (iii) is subject to adherence to the provisions regarding restructuring of accounts and contained in the Master Circular which would inter alia require that the application for restructuring should be received before the expiry of period of two years from the original DCCO and when the account is still standard as per record of recovery. The other conditions applicable would be:
In case where there is moratorium for payment of interest, banks should not book income on accrual basis beyond two years from the original DCCO, considering the high risk involved in such restructured accounts.

Banks should maintain provisions on such accounts as long as these are classified as standard assets under:

(v) For the purpose of these guidelines, mere extension of DCCO will also be treated as restructure even if all other terms and conditions remain the same.

**Project Loans for Non-Infrastructure Sector**

A loan for a non-infrastructure project will be classified as NPA during any time before commencement of commercial operations as per record of recovery (90 days overdue), unless it is restructured and becomes eligible for classifications as 'standard asset' in terms

A loan for an infrastructure project will be classified as NPA if it fails to commence commercial operations within two years from the original DCCO, even if it is regular as per record of recovery, unless it is restructured and becomes eligible for classification as standard asset in terms of paras (iii) to (v) below.

In case of non-infrastructure projects, if the delay in commencement of commercial operations extends beyond six months from the date of completion as determined at the time of financial closure, banks can prescribe a fresh DCCO, and retain the 'standard' classification by undertaking restructuring of accounts in accordance with the provisions contained in this Master Circular, provided the fresh DCCO does not extend beyond a period of twelve months from the original DCCO. This would among others also imply that the restructuring application is received before the expiry of six months from the original DCCO, and when the account is still 'standard' as per the record of recovery.

**The Other Conditions Applicable would be:**

In cases where there is moratorium for payment of interest, banks should not book income on accrual basis beyond six months from the original DCCO, considering the high risk involved in such restructure accounts.

Banks should maintain provisions on such accounts as long as these are classified as standard assets as under:

<table>
<thead>
<tr>
<th></th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Until the first six months from</td>
<td>0.40%</td>
</tr>
<tr>
<td>The original DCCO</td>
<td></td>
</tr>
<tr>
<td>During the next six months</td>
<td>1.00%</td>
</tr>
</tbody>
</table>

(iv) For this purpose, mere extension of DCCO will also be treated as restructuring even if all other terms and conditions remain the same.

**Other Issues**

All other aspects of restructuring of project loans before commencement of commercial operations would be governed by the provisions of Part B of Master Circular on Prudential norms on Income Recognition, Asset Classification and Provisioning Pertaining to Advances. Restructuring of project loans after commencement of commercial operations will also be governed by these instructions.
Any change in the repayment schedule of a project loan caused due to an increase in the project outlay on account of increase in scope and size of the project, would not be treated as restructuring if:

a. The increase in scope and size of the project takes place before commencement of commercial operations of the existing project.

b. The rise in cost excluding any cost-overrun in respect of the original project is 25% or more of the original outlay

c. The bank re-assesses the viability of the project before approving the enhancement of scope and fixing a fresh DCCP.

d. On re-rating, (if already rated) the new rating is not below the previous rating by more than one notch

(III) These guidelines would apply to those cases where the modification to terms of existing loans, as indicated above, are approved by banks from the date of this circular.

3.4.15. Income Recognition

i. Banks may recognize income on accrual basis in respect of the projects under implementation, which are classified as ‘standard’

ii. Banks should not recognize income on accrual basis in respect of the projects under implementation which are classified as a ‘sub standard’ Asset. Banks may recognize income in such accounts only on realization on cash basis.

Consequently, banks which have wrongly recognized income in the past should reverse the interest if it was recognized as income during the current year or make a provision for an equivalent amount if it was recognized as income in the previous year(s).

As regards the regulatory treatment of ‘funded interest’ recognized as income and ‘conversion into equity debentures or any other instrument’ banks should adopt the following:

a. Funded Interest: Income recognition in respect of the NPA regardless whether these are or are not subjected to restructuring/rescheduling/renegotiation of terms of the loan agreement, should be done strictly on cash basis, only on realization and not if the amount of interest overdue has been funded. If, however, the amount of funded interest is recognized as income, a provision for an equal amount should also be made simultaneously. In other words, any funding of interest in respect of NPAs, if recognized as income, should be fully provided for.

b. Conversion into equity, debentures or any other instrument: The amount outstanding converted into other instruments would normally comprise principal and the interest components. If the amount of interest dues is converted into equity or any other instrument, and income is recognized in consequence, full provision should be made for the amount of income so recognized to offset the effect of such income recognition. Such provision would be in addition to the amount of provision that may be necessary for the depreciation in the value of the equity or other instruments, as per the investment valuation norms. However, if the conversion of interest is into equity which is quoted, interest income can be recognized at market value of equity which is quoted, interest income can be recognized at market value of equity, as on the date of conversion, not exceeding
the amount of interest converted to equity. Such equity must thereafter be classified in the ‘available for sale’ category and valued at lower of cost or market value. In case of conversion of principal and/or interest in respect of NPAs into debentures, such debentures should be treated as NPA, ab initio, in the same asset classification as was applicable to loan just before conversion and provision made as per norms.

This norm would also apply to zero coupon bonds or other instruments which seek to defer the liability of the issuer. On such debentures, income should be recognized only on realization basis. The income in respect of unrealized interest which is converted into debentures or any other fixed maturity instrument should be recognized only on redemption of such instrument. Subject to the above, the equity shares or other instruments arising from conversion of the principal amount of loan would also be subject to the usual prudential valuation norms as applicable to such instruments.

Provisioning

While there will be no change in the extant norms on provisioning for NPAs banks which are already holding provisions against some of the accounts, which may now be classified as ‘standard’, shall continue to hold the provisions and shall not reverse the same.

Takeout Finance

Takeout finance is the product emerging in the context of the funding of longterm infrastructure projects. Under this arrangement, the institution/the bank financing infrastructure projects will have an arrangement with any financial institution for transferring to the latter the outstanding in respect of such financing in their books on a predetermined basis. In view of the timelag involved in taking-over, the possibility of a default in the meantime cannot be ruled out. The norms of asset classification will have to be followed by the concerned bank/financial institution in whose books the account stands as balance sheet item as on the relevant date. If the lending institution observes that the asset has turned NPA on the basis of the record of recovery, it should be classified accordingly.

The lending institution should not recognize income on accrual basis and account for the same only when it is paid by the borrower / taking over institution (if the arrangement so provides). The lending institution should also make provisions against any asset turning into NPA pending its takeover by taking over institution, the corresponding provisions could be reversed. However, the taking over institution, on taking over such assets, should make provisions treating the account as NPA from the actual date of it becoming NPA even though the account was not in its books as on that date.

Post Shipment Supplier’s Credit

(i) In respect of post shipment credit extended by the banks covering export of goods to countries for which the ECGC’s cover is available, EXIM Bank has introduced a guaranteecum-refinance programme whereby, in the event of default, EXIM Bank will pay the guaranteed amount to the bank within a period of 30 days from the day the bank invokes the guarantee after the exporter has filed claim with ECGC.

(ii) Accordingly, to the extent payment has been received from the EXIM Bank, the advance may not be treated as a nonperforming asset for asset classification and provisioning purposes.
Export Project Finance

(i) In respect of export project finance, there could be instances where the actual importer has paid the dues to the bank abroad but the bank in turn is unable to remit the amount due to political developments such as war, strife, UN embargo, etc.

(ii) In such cases, where the lending bank is able to establish through documentary evidence that the importer has cleared the dues in full by depositing the amount in the bank abroad before it turned into NPA in the books of the bank, but the importer’s country is not allowing the funds to be remitted due to political or other reasons, the asset classification may be made after a period of one year from the date the amount was deposited by the importer in the bank abroad.

Advances under Rehabilitation Approved by BIFR/TLI

Banks are not permitted to upgrade the classification of any advance in respect of which the terms have been renegotiated unless the package of renegotiated terms has worked satisfactorily for a period of one year. While the existing credit facilities sanctioned under the rehabilitation packages, the Income Recognition, Asset Classification norms will become applicable after a period of one year from the date of disbursement.

3.5. PROVISIONING NORMS

The primary responsibility for making adequate provisions for any diminution in the value of loan assets, investment or other assets is that of the bank managements and the statutory auditors. The assessment made by the inspecting officer of the RBI is furnished to the bank to assist the bank management and the statutory auditors in taking a decision in regard to making adequate and necessary provisions in terms of prudential guidelines.

In conformity with the prudential norms, provisions should be made on the nonperforming assets on the basis of classification of assets into prescribed categories as detailed in paragraphs 4 supra. Taking into account the time lag between an account becoming doubtful of recovery, its recognition as such, the realization of the security and the erosion over time in the value of security charged to the bank, the banks should make provision against substandard assets, doubtful assets and loss assets as below:

3.5.1. Loss assets

Loss assets should be written off. If loss assets are permitted to remain in the books for any reason, 100 percent of the outstanding should be provided for.

3.5.2. Doubtful Assets

i. 100 percent of the extent to which the advance is not covered by the realizable value of the security to which the bank has a valid recourse and the realizable value is estimated on a realistic basis.

ii. In regard to the secured portion, provision may be made on the following basis, at the rates ranging from 20 percent to 100 percent of the secured portion depending upon the period for which the asset has remained doubtful:
Period for which the advance has remained in requirement

<table>
<thead>
<tr>
<th>‘Doubtful’ Category</th>
<th>Provision remained in requirement (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upto one year</td>
<td>20</td>
</tr>
<tr>
<td>One to three years</td>
<td>30</td>
</tr>
<tr>
<td>More than three years</td>
<td>100</td>
</tr>
</tbody>
</table>

Note: Valuation of Security for provisioning purposes

With a view to bringing down divergence arising out of difference in assessment of the value of security, in cases of NPAs with balance of Rs. 5 crore and above stock audit at annual intervals by external agencies appointed as per the guidelines approved by the Board would be mandatory in order to enhance the reliability on stock valuation. Collaterals such as immovable properties charged in favour of the bank should be got valued once in three years by valuers appointed as per the guidelines approved by the Board of Directors.

### 3.5.3. Substandard Assets

(i) A general provision of 10 percent on total outstanding should be made without making any allowance for ECGC guarantee cover and securities available.

(ii) The ‘unsecured exposures’ which are identified as ‘substandard’ would attract additional provision of 10 percent, i.e., a total of 20 percent on the outstanding balance. However, in view of certain safeguards such as accounts available in respect of infrastructure lending, infrastructure loan accounts which are classified as sub-standard will attract a provisioning of 15 percent instead of the aforesaid prescription of 20 percent. To avail of this benefit of lower provisioning, the banks should have in place an appropriate mechanism to the cash flows and also have a clear and legal first claim on these cash flows. The provisioning requirement for unsecured ‘doubtful’ assets is 100 percent. Unsecured exposure is defined as an exposure where the realizable value of the security, as assessed by the bank/approved valuers/Reserve Bank’s inspecting officers, is not more than 10 percent, ab-initio, of the outstanding exposure. ‘Exposure’ shall include all funded and non-funded exposures (including underwriting and similar commitments). ‘Security’ will mean tangible security properly discharged to the bank and will not include intangible securities like guarantees (including State government guarantees), comfort letters etc.

i. In order to enhance transparency and ensure correct reflection of the unsecured advances in Schedule 9 of the bank’s balance sheet, it is advised that the following would be applicable from the financial year 2009-10 onwards:

a. a) For determining the amount of unsecured advances for reflecting in schedule 9 of the published balance sheet, the rights, licenses, authorizations, etc., charged to the banks as collateral in respect of projects (including infrastructure projects) financed by them, should not be reckoned as tangible security. Hence such advances shall be reckoned as unsecured.
b. b) However, banks may treat annuities under build-operate-transfer (BOT) model in respect of road / highway projects and toll collection rights, where there are provisions to compensate the project sponsor if a certain level of traffic is not achieved, as tangible securities subject to the condition that bank’s right to receive annuities and toll collection rights is legally enforceable and irrevocable.

c. c) Banks should also disclose the total amount of advances for which intangible securities such as charge over the rights, licenses, authority, etc. has been taken as also the estimated value of such intangible collateral. The disclosure may be made under a separate head in “Notes to Accounts”. This would differentiate such loans from other entirely unsecured loans.

3.5.4. Standard Assets

i. The provisioning requirements for all types of standard assets stands amended as below, with effect from November 5, 2009. Banks should make general provision for standard assets at the following rates for the funded outstanding on global loan portfolio basis:

a. Direct advances to agricultural and SME sectors at 0.25 percent;

b. advances to Commercial Real Estate (CRE) Sector at 1.00 percent;

c. All other loans and advances not included in (a) and (b) above at 0.40 percent.

ii. The revised norms would be effective prospectively but the provisions held at present should not be reversed. However, in future, if by applying the revised provisioning norms, any provisions are required over and above the level of provisions currently held for the standard category assets, these should be duly provided for.

iii. While the provisions on individual portfolios are required to be calculated at the rates applicable to them, the excess or shortfall in the provisioning, vis-à-vis the position as on any previous date, should be determined on an aggregate basis. If the provisions on an aggregate basis required to be held with effect from November 5, 2009 are less than the provisions already held, the provisions rendered surplus should not be reversed to P&L and should continue to be maintained at the existing level. In case of shortfall determined on aggregate basis, the balance should be provided for by debit to P&L.

iv. The provisions on standard assets should not be reckoned for arriving at net NPAs.

v. The provisions towards Standard Assets need not be netted from gross advances but shown separately as ‘Contingent Provisions against Standard Assets’ under ‘Other Liabilities and Provisions Others’ in Schedule 5 of the balance sheet.

3.5.5. Prudential Norms on Creation and Utilization of Floating Provisions Principle for Creation of Floating Provisions by Banks

The bank’s board of directors should lay down approved policy regarding the level to which the floating provisions can be created. The bank should hold floating provisions for ‘advances’ and ‘investments’ separately and the guidelines prescribed will be applicable to floating provisions held for both ‘advances’ & ‘investment’ portfolios.
3.5.6. Principle for Utilization of Floating Provisions by Banks

a. The floating provisions should not be used for making specific provisions as per the extent prudential guidelines in respect of non-performing assets for making regulatory provisions for standard assets. The floating provisions can be used only for contingencies under extraordinary circumstances for making specific provisions in impaired accounts after obtaining board’s approval and with prior permission of RBI. The boards of the banks should lay down an approved policy as to what circumstances would be considered extraordinary.

b. To facilitate bank’s boards to evolve suitable policies in this regard, it is clarified that the extra-ordinary circumstances refer to losses which do not arise in the normal course of business and are exceptional and non-recurring in nature. These extra-ordinary circumstances could broadly fall under three categories viz. General, Market and Credit. Under general category, there can be situations where bank is put unexpectedly to loss due to events such as civil unrest or collapse of currency in a country. Natural calamities and pandemics may also be included in the general category. Market category would include events such as a general melt down in the markets, which affects the entire financial system. Among the credit category, only exceptional credit losses would be considered as an extra-ordinary circumstance.

c. In terms of the Agricultural Debt Waiver and Debt Relief Scheme, 2008, lending instructions shall neither claim from the Central Government, nor recover from the farmer, interest in excess of the principal amount, unapplied interest, penal interest, legal charges, inspection charges, miscellaneous charges, etc. All such interest / charges will be borne by the lending institutions. In view of the extraordinary circumstances in which the banks are required to bear such interest / charges, banks are allowed, as a one time measure, to utilize, at their discretion, the Floating Provisions held for ‘advances’ portfolio, only to the extent of meeting the interest / charges referred to above.

3.5.7. Accounting

Floating provisions cannot be reversed by credit to the profit and loss account. They can only be utilized for making specific provisions in extraordinary circumstances as mentioned above. Until such utilization, these provisions can be netted off from gross NPAs to arrive at disclosure of net NPAs. Alternatively, they can be treated as part of Tier II capital within the overall ceiling of 1.25% of total risk weighted assets.

3.5.8. Disclosures

Banks should make comprehensive disclosures on floating provisions in the “notes on accounts” to the balance sheet on (a) opening balance in the floating provisions account, (b) the quantum of floating provisions made in the accounting year, (c) purpose and amount of draw down made during the accounting year, and (d) closing balance in the floating provisions account.

3.5.9. Additional Provisions for NPAs at Higher Than Prescribed Rates

The regulatory norms for provisioning represent the minimum requirement. A bank may voluntarily make specific provisions for advances at rates which are higher than the rates prescribed under existing regulations, to provide for estimated actual loss in
collectible amount, provided such higher rates are approved by the Board of Directors and consistently adopted from year to year. Such additional provisions are not to be considered as floating provisions. The additional provisions for NPAs, like the minimum regulatory provision on NPAs, may be netted off from gross NPAs to arrive at the net NPAs.

3.5.10. Provisions on Leased Assets

i. 10 percent of the sum of the net investment in the lease and the unrealized portion of finance income net of finance charge component. The terms ‘net investment in the lease’, ‘finance income’ and ‘finance charge’ are as defined in ‘AS 19 Leases’ issued by the ICAI.

   a. Unsecured lease exposures, as defined in paragraph 5.4 above, which are identified as ‘substandard’ would attract additional provision of 10 percent, i.e., a total of 20 percent.

Doubtful Assets

100 percent of the extent to which, the finance is not secured by the realizable value of the leased asset, Realisable value is to be estimated on a realistic basis. In addition to the above provision, provisions at the following rates should be made on the sum of the net investment in the lease and the unrealized portion of finance income net of finance charge component of the secured portion, depending upon the period for which asset has been doubtful.

Loss assets

The entire asset should be written off. If for any reason, an asset is allowed to remain in books, 100 percent of the sum of the net investment in the lease and the unrealized portion of finance income net of finance charge component should be provided for.

3.5.11. Guideline for Provisions under Special Circumstances

Advances granted under rehabilitation packages approved by BIFR/term lending institutions.

i. In respect of advances under rehabilitation package approved by BIFR/term lending institutions, the provision should continue to be made in respect of dues to the bank on the existing credit facilities as per their classification as substandard or doubtful asset.

ii. As regards the additional facilities sanctioned as per package finalized by BIFR and/or term lending institutions, provision on additional facilities sanctioned need not be made for a period of one year from the date of disbursement.

iii. In respect of additional credit facilities granted to SSI units which are identified as sick [as defined in Section IV (Para 2.8) of RPCD circular RPCD. PLNFS. BC. No. 83/06.02.31/2004-2005 dated 1 March 2005] and where rehabilitation packages/nursing programmes have been drawn by the banks themselves or under consortium arrangements, no provision need be made for a period of one year.

Advance against term deposits, NSCs eligible for surrender, IVPs, KVPs, gold ornaments, government & other securities and life insurance policies would attract provisioning requirements as applicable to their asset classification status.
Treatment of Interest Suspense Account

Amounts held in Interest Suspense Account should not be reckoned as part of provisions. Amounts lying in the Interest Suspense Account should be deducted from the relative advances and thereafter, provisioning as per the norms, should be made on the balances after such deduction.

Advance Covered by ECGC Guarantee

In the cash of advances classified as doubtful and guaranteed by ECGC, provision should be made only for the balance in excess of the amount guaranteed by the Corporation. Further, while arriving at the provision required to be made for doubtful assets, realizable value of the securities should first be deducted from the outstanding balance in respect of the amount guaranteed by the Corporation and then provision made as illustrated hereunder:

Advance Conversed by CGTSI Guarantee

In case the advance covered by CGTSI guarantee becomes non-performing, no provision need be made towards the guaranteed portion. The amount outstanding in excess of the guaranteed portion should be provided for as per the extant guidelines on provisioning for non-performing advances. Two illustrative examples are given below:

Takeout Finance

The lending institution should make provisions against a ‘takeout finance’ turning into NPA pending its takeover by the taking over institution. As and when the asset is taken-over by the taking over institution, the corresponding provisions could be reversed

Reserve for Exchange Rate Fluctuations Account (RERFA)

When exchange rate movements of Indian rupee turn adverse, the outstanding amount of foreign currency denominated loans (where actual disbursement was made in Indian Rupee) which become overdue goes up correspondingly, with its attendant implications of provisioning requirements. Such assets should not normally be revalued. In case such assets need to be revalued as per requirement of accounting practices or for any other requirement, the following procedure may be adopted:

- The loss on revaluation of assets has to be booked in the bank’s Profit & Loss Account
- Besides the provisioning requirement as per Asset Classification, banks should treat the full amount of the Revaluation Gain relating to the corresponding assets, if any on account of Foreign Exchange Fluctuation as provision against the particular assets.  

Provisioning for Country Risk

Banks shall make provisions, with effect from the year ending 31 March 22003, on the net funded country exposures on a graded scale ranging from 0.25 to 100 percent according to the risk categories mentioned below. To begin with, banks shall make provisions as per the following schedule:

Banks are required to make provision for country risk in respect of a country where its net funded exposure is one per cent or more of its total assets.
The provision for country risk shall be in addition to the provisions required to be held according to the asset classification status of the asset. In the case of ‘loss assets’ and ‘doubtful assets’, provision held, including provision held for country risk, may not exceed 100% of the outstanding.

Banks may not make any provision for ‘home country’ exposures i.e. exposure to India. The exposures of foreign branches of Indian Banks to the host country should be included. Foreign banks shall compute the country exposures of their Indian branches and shall hold appropriate provisions in their Indian books. However, their exposures to India will be excluded.

Bank may make a lower level of provisioning (say 25% of the requirement) in respect of short term exposures (i.e. exposures with contractual maturity of less than 180 days)

**Excess Provisions on Sale of Standard Asset/NPAs**

If the sale is in respect of Standard Asset and the sale consideration is higher that the book value, the excess provisions may be credited to Profit and Loss Account.

Excess provisions which arise on sale of NPAs can be admitted as Tier II Capital subject to the overall ceiling of 1.25% of total Risk Weighted Assets. Accordingly, these excess provisions that arise on sale of NPAs would be eligible for Tier II Status in terms of paragraph 4.3.2. of Master Circular DBOD.No.BP.BC.73/21-01-002/2009-10 dated February 8, 2010 on prudential guidelines on Capital Adequacy and Market Discipline – New Capital Adequacy Framework (NCAF) and paragraph 2.1.1.2.Cof Master Circular DBOD.No.BP.B.C.6/21-01-002/2009-10 dated July 1, 2009 on Prudential Norms on Capital adequacy – Basel I Framework.

**Provisions for Diminution of Fair Value**

Provisions for diminution of fair value of restructured advances, both in respect of Standard Assets as well as NPAs, made on account of reduction in rate of interest and/or reschedulement of principal amount are permitted to be netted from the relative asset.

**Provisioning Norms for Liquidity Facility Provided for Securitisation Transactions**

The amount of liquidity facility drawn and outstanding for more than 90 days, in respect of securitization transactions undertaken in terms of our guidelines on securitization dated February 1, 2006, should be fully provided for.

**Provisioning Requirements for Derivative Exposures**

Credit exposures computed as per the current marked to market value of the contract, arising on account of the interest rate on foreign exchange derivative transactions, and gold, shall also attract provisioning requirement as applicable to the loan assets in the ‘standard’ category, of the concerned counterparties. All conditions applicable for treatment of the provisions for standard assets would also apply to the aforesaid provisions for derivative and gold exposures.

**Provisioning Coverage Ratio**

At present, the provisioning requirements for NPAs range between 10 per cent and 100 per cent of the outstanding amount, depending on the age of the NPAs and the security available. Banks can also make additional specific provisions subject to a consistent policy.
based on riskiness of their credit portfolios, because the rates of provisioning stipulated for NPAs are the regulatory minimum. It has been observed that there is a wide heterogeneity and variance in the level of provisioning coverage ratio across different banks.

Currently there is a realization from a macro-prudential perspective that banks should build up provisioning and capital buffers in good times i.e. when the profits are good, which can be used for absorbing losses in a downturn. With this in view, there is a need for improving the provisioning cover as the banking system is currently making good profits. This will enhance the soundness of individual banks, as also the stability of the financial sector. It has therefore been decided that banks should augment their provisioning cushions consisting of specific provisions against NPAs as well as floating provisions, and ensure that their total provisioning coverage ratio, including floating provisions, is not less than 70 per cent

Provisioning Coverage Ratio (PCR) is essentially the ratio of provisioning to gross non-performing assets and indicates the extent of funds a bank has kept aside to cover loan losses. Banks are advised to compute the PCR as per the format given in QAnnex-3.

Banks should achieve this norm not later than end-September 2010. Also, the PCR should be disclosed in the Notes to Accounts on the Balance Sheet.

3.6. DIVERGENCE IN ASSET CLASSIFICATION AND PROVISIONING

Banks should ensure scrupulous compliance with the instructions for recognition of credit impairment and view aberrations by dealing officials seriously.

Banks should establish appropriate internal systems to eliminate the tendency to delay or postpone the identification of NPAs, especially in respect of high value accounts. Banks should fix a minimum cut off point to decide what would constitute a high value account depending upon their respective levels. The cut off point should be valid for the entire year.

The responsibility and validation levels for ensuring proper asset classification may be fixed by the banks.

Where there is wilful non-compliance by the officials responsible for classification and is well documented, RBI would initiate deterrent action including imposition of monetary penalties.

3.7. CONCLUSION

The meaning of NPAs, income recognition, asset classification, provision norms and divergence in asset classification and provisions as per the norms of Reserve Bank of India is briefly discussed.