CHAPTER II

GUIDELINES OF NPA
CHAPTER - II
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CHAPTER II
GUIDELINES OF NPA FOR COMMERCIAL BANKS

2.1. GENERAL

2.1.1 As per the recommendations made by the Committee on Financial System under Chairmanship of Shri M. Narasimham, the Reserve Bank has introduced, in a phased manner, prudential norms for income recognition, asset classification and provisioning for the advances portfolio of the banks with a view to reflect true and fair picture of bank's actual financial health in its balance sheet.

2.1.2 Broadly, the policy of income recognition aimed to be objective and based on record of recovery rather than on any subjective considerations. Likewise, 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 into different categories. Availability of security or net worth of the borrower /guarantor should not be taken into account for the purpose of treating an advance as non-performing asset or otherwise, as income recognition is based on the record of recovery.

2.1.3 With the introduction of prudential norms, the Health Code based system for classification of advances has ceased to be a subject of supervisory interest. As such, all related reporting requirements, etc. also ceased to be a supervisory requirement, but could be continued in the banks entirely at their discretion and the management policy, if felt necessary.
2. 2. NON-PERFORMING ASSETS (NPA)

2.2.1 Classification of Assets as Non-Performing

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

Earlier an asset was considered as nonperforming asset (NPA) based on the concept of 'Past Due'.

A 'nonperforming asset' (NPA) was defined as credit in respect of which interest and/or instalment of principal has remained 'past due' for a specific period of time. The said specific period was reduced in a phased manner as described in Table 2.1

<table>
<thead>
<tr>
<th>Year ending 31 March</th>
<th>Specific period</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993</td>
<td>4 quarters</td>
</tr>
<tr>
<td>1994</td>
<td>3 quarters</td>
</tr>
<tr>
<td>1995</td>
<td>2 quarters</td>
</tr>
</tbody>
</table>

Source: IRAC norms RBI web site

Past due: An amount is considered as past due, when it remains outstanding for 30 days beyond the due date. However, with effect from March 31, 2001 the 'past due' concept has been dispensed with.

Accordingly, from March 31, 2001, a non-performing asset (NPA) is an advance, where:

(i) Interest and/or instalment of principal remain overdue* for a period of more than 180 days in respect of a Term Loan.

(ii) The account remains 'Out of order' for a period of more than 180 days, in respect of an Overdraft/Cash Credit (OD/CC).

(iii) The bill remains overdue for a period of more than 180 days, in the case of bills purchased and discounted.
(iv) Interest and/or instalment of principal remain overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purposes as indicated in Annexure 1, and in respect of agriculture loans, other than those specified in Annexure 1 identification of NPAs would be done on the same basis as non-agricultural advances.

(v) Any amount to be received remains overdue for a period of more than 180 days in respect of other accounts.

* Any amount due to the bank under any credit facility, if not paid by the due date fixed by the bank becomes overdue.

2.2.2 With the view of moving towards international best practices and to ensure greater transparency, it was decided to adopt the '90 days’ overdue norms for identification of NPAs, from the year ending 31 March 2004.

Accordingly, with effect from 31 March 2004, a non-performing asset is a loan or an advance where:

(i) Interest and/or instalment of principal remain overdue for a period of more than 90 days in respect of a Term Loan.

(ii) The account remains 'Out of order'@ for a period of more than 90 days, in respect of an Overdraft/Cash Credit (OD/CC).

(iii) The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,

(iv) Interest and/or instalment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purposes, and in respect of agriculture loans, other than those specified in 2.7.1.11 identification of NPAs would be done on the same basis as non-agricultural advances.
(v) Any amount to be received remains overdue for a period of more than 90 days in respect of other 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 cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 180 days (90 days from 31.03.2004) or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'".

2.2.3 With effect from September 30, 2004 the following revised norms were applicable to all direct agricultural advances (as listed in the Annexure I):

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

(ii) For the purpose of these guidelines, "long duration" crops would be crops with crop season longer than one year and crops, which are not "long duration" crops would be treated as "short duration" crops.

(iii) The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers' Committee in each state.

(iv) Depending upon the duration of crops raised by an agriculturist, the above NPA norms would also be made applicable to agricultural term loans availed of by him. In respect
of agricultural loans, other than those specified in the Annexure 1 and term loans given to nonagriculturists, identification of NPAs would be done on the same basis as non-agricultural advances which, at present, is the 90 days delinquency norm. 

(v) Banks have to ensure that while granting loans and advances, realistic repayment schedules are fixed on the basis of cash flows / fluidity with the borrowers. 

2.2.4 **Identification of assets as NPAs should be done on an ongoing basis**

The system should ensure that identification of NPAs is done on an on-going basis and 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 prescribed norms. Banks should also make provisions for NPAs as at the end of each calendar quarter i.e as at the end of March/June/September/December, so that the income and expenditure account for the respective quarters as well as the P&L account and balance sheet for the year end reflects the provision made for NPAs 

2.2.5 **Charging of interest at monthly rests**

(i) Banks should start charging interest at monthly rests in the context of adopting 90 days' norm for recognition of loan impairment from the year ending 31 March 2004 and consequential need for close monitoring of borrowers' accounts. However, the date of classification of an advance as NPA, should not be changed on account of charging of interest at monthly basis. Banks should classify an account as NPA only if the interest charged during any quarter is not serviced fully within 180
days from the end of the quarter w.e.f. April 1, 2002 and 90 days from the end of the quarter w.e.f. March 31, 2004.

(ii) The practice of charging/compounding of interest on agricultural advances was linked to crop seasons and the instructions regarding charging of interest on monthly rests is not be applicable to agricultural advances.

(iii) Banks had to move over to monthly compounding of interest from 1 April 2003 as under:

(a) In the case of Cash Credit and Overdrafts application of interest on monthly rests was applicable from 1 April 2003.

(b) In the case of loans of longer/ fixed tenor, banks did move over to application of interest at monthly rests at the time of review or renewal of such loan accounts.

(c) Interest at monthly rests is applicable in case of all new term loans and other loans of longer/fixed tenor.

(iv) While compounding interest at monthly rests effective from 1 April 2003, banks had to ensure that in respect of advances where administered interest rates are applicable, they should re-align the rates suitably keeping in view the minimum lending rate charged by the bank (in view of the freedom given to them for fixing lending rates) so that they comply with the same. In all other cases also, banks should ensure that the effective rate does not go up merely on account of the switchover to the system of charging interest on monthly rests.

(v) Banks had to take into consideration due date/s fixed on the basis of fluidity with borrowers and harvesting/marketing season while charging interest and compound the same if the loan/ instalment becomes overdue in respect of short duration crops and allied agricultural activities.
The diagram showing the transition from one category of Non performing Asset to the other is drawn in Diagram 2.1

Source: Banking Update July 2004
2.2 Treatment of Accounts as NPAs

2.2.6 Record of Recovery

(i) The treatment of an asset as NPA should be based on the record of recovery. Banks should not treat an advance as NPA merely due to existence of some deficiencies which are of temporary in nature such as non-availability of adequate drawing power, balance outstanding exceeding the limit, nonsubmission of stock statements and the non-renewal of the limits on the due date, etc. Where there is a threat of loss, or the recoverability of the advances is in doubt, the asset should be treated as NPA.

(ii) A credit facility should be treated as NPA as per norms given in paragraph 2.1 above. However, where the accounts of the borrowers have been regularised by repayment of overdue amounts through genuine sources (not by sanction of additional facilities or transfer of funds between accounts), the accounts need not be treated as NPAs. In such cases, it should, however, be ensured that the accounts remain in order subsequently and a solitary credit entry made in an account on or before the balance sheet date which extinguishes the overdue amount of interest or instalment of principal is not reckoned as the sole criteria for treatment the account as a standard asset.

2.2.7 Treatment of NPAs – Borrower-wise and not Facility-wise

(i) In respect of a borrower having more than one facility with a bank, all the facilities granted by the bank will have to be treated as NPA and not the particular facility or part thereof which has become irregular.

(ii) However, in respect of consortium advances or financing under multiple banking arrangement, each bank may classify the borrowal accounts according to its own record of recovery and
other aspects having a bearing on the recoverability of the advances.

2.2.8 **Agricultural Advances – Default in repayment due to natural calamities**

(i) Where natural calamities impair the repaying capacity of agricultural borrowers, primary (urban) co-operative banks, as a relief measure may decide on their own to:
(a) convert the short-term production loan into a term loan or re-schedule the repayment period, and
(b) sanction fresh short-term loans

(ii) In such cases of conversion or re-schedulement, the term loan as well as fresh short-term loan may be treated as current dues and need not be classified as non performing asset (NPA). The asset classification of these loans would, therefore, be governed by the revised terms and conditions and these would be treated as NPA under the extant norms applicable for classifying agricultural advances as NPAs.

2.2.9 **Housing Loan to Staff of Bank**

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 a default in repayment of instalment of principal or payment of interest on the respective due dates.
2.2.5 Credit facilities Guaranteed by Central /State Government

(i) The credit facilities backed by guarantee of the Central Government though overdue should not be treated as NPA

(ii) This exemption from classification of government guaranteed advances as NPA is not for the purpose of recognition of income.

(iii) Advances sanctioned with effect from 1 April 2000, against state government guarantees should be classified as NPA in the normal course, if the guarantee gets invoked and remains in default for more than 90 days (with effect from 31.03.2004).

2.2.10 Project Financing

In the case of bank finance given for industrial projects 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 NPA, with reference to the date of debit of interest. They become overdue after due date for payment of interest, if uncollected.

2.2.11 Concept of Commencement of Commercial Production and Restructuring of Loan Accounts

(i) Where a unit commences commercial production, but the level and volume of production reached immediately after the date of completion of the project is not adequate to generate the required cash flow to service the loan, it may be necessary to re-fix the repayment schedule. In such cases, the Board of Directors of the bank may lay down broad parameters for guidance of the staff for taking a view whether the unit has stabilised commercial production and there is a need for rescheduling of the loan to treat
such advance as NPA or not. In framing these parameters, the following points may be kept in view:

(a) In order to arrive at a decision as to whether the unit/project has achieved regular commercial production, the main guiding factor would be whether the unit has achieved cash break-even in order to service the loan.

(b) If in the opinion of the bank, the bottleneck in achieving regular commercial production is of a temporary nature not indicative of any long-term impairment of the unit's economic viability and it is likely to achieve cash break even if some time is allowed, the bank may reschedule the loan and treat the asset as standard.

(c) However, the lead time would normally not exceed one year from the schedule of commencement of commercial production as indicated in the terms of sanction.

(ii) In respect of credit facilities sanctioned under consortium arrangements, the decision as to whether the borrowing unit has achieved regular commercial production and there is a need for rescheduling may be taken by the lead institution or lead bank and other participating institutions/banks may follow the same.

(iii) (a) Treatment of restructured accounts
(i) Restructuring/rescheduling/re negotiation - of the terms of loan agreement in respect of standard and substandard accounts can take place at three stages, viz.
(a) before commencement of commercial production,
(b) after commencement of commercial production but before the asset has been classified as sub-standard, and
(c) after commencement of commercial production and the asset has been classified as sub-standard.

(ii) In each of the foregoing three stages, the rescheduling, etc. of principal and/or of interest could take place with or without sacrifice.

(b) Treatment of restructured standard accounts

(i) A rescheduling of the instalments of principal alone, at any of the stages at (a) and (b) above would not cause a standard asset to be classified in the sub-standard category provided the loan/credit facility is fully secured.

(ii) A rescheduling of interest element at any of the aforesaid two stages would not cause an asset to be down-graded to sub-standard category subject to the condition that the amount of sacrifice, if any, in the element of interest, is either written off or provision is made to the extent of the sacrifice involved.

(c) Treatment of restructured sub-standard accounts

(i) A rescheduling of the instalment of principal alone would render a sub-standard asset eligible to be continued in the sub-standard category for the specified period, provided the loan/credit facility is fully secured.

(ii) A rescheduling of interest element would render a substandard asset eligible to be continued to be classified in substandard category for the specified period subject to the condition that the amount of sacrifice, if any, in the element of interest, is either written off or provision is made to the extent of the sacrifice involved.

(iii) The substandard accounts which have been subjected to restructuring, etc. whether in respect of principal instalment or interest amount, would be eligible to be upgraded to the standard category only after the specified period, i.e. one year after the date when the first payment of interest or principal, whichever is
earlier, falls due, subject to satisfactory performance during the period.

(iv) In case, however, the satisfactory performance during the one year period is not evidenced, the asset classification of the restructured account would be governed as per the applicable prudential norms with reference to the pre-restructuring payment schedule.

(d) Applicability
(i) The foregoing norms for restructuring, etc. would be applicable to standard and sub-standard assets only. All other prudential guidelines relating to income recognition, asset classification and provisioning would remain unaltered.
(ii) The aforesaid instructions would be applicable to all types of credit facilities, including working capital limit extended to industrial units, provided they are fully covered by tangible securities.
(iii) These guidelines are not applicable to credit facilities extended to traders.
(iv) While assessing the extent of security available to the credit facilities, collateral security would also be reckoned, provided such collateral is a tangible security properly charged to the bank and is not in the intangible form like guarantee, etc.

(e) General
All standard and sub-standard accounts subjected to restructuring, etc. would be eligible for fresh financing of funding requirements, as per normal policy parameters and eligibility criteria.
2.2.12 Other Advances

(i) Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs and Life policies need not be treated as NPAs although interest thereon may not have been paid for more than 90 days (with effect from 31.03.2004), provided adequate margin is available in the accounts.

(ii) Banks should fix monthly/quarterly instalments for repayment of gold loans for non-agricultural purposes taking into account the pattern of income generation and repayment capacity of the borrowers and such gold loan accounts may be treated as NPAs if instalments of principal and/or interest thereon are overdue for more than 90 days (with effect from 31.03.2004).

(iii) As regards gold loans granted for agricultural purposes, interest is required to be charged as per Supreme Court judgement at yearly intervals and payment should coincide with the harvesting of crops. Accordingly, such advances will be treated as NPA only if instalments of principal and/or interest become overdue after due date.

2.2.13 Recognition of Income on Investment Treated as NPAs

The investments are also subject to the prudential norms on income recognition. Banks should not book income on accrual basis in respect of any security irrespective of the category in which it is included, where the interest/principal is in arrears for more than 90 days (with effect from 31 Mar 2004)
2.2.14 NPA Reporting to Reserve Bank

Banks should report the figures of NPAs to the Regional Office of the Reserve Bank at the end of each year within two months from the close of the year in the prescribed Proforma.

2.3 ASSET CLASSIFICATION

2.3.1 Classification

Banks should classify their assets into the broad groups as shown in Box 2.1

Box 2.1

SHOWING THE ASSET CLASSIFICATION

(i) Standard Assets
(ii) Sub-standard Assets
(iii) Doubtful Assets
(iv) Loss Assets

Source: RBI web site

2.3.2 Definitions

2.3.2.1 Standard Assets

Standard Asset is one which does not disclose any problems and which does not carry more than normal risk attached to the business. Such an asset should not be an NPA.

2.3.2.2 Sub-standard Assets

(i) With effect from 31.03.2001, the sub-standard asset is one which has remained as NPA for a period not exceeding 18 months. However, with effect from 31 March 2005 this period of 18 months has been reduced to 12 months.

(ii) In case of sub-standard assets, the current net worth of the borrowers/ guarantors or the current market value of the security charged is not enough to ensure recovery of the dues to the
banks in full. In other words, such assets will have well defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.

(iii) An asset where the terms of the loan agreement regarding interest and principal have been re-negotiated or rescheduled after commencement of production, should be classified as sub-standard and should remain in such category for at least 18 months of satisfactory performance under the re-negotiated or rescheduled terms. However, the period of 18 months may be reduced to one year (or four quarters) if the interest and instalment of loans have been serviced regularly as per the terms of re-schedulement. In other words, the classification of an asset should not be upgraded merely as a result of rescheduling, unless there is satisfactory compliance of this condition.

2.3.2.3 Doubtful Assets

(i) With effect from 31.03.2001, an asset is required to be classified as doubtful, if it has remained in the sub-standard category for 18 months. As in the case of sub-standard assets, rescheduling does not entitle the bank to upgrade the quality of an advance automatically.

(ii) A loan classified as doubtful has all the weaknesses inherent as that classified as sub-standard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

Note: With effect from 31 March 2005, an asset is classified as doubtful if it remained in the sub-standard category for 12 months. Banks are permitted to phase the consequent additional
provisioning over a four-year period commencing from the year ended 31 March 2005, with a minimum of 20 per cent each year.

2.3.2.4 Loss Assets
A loss asset is one where loss has been identified by the bank or internal or external auditors or by the Co-operation Department or by the Reserve Bank of India inspection but the amount has not been written off, wholly or partly. In other words, such an asset is considered un-collectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

2.3.3 Guidelines for Classification of Assets
2.3.3.1 Basic Considerations
(i) Broadly speaking, classification of assets into above categories should be done taking into account the degree of well defined credit weaknesses and extent of dependence on collateral security for realisation of dues.
(ii) In respect of accounts where there are potential threats to recovery on account of erosion in the value of security and existence of other factors such as, frauds committed by borrowers, it will not be prudent for the banks to classify them first as sub-standard and then as doubtful after expiry of 18 months (12 months with effect from 31.03.2005) from the date the account has become NPA. Such accounts should be straight away classified as doubtful asset or loss asset, as appropriate, irrespective of the period for which it has remained as NPA.
2.3.3.2 Advances Granted under Rehabilitation Packages Approved by BIFR/Term Lending Institutions

(i) Banks are not permitted to upgrade the classification of any advance in respect of which the terms have been renegotiated unless the package of re-negotiated terms has worked satisfactorily for a period of one year. While the existing credit facilities sanctioned to a unit under rehabilitation packages approved by BIFR/term lending institutions will continue to be classified as sub-standard or doubtful as the case may be in respect of additional facilities sanctioned under the rehabilitation packages the income recognition and asset classification norms will become applicable after a period of one year from the date of disbursement.

(ii) A similar relaxation be made in respect of SSI units which are identified as sick by banks themselves and where rehabilitation packages/nursing programmes have been drawn by the banks themselves or under consortium arrangements.

2.3.3.3 Internal System for Classification of Assets as NPA

(i) 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 cut-off point should be valid for the entire accounting year.

(ii) Responsibility and validation levels for ensuring proper asset classification may be fixed by the bank.

(iii) 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 extant guidelines.

(iv) RBI would continue to identify the divergences arising due to non-compliance, for fixing accountability. Where there is wilful non-compliance by the official responsible for classification and is well documented, RBI would initiate deterrent action including imposition of monetary penalties.

2.4. INCOME RECOGNITION

2.4.1 Income Recognition - Policy

2.4.1.1 The policy of income recognition has to be with certain objective and based on the record of recovery. Income from nonperforming assets (NPA) is not recognised on accrual basis but is booked as income only when it is actually received. Therefore, banks should not charge and take to income account interest on all non-performing assets.

2.4.1.2 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 available in the accounts.

2.4.1.3 Fees and commissions earned by the banks as a result of re-negotiations or rescheduling of outstanding debts should be recognised on an accrual basis over the period of time covered by the re-negotiated or rescheduled extension of credit.

2.4.1.4 If Government guaranted advances become 'overdue' and thereby NPA, the interest on such advances should not be taken to income account unless the interest has been realised. The exemption, if any, is granted only for the purpose of asset classification.
2.4.2 Reversal of Income on Accounts Becoming NPAs

2.4.2.1 If any advance including bills purchased and discounted becomes NPA as at the close of any year, interest accrued and credited to income account in the corresponding previous year, should be reversed or provided for if the same is not realised. This will apply to Government guaranteed accounts also.

2.4.2.2 If interest income from assets in respect of a borrower becomes subject to non-accrual, fees, commission and similar income with respect to same borrower that have been accrued should ceased to accrue in the current period and should be reversed or provided for with respect to past periods, if remains uncollected.

2.4.2.3 Banks undertaking equipment leasing should follow prudential accounting standards. Lease rentals comprises two elements – a finance charge (i.e. interest charge) and a charge towards recovery of the cost of the asset. The interest component alone should be taken to income account. Such income taken to income account, before the asset became NPA, and remained unrealised should be reversed or provided for in the current accounting period.

2.4.3 Partial Recovery of NPAs

Interest realised 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.

2.4.4 Interest Application

2.4.4.1 In case of NPAs where interest has not been received for 180 days (90 days with effect from 31.03.2004) or more, as a prudential norm, there is no use in debiting (charging) the said
account by interest accrued in subsequent quarters and taking this accrued interest amount as income of the bank as the said interest is not being received. It is simultaneously desirable to show such accrued interest separately or park in a separate account so that interest receivable on such NPA account is computed and shown as such, though not accounted as income of the bank for the period.

2.4.4.2 The interest accrued in respect of performing assets may be taken to income account as the interest is reasonably expected to be received. However, if interest is not actually received for any reason in these cases and the account is to be treated as an NPA as per the guidelines, then the amount of interest so taken to income should be reversed or should be provided for in full.

2.4.4.3 With a view to ensure uniformity in accounting the accrued interest in respect of both the performing and non-performing assets, the following guidelines may be adopted

(i) Interest accrued in respect of non-performing advances should not be debited to borrowal accounts but shown separately under 'Interest Receivable Account' on the 'Property and Assets' side of the balance sheet and corresponding amount shown under 'Overdue Interest Reserve Account' on the 'Capital and Liabilities' side of the balance sheet.

(ii) In respect of borrowal accounts, which are treated as performing assets, accrued interest can alternatively be debited to the borrowal account and credited to Interest account and taken to income account. In such case where the accrued interest has been debited to such borrowal account but not actually received before the end of the accounting year viz. 31 March, or the account has to be treated as NPA earlier as per the guidelines, equivalent amount corresponding to such unrealised interest
should be reversed by debit to profit and loss account and credited to 'Overdue Interest Reserve' Account.

2.4.4.4 In this context, it may be clarified that overdue interest reserve is not created out of the real or earned income received by the bank and as such, the amounts held in the Overdue Interest Reserve Account can not be regarded as 'reserve' or a part of the owned funds of the banks. It will also be observed that the Balance Sheet format prescribed under the Third Schedule to the Banking Regulation Act,

2.5. PROVISIONING NORMS
2.5.1 Norms for Provisioning on Loans & Advances
2.5.1.1 In conformity with the prudential norms, provisions should be made on the non-performing assets on the basis of classification of assets into prescribed categories as detailed in paragraph 3 above.
2.5.1.2 Taking into account the time lag between an account becoming doubtful of recovery, its recognition as such, the realisation of the security and the erosion over time in the value of security charged to the bank, the banks should make provision against loss assets, doubtful assets and substandard assets.

(i) Loss Assets
(a) The entire assets should be written off after obtaining necessary approval from the competent authority and as per the provisions of the Co-operative Societies Act/Rules. If the assets are permitted to remain in the books for any reason, 100 per cent of the outstanding should be provided for.
(b) In respect of an asset identified as a loss asset, full provision at 100 per cent should be made if the expected salvage value of the security is negligible.

(ii) **Doubtful Assets**

(a) 100 per cent of the extent to which the advance is not covered by the realisable value of the security to which the bank has a valid recourse should be made and the realizable value is estimated on a realistic basis.

(b) In regard to the **secured portion**, provision may be made on the following basis, at the rates ranging from 20 per cent to 100 per cent of the secured portion depending upon the period for which the asset has remained doubtful:

<table>
<thead>
<tr>
<th>Period for which the advance remained in ‘doubtful’ category</th>
<th>Provision</th>
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<tbody>
<tr>
<td>Box 2.2</td>
<td>Box 2.2</td>
</tr>
<tr>
<td>Up to one year</td>
<td>20 per cent</td>
</tr>
<tr>
<td>One to three years</td>
<td>30 per cent</td>
</tr>
<tr>
<td>More than three years</td>
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(i) completed as on March 31, 2004

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<th>Year</th>
<th>Provision</th>
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<tr>
<td>2005</td>
<td>50 per cent as on March 31, 2004</td>
</tr>
<tr>
<td>2006</td>
<td>60 per cent with effect from March 31,</td>
</tr>
<tr>
<td></td>
<td>75 per cent with effect from March 31,</td>
</tr>
<tr>
<td>2007</td>
<td>100 per cent with effect from March 31,</td>
</tr>
</tbody>
</table>

Source: RBI web site
(ii) completed as on March 31, 2005
100 percent with effect from March 31, 2005

An attempt has been made by analyzing two illustrations
As furnished below for clarity in this regard.

**Illustration 1.** Existing stock of advances classified as 'doubtful more than 3 years' as on 31 March 2004
The outstanding amount as on 31 March 2004: Rs 25,000
Realisable value of security: Rs 20,000
Period for which the advance has remained in 'doubtful' category as on 31 March 2004: 4 years (i.e. Doubtful more than 3 years)
Provisioning requirement are shown in Table 2.2:

**Table 2.2**

<table>
<thead>
<tr>
<th></th>
<th>Showing Provisions on secured portion</th>
<th>Provisions on unsecured portion</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Secured Portion</td>
<td>Unsecured Portion</td>
</tr>
<tr>
<td></td>
<td>%</td>
<td>Amount</td>
</tr>
<tr>
<td>31 Mar 2004</td>
<td>50</td>
<td>10000</td>
</tr>
<tr>
<td>31 Mar 2005</td>
<td>60</td>
<td>12000</td>
</tr>
<tr>
<td>31 Mar 2006</td>
<td>75</td>
<td>15000</td>
</tr>
<tr>
<td>31 Mar 2007</td>
<td>100</td>
<td>20000</td>
</tr>
</tbody>
</table>

Source: RBI web site

**Illustration 2:** Advances classified as 'doubtful more than three years' on or after 1 April 2004
The outstanding amount as on 31 March 2004: Rs 10,000
Realisable value of security: Rs 8,000
Period for which the advance has remained in 'doubtful' category as on 31 March 2004: 2.5 years
Provisioning requirement is described in table 2.3:

Table 2.3
Provisions on
<table>
<thead>
<tr>
<th>Asset classification</th>
<th>% Amt</th>
<th>% Amt</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>31 Mar 2004 Doubtful 1 to 3 years</td>
<td>30</td>
<td>2400 100</td>
<td>2000 4400</td>
</tr>
<tr>
<td>31 Mar 2005 Doubtful over 3 years</td>
<td>100</td>
<td>8000 100</td>
<td>2000 10000</td>
</tr>
</tbody>
</table>

- Additional provisioning consequent upon the change in the definition of doubtful assets (vide para 3.2.2) effective from March 31, 2001 was to be made in phases as under:

- As on 31.03.2001, 50 percent of the additional provisioning requirement on the assets which became doubtful on account of new norm of 18 months for transition from sub-standard asset to doubtful category.

- As on 31.03.2002, balance of the provisions not made during the previous year, in addition to the provisions needed, as on 31.03.2002.

(iii) **Sub-standard Assets**
A general provision of 10 per cent on total outstanding should be made without making any allowance for DICGC/ECGC guarantee cover and securities vailable.

(iv) **Provision on Standard Assets**
(a) From the year ending 31.03.2000, the banks should make a general provision of a minimum of 0.25 per cent on standard assets.
(b) The provisions towards “standard assets” need not be netted from gross advances but shown separately as “Contingent
Provision against Standard Assets" under "Other Funds and Reserves" in the Balance Sheet.

(c) In case banks are already maintaining excess provision than what is required/prescribed by Statutory Auditor/RBI Inspection for impaired credits under Bad and Doubtful Debt Reserve, additional provision required for Standard Assets may be segregated from Bad and Doubtful Debt Reserve and the same may be parked under the head "Contingent Provisions against Standard Assets" with the approval of their Board of Directors. Shortfall if any, on this account may be made good in the normal course.

(d) The above contingent provision will be eligible for inclusion in Tier II capital.

(v) Higher provisions

There is no objection if the banks create bad and doubtful debts reserve beyond the specified limits on their own or if provided in the respective State Co-operative Societies Acts.

2.5.2 Provisioning Norms for sale of financial assets to Securitisation Companies( SC)/ Reconstruction Companies (RC)

(a) If the sale to SC/RC is at a price below the net book value(NBV) (i.e. book value less the provision held), the short fall should be written off / debited to P&L A/c of that year, subject to the provisions of the Co-operative societies Acts/rules/ administrative guidelines in regard to write-off of debts.

(b) If the sale is for a value higher than the NBV, the excess provision will not be reserved but will be utilised to meet the shortfall/ loss on account of sale of other assets to SC/RC.
2.5.3 **Guidelines for Provisions in Specific Cases**

(i) **Government guaranteed advances**

(a) In respect of advances sanctioned against State Government guarantee w.e.f. 01.04.2000, if the guarantee gets invoked and remains in default for more than 180 days (90 days with effect from 31.03.2004), the banks should make normal provisions as prescribed in paragraph 5.1.2 above.

(b) As regards advances guaranteed by State Governments in respect of which guarantee stands invoked as on 31.03.2000, necessary provision should be made, in a phased manner, during the financial years ending 31.03.2000 to 31.03.2003 with a minimum of 25 per cent each year.

(ii) **Advances granted under rehabilitation packages approved by BIFR/term lending institutions**

(a) The existing credit facilities sanctioned to a unit under rehabilitation package approved by BIFR/term lending institutions, should continue to be classified as sub-standard or doubtful asset as the case may be.

(b) However, the additional facilities sanctioned as per package finalised by BIFR and/or term lending institutions, the income recognition and asset classification norms will become applicable after a period of one year from the date of disbursement.

(c) In respect of additional credit facilities granted to SSI units which are identified as sick 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.
(iii) Advances against fixed/term deposit, NSCs eligible for surrender, IVPs, KVPs, and life policies are exempted from provisioning requirements.

(iv) Advances against gold ornaments, government securities and all other kinds of securities are not exempted from provisioning requirements.

(v) Advances covered by ECGC/DICGC guarantee
(a) In the case of advances guaranteed by DICGC/ECGC, provision should be made only for the balance in excess of the amount guaranteed by these Corporations. Further, while arriving at the provision required to be made for Doubtful Assets, realisable value of the securities should first be deducted from the outstanding balance in respect of the amount guaranteed by these Corporations and then provision made as illustrated hereunder:

**Example**
Outstanding Balance Rs. 4 lakhs DICGC Cover 50 per cent
Period for which the advance has remained doubtful More than 3 years. Value of security held (excludes worth of borrower/guarantor) Rs.1.50 lakhs  Provision required to be made is shown in Table 2.4;

**Table 2.4**
Showing Provision for Accounts under DICGC cover

<table>
<thead>
<tr>
<th>Outstanding balance</th>
<th>Rs.4.00 lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less: Value of security held</td>
<td>Rs.1.50 lakhs</td>
</tr>
<tr>
<td>Unrealised balance</td>
<td>Rs.2.50 lakhs</td>
</tr>
<tr>
<td>Less: DICGC Cover (50% of unrealisable balance)</td>
<td>Rs.1.25 lakhs</td>
</tr>
<tr>
<td>Net unsecured balance</td>
<td>Rs.1.25 lakhs</td>
</tr>
</tbody>
</table>

Source: RBI web site
Provision for unsecured portion of advance Rs.1.25 lakhs (@ 100 percent of unsecured portion)

Provision for secured portion of advance (as on March 31 2005)
Rs.0.90 lakhs (@ 60 per cent of secured portion of Rs.1.50 lakh).
Total provision required to be made Rs.2.15 lakhs (as on March 31, 2005).

(b) In case the banks are following more stringent method of provisioning in respect of advances covered by the guarantees of DICGC/ ECGC, as compared to the method given in earlier paragraphs, they may have the option to continue to follow the same procedure.

2.6. DIVERSION IN ASSET CLASSIFICATION AND PROVISIONING

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

(ii) 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.

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

(iv) 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.
2.7. CLARIFICATION OF TERMINOLOGY

2.7.1.1 Submission of Stock statements for working capital account

Banks should ensure that drawings in the working capital accounts are covered by the adequacy of current assets, since current assets are first appropriated in times of distress. Considering the practical 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 borrowal account will become NPA if such irregular drawings are permitted in the account for a continuous period of 180 days (90 days with effect from 31.03.2004).

2.7.1.2 Review / renewal of Working Capital limit

Regular and ad-hoc credit limits need to be reviewed/regularised not later than three months from the due date/date of ad-hoc 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/ad-hoc credit limits have not been reviewed or have not been reviewed within 180 days from the due date/date of ad-hoc sanction will be treated as NPA, which period will be reduced to 90 days with effect from 31.03.2004.
2.7.1.3 **Regularisation of the account around the date of balance sheet.**

The asset classification of borrowal accounts where a solitary or a few credits are recorded before the balance sheet date should be handled with care and without scope for subjectivity. Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as a NPA. In other genuine cases, the banks must furnish satisfactory evidence to the Statutory Auditors /Inspecting Officers about the manner of regularisation of the account to eliminate doubts on their performing status.

2.7.1.4 **Classification of NPAs where there is a threat to recovery**

An NPA need not go through the various stages of classification in case of serious credit impairment and such assets should be straightway classified as a doubtful/loss asset as appropriate. Erosion in the value of security can be reckoned as significant when the realizable value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be. Such NPAs may be straightaway classified under doubtful category and provisioning should be made as applicable to doubtful assets.

2.7.1.5 **Consortium accounts**

Asset classification of accounts under consortium should be based on the record of recovery of the individual member banks and other aspects having a bearing on the recoverability of the
advances. Where the remittances by the borrower under consortium lending arrangements are pooled with one 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 the other member banks, and therefore, be treated as NPA. The banks participating in the consortium should, therefore, arrange to get their share of recovery transferred from the lead bank or get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respective books.

2.7.1.6 Appropriation of recoveries
In the absence of a clear agreement between the bank and the borrower for the purpose, banks should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner.

2.7.1.7 Activities allied to agriculture
As indicated in para 2.1.3, the norms for classifying direct agricultural advances, as NPAs have since been revised w.e.f. September 30, 2004.

2.7.1.8 Overdues in other credit facilities
A number of banks adopt the practice of parking the dues of the borrower in respect of devolved letters of credit and invoked guarantees in a separate account which is not a regular sanctioned facility. As a result, these are not reflected in the principal operating account of the borrower. This renders application of the prudential norms for identification of NPAs difficult. It is, therefore, advised that if the debts arising out of devolvement of letters of credit or invoked guarantees are parked
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.

2.7.1.9 Treatment of loss assets
If the realisable value of the security, as assessed by the bank/approved valuers / RBI is less than 10 per cent of the outstanding in the borrowal accounts, the existence of security should be ignored and the asset should be straightaway classified as loss asset. It may be either written off after fully provided for by the bank.

2.7.1.10 Valuation of Security
With a view to bringing down divergence arising out of difference in assessment of the value of security it has been decided that in cases of NPAs with balance of Rs.10 lakh and above:

(a) The current assets and their valuation are looked into at the time of Statutory Audit/Concurrent audit. However, in order to enhance the reliability on stock valuations, stock audit at annual intervals by external agencies could be considered in case of larger advances. The cut off limit and the names of the external agencies may be finalised by the Board.

(b) 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.
2.7.1.11 Direct Finance to Farmers for Agricultural Purposes

I) Short-term loans for raising crops i.e. for crop loans. In addition, advances upto Rs.5 lakh to farmers against pledge/hypothecation of agricultural produce (including warehouse receipts) for a period not exceeding 12 months, where the farmers were given crop loans for raising the produce, provided the borrowers draw credit from one bank.

II) Medium and long-term loans (Provided directly to farmers for financing production and development needs).

(i) **Purchase of agricultural implements and machinery**
(a) Purchase of agricultural implements - Iron ploughs, harrows, hose, land-levellers, bundformers, hand tools, sprayers, dusters, haypress, sugarcane crushers, thresher machines, etc.
(b) Purchase of farm machinery - Tractors, trailers, power tillers, tractor accessories viz., disc ploughs, etc.
(c) Purchase of trucks, mini-trucks, jeeps, pick-up vans, bullock carts and other transport equipment, etc. to assist the transport of agricultural inputs and farm products.
(d) Transport of agricultural inputs and farm products.
(e) Purchase of plough animals.

(ii) **Development of irrigation potential through**
(a) Construction of shallow and deep tube wells, tanks, higher etc., and purchase of drilling units.
(b) Constructing, deepening clearing of surface wells, boring of wells, electrification of wells, purchase of oil engines and installation of electric motor and pumps.
(c) Purchase and installation of turbine pumps, construction of field channels (open as well as underground), etc.
(d) Construction of lift irrigation project.
(e) Installation of sprinkler irrigation system.
(f) Purchase of generator sets for energisation of pumpsets used for agricultural purposes.

(iii) **Reclamation and Land Development Schemes**
Bundling of farm lands, levelling of land, terracing, conversion of dry paddy lands into wet irrigable paddy lands, wasteland development, development of farm drainage, reclamation of soil lands and prevention of salinisation, reclamation of ravine lands, purchase of bulldozers, etc.

(iv) **Construction of farm buildings and structures, etc.**
Bullock sheds, implement sheds, tractor and truck sheds, farm stores, etc.

(v) **Construction and running of storage facilities**
Construction and running of warehouses, godowns, silos and loans granted to farmer for establishing cold storages used for storing own produce.

(vi) **Production and processing of hybrid seeds for crops.**
(vii) **Payment of irrigation charges, etc.**
Charges for hired water from wells and tube wells, canal water charges, maintenance and upkeep of oil engines and electric motors, payment of labour charges, electricity charges, marketing charges, service charges to Customs Service Units, payment of development cess, etc.
(viii) **Other types of direct finance to farmers**

(a) Short-term loans

(1) To traditional /non-traditional plantations and horticulture.

(b) Medium and long term loans

1. Development loans to all plantations, horticulture, forestry and wasteland.

2. Financing of small and marginal farmers for purchase of land for agricultural purposes.
2.8 GUIDELINES OF NPA FOR COOPERATIVE BANKS

The guidelines of NPA for cooperative Banks are identical to that of Commercial banks. The distinctive additional clause to be added to the guidelines are as follows under clause No.:

2.1.2 Exemptions: Gold Loans and small Loans upto Rs 1.00 lac are exempted from the 90days norm for recognition of impairment. These loans will continue to be governed by the 180days norms for classification as NPA even after 31,Mar 2004.
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