CHAPTER 5
MEANING OF NON
PERFORMING ASSETS
and PROVISIONING
NORMS
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5.1 General Introduction and meaning of NPA :
5.1.1 The previous chapters discussed the various items that appear in the balance sheet of a bank. This chapter highlights the meaning of NPAs, the prudential norms on Income Recognition and Asset Classification and Provisioning.

5.1.2 NPA is defined as a loan asset, which has ceased to generate any income for a bank whether in the form of interest or principal repayment. As per the prudential norms suggested by the Reserve Bank of India (RBI), a bank cannot book interest on an NPA on accrual basis. In other words, such interests can be booked only when it has been actually received. Therefore, an NPA account not only reduces profitability of banks by provisioning in the profit and loss account, but their carrying cost is also increased which results in excess & avoidable management attention. Apart from this, a high level of NPA also puts strain on a bank’s net worth because banks are under pressure to maintain a desired level of Capital Adequacy and in the absence of comfortable profit level; banks eventually look towards their internal financial strength to fulfil the norms thereby slowly eroding the net worth.

5.1.3 A common perspective is that banks’ non-performing loans are influenced by structural nature of the economy. The structural nature of India’s financial market has undergone significant changes due to financial sector reforms. Government intervention in the credit market has eased significantly. There has been shift in emphasis from direct instruments to indirect instruments of monetary management. Statutory pre-emption of banks’ funds has been reduced through lowering of CRR and SLR. Interest rates have been deregulated in order to facilitate price discovery and foster market mechanism. Banks have been given freedom to charge lending rates. Rapid advances in information technology has contributed to significant reduction in transaction costs, facilitated greater diversification of portfolio, and improvements in credit delivery of banks. Various studies have shown that NPAs have two components; the overhang component and the incremental component (Jalan, 2002, Munniappan, 2002). The overhang component arises due to infirmities in structural and institutional environment while the increment component arises from factors
internal to banks’ management and credit culture. At the international level, several studies have identified a range of factors influencing NPAs of banks. Some have argued that the problem of NPAs could be due to plain bad luck attributing to business cycle, and unanticipated shocks such as business failures of producing firms, and disruption of activities due to various calamities. Another viewpoint is that the problem of NPAs may be due to bad management by banks (Caprio, and Klingebiel, 2000). According to the latter view, in an increasingly competitive financial market, economic factors have evolved as the key influences on banks’ non-performing loans. In this context, various studies have underscored the role of banks’ lending policy in general and the ‘terms of credit’ defined over, inter alia, cost, maturity, and collateral in influencing the movement of banks non-performing loans (Reddy, 2004, Mohan, 2003, 2004, Sergio, 1996, McGoven, 1993, Christine, 1995, Bloem and Gorterl 2001). In the Indian context, during the period 1993-2004, the ratio of banks’ gross non-performing loans to advances has declined from about 24-25 per cent to 7.8 per cent amidst significant improvement in the lending terms. A comparative position of gross NPAs to advances ratio and the terms of credit variables including maturity (share of term loans in total advances), interest cost of deposits, operating expenses to asset ratio, total expenses to assets ratio, lending rates and credit-deposit ratio of public sector banks during the last ten years provide useful insights. There is evidence that, for the public sector banks, the gross NPA ratio has declined from 23 per cent in 1992-93 to 7.8 per cent in 2003-04. The prime lending rate of interest of banks has declined by 500-750 basis points during period 1992-93 to 2003-04. The maturity terms of loans, defined as the ratio of term loans to advances, has improved from about 30 per cent to about 45 per cent. The credit orientation of banks, measured by credit-deposit ratio, which declined during the period 1993-99, has improved in the recent years. The proportion of secured loans has remained at high level, reflecting the stability in banks’ approach to risk management. Besides, bank size induced risk element has moderated with stronger balance sheets. Rajaraman and Vasishtha (2002) in an empirical study provided evidence of significant bivariate relationship between operating inefficiency indicator and problem loans of India’s public sector banks. Das and Ghosh (2003) made an empirical analysis of nonperforming loans of India’s public sector banks relating to various indicators such as asset size, credit growth and macroeconomic condition, and operating efficiency indicators.
5.1.4 An empirical analysis suggests that besides supporting policy environment, banks have to devise appropriate lending terms taking account the cost of credit, cost of funds, maturity of Loans, and credit orientation among other factors so as to induce lower defaults on borrowers.

5.1.5 The first master circular on NPA came in the year 1993, and subsequent amendments were made to it. This chapter primarily focusses on the practices in NPA policies since 2009.

5.1.6 A meeting with all the bankers highlighted that all banks mandatorily follow the NPA norms on Asset classification and provisioning and they constantly make amendments in their working and accounting procedures in the line of RBI guidelines which keeps on changing from time to time. Almost every banks have an NPA and recovery cell to monitor the NPA accounts and prevent slippages.

5.2 Non Performing Assets

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

5.2.2 A non performing asset (NPA) 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’ as indicated at paragraph 5.3 below, 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. *the instalment of principal or interest thereon remains overdue for two crop seasons for short duration crops, (Agricultural loans)*

v. *the instalment of principal or interest thereon remains overdue for one crop season for long duration crops.*
vi. the amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction undertaken in terms of guidelines on securitisation dated February 1, 2006.

5.2.3 Banks should classify an account as NPA only if the interest due and charged during any quarter is not serviced fully within 90 days.

5.3 Status of Out of Order.

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 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as ‘out of order’.

5.4 ‘Overdue’

Any amount due to the bank under any credit facility is ‘overdue’ if it is not paid on the due date fixed by the bank.

5.5 TYPES OF NPA:

1. Gross NPA

2. Net NPA

5.5.1 Gross NPA:

Gross NPAs are the sum total of all loan assets that are classified as NPAs as per RBI guidelines as on Balance Sheet date. **Gross NPA reflects the real NPAs and the quality of the loans made by banks.** It consists of all the nonstandard assets like as sub-standard, doubtful, and loss assets. It can be calculated with the help of following ratio:

Gross NPAs Ratio = Gross NPAs /Gross Advances
5.5.2 Net NPA:

Net NPAs are those type of NPAs in which the bank has deducted the provision regarding NPAs. **Net NPA is obtained by reducing the provisions from Gross NPAs and shows the actual burden of banks.** Since in India, bank balance sheets contain a huge amount of NPAs and the process of recovery and write off of loans is very time consuming, the provisions the banks have to make against the NPAs according to the central bank guidelines, are quite significant. That is why the difference between gross and net NPA is quite high. It can be calculated by following:

Net NPAs = Gross NPAs – Provisions on Gross Advances

5.6. **INCOME RECOGNITION**

5.6.1 Income Recognition Policy

The policy of income recognition has to be objective and 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 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.

5.6.2 Reversal of income

If any advance, including bills purchased and discounted, becomes NPA as at the close of any year, the entire interest accrued and credited to income account in the past periods,
should be reversed or provided for 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 or provided for with respect to past periods, if uncollected.

5.6.3 Leased Assets

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

5.6.4 Appropriation of recovery in 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.

In the absence of a clear agreement between the bank 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.

5.6.5 Interest Application

There is no objection to the banks using their own discretion in debiting interest to an NPA account taking the same to Interest Suspense Account or maintaining only a record of such interest in proforma accounts.
5.7 Computation of NPA levels

Banks should deduct the following items from the Gross Advances and Gross NPAs to arrive at the Net advances and Net NPAs respectively:

i) Balance in Interest Suspense Account

ii) DICGC/ECGC claims received and held, pending adjustment

iii) Part payment received and kept in suspense account

iv) Total provisions held (excluding amount of technical write off and provision on standard assets)

For the purpose, the amount of gross advances should exclude the amount of Technical Write off but would include all outstanding loans and advances; including the advances for which refinance has been availed but excluding the amount of rediscounted bills. The level of gross and net NPAs will be arrived at in percentage terms by dividing the amount of gross and net NPAs by gross and net advances, computed as above, respectively.

5.8 ASSET CLASSIFICATION

5.8.1 Categories of NPAs

Banks are required to classify nonperforming assets further into the following three categories based on the period for which the asset has remained nonperforming and the realisability of the dues:

Substandard Assets

Doubtful Assets

Loss Assets
5.8.1.1 Substandard Assets

With effect from 31 March 2005, a substandard asset would be one, which has remained NPA for a period less than or equal to 12 months. In such cases, the current net worth of the borrower/guarantor 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 an asset 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.

5.8.1.2 Doubtful Assets

With effect from March 31, 2005, an asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as substandard, 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.

5.8.1.3 Loss Assets

A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.
5.9 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 extant guidelines.

5.9.1. Availability of security / net worth 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 5.9.7(fraudulent a/cs) as income recognition is based on record of recovery.

5.9.2 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 the following guidelines:
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. 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.

Regular and ad hoc credit limits need to be reviewed/ regularized 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/ renewed within 180 days from the due date/ date of ad hoc sanction will be treated as NPA.

5.9.3 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 which is classified as NPA, contents of paragraphs 5.9.13 and 5.9.14 will be applicable.

5.9.4 Accounts regularized near about the balance sheet date

The asset classification of borrower 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 regularization of the account to eliminate doubts on their performing status.

5.9.5 **Asset Classification to be borrower-wise and not facility-wise**

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.** (one a/c npa, all a/c npa)

ii) If the debits 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.

iii) The bills discounted under LC favouring 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 overdues 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 borrower-wise 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 were 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 parked 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 borrower-wise asset classification, though such receivable overdue 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 be 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 at 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 borrower-wise 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 unrealised 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 and held in a 'Suspense a/c' in the same manner as is done in the case of overdue advances.

5.9.6 Advances under consortium arrangements

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.

5.9.7 **Accounts where there is erosion in the value of security/frauds committed by borrowers**

In respect of accounts where there are potential threats for recovery on account of erosion in the value of security or non-availability of security and existence of other factors such as frauds committed by borrowers it will not be prudent that such accounts should go through various stages of asset classification. In cases of such serious credit impairment the asset should be straightaway classified as doubtful or loss asset as appropriate:

i. Erosion in the value of security can be reckoned as significant when the realisable 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.

ii. 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 borrower accounts, the existence of security should be ignored and the asset should be straightaway classified as loss asset. It may be either written off or fully provided for by the bank.

5.9.8 **Advances to PACS/FSS ceded to Commercial Banks**

In respect of agricultural advances as well as advances for other purposes granted by banks to 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 in case 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 & advances, if any, granted by the 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.

5.9.9 Advances against Term Deposits, NSCs, KVP/IVP, etc

Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs and life policies need not be treated as NPAs, provided adequate margin is available in the accounts. Advances against gold ornaments, government securities and all other securities are not covered by this exemption.

5.9.10 Loans with moratorium for payment of interest

i. In the case of bank 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 do not become NPA, with reference to the date of debit of interest. They become overdue after due date for payment of interest, if uncollected.

ii. 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 installments of principal or payment of interest on the respective due dates.

5.9.11 Agricultural advances

i. 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. A loan granted for long duration crops will be treated as NPA, if the installments of principal or interest thereon remains overdue for one crop season. 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. The crop season for each crop, which means the period up to harvesting of the crops, would be as determined by the State
Level Bankers’ Committee in each State. 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.

The above norms should be made applicable to all direct agricultural advances to priority sector. In respect of agricultural loans, identification of NPAs would be done on the same basis as non-agricultural advances, which, at present, is the 90 days delinquency norm.

ii. Where natural calamities impair the repaying capacity of agricultural borrowers, banks may decide on their own as a relief measure conversion of the short-term production loan into a term loan or re-schedulement of the repayment period; and the sanctioning of fresh short-term loan, subject to guidelines contained in RBI circular RPCD. No.PLFS.BC.6/05.04.02/200405 dated July 1, 2005.

iii. 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 NPA. The asset classification of these loans would thereafter be governed by the revised terms & conditions and would be treated as NPA if interest and/or instalment of principal remain overdue for two crop seasons for short duration crops and for one crop season for long duration crops. 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" would be treated as "short duration" crops.

iv. The debts as on March 31, 2004 of farmers, who have suffered production and income losses on account of successive natural calamities, i.e., drought, flood, or other calamities which might have occurred in the districts for two or more successive years during the past five years may be rescheduled/ restructured by the banks, provided the State Government concerned has declared such districts as calamity affected. Accordingly, the interest outstanding/accrued in the accounts of such borrowers (crop loans and agriculture term loans) up to March 31, 2004 may be clubbed with the principal outstanding therein as on March 31, 2004, and the amount thus arrived at shall be repayable over a period of five years, at current interest rates, including an initial moratorium of two years. As regards the crop loans and agricultural term loans which have
already been restructured on account of natural calamities as per the standing guidelines, only the overdue installments including interest thereon as on March 31, 2004 may be taken into account for the proposed restructuring. On restructuring as above, the farmers concerned will become eligible for fresh loans. The rescheduled/restructured loans as also the fresh loans to be issued to the farmers may be treated as current dues and need not be classified as NPA. While the fresh loans would be governed by the NPA norms as applicable to agricultural loans, in case of rescheduled/restructured loans, the NPA norms would be applicable from the third year onwards, i.e., on expiry of the initial moratorium period of two years.

v. In case of Kharif crop loans in the districts affected by failure of the South-west monsoon as notified by the State Government, recovery of any amount either by way of principal or interest during the financial year 2002-03 need not be affected. Further, the principal amount of crop loans in such cases should be converted into term loans and will be recovered over a period of minimum 5 years in case of small and marginal farmers and 4 years in case of other farmers. Interest due in the financial year 2002-03 on crop loans should also be deferred and no interest should be charged on the deferred interest. In such cases of conversion or re-schedulement of crop loans into term loans, the term loans may be treated as current dues and need not be classified as NPA. The asset classification of these loans would thereafter be governed by the revised terms and conditions and would be treated as NPA if interest and / or instalment of principal remain overdue for two crop seasons.

vi. While fixing the repayment schedule in case of rural housing advances granted to agriculturists under Indira Awas Yojana and Golden Jubilee Rural Housing Finance Scheme, banks should ensure that the interest/instalment payable on such advances are linked to crop cycles.

5.9.12 **Government guaranteed advances**

The credit facilities backed by guarantee of the Central Government though overdue may be treated as NPA only when the Government repudiates its guarantee when invoked. This exemption from classification of Government guaranteed advances as NPA is not for
the purpose of recognition of income. The requirement of invocation of guarantee has been delinked for deciding the asset classification and provisioning requirements in respect of State Government guaranteed exposures. With effect from the year ending 31 March 2006 State Government guaranteed advances and investments in State Government guaranteed securities would attract asset classification and provisioning norms if interest and/or principal or any other amount due to the bank remains overdue for more than 90 days.

5.9.13 Projects under implementation

5.9.13.i: It was observed that there were instances, where despite substantial time overrun in the projects under implementation, the underlying loan assets remained classified in the standard category merely because the project continued to be under implementation. Recognizing that unduly long time overrun in a project adversely affected its viability and the quality of the asset deteriorated, a need was felt to evolve an objective and definite timeframe for completion of projects so as to ensure that the loan assets relating to projects under implementation were appropriately classified and asset quality correctly reflected. In the light of the above background, it was decided to extend the norms detailed below on income recognition, asset classification and provisioning to banks with respect to industrial projects under implementation, which involve time overrun.

i. The projects under implementation are grouped into three categories for the purpose of determining the date when the project ought to be completed:

**Category I:** Projects where financial closure had been achieved and formally documented.

**Category II:** Projects sanctioned before 1997 with original project cost of Rs.100 crore or more where financial closure was not formally documented.

**Category III:** Projects sanctioned before 1997 with original project cost of less than Rs.100 crore where financial closure was not formally documented.
5.9.13.ii Asset classification

In case of each of the three categories, the date when the project ought to be completed and the classification of the underlying loan asset should be determined in the following manner:

**Category I** (Projects where financial closure had been achieved and formally documented): In such cases the date of completion of the project should be as envisaged at the time of original financial closure. In all such cases, the asset may be treated as *standard asset for a period not exceeding two years beyond the date of completion of the project, as originally envisaged at the time of initial financial closure of the project*. In case, however, in respect of a project financed after 1997, the financial closure had not been formally documented, the norms enumerated for category III below, would apply.

**Category II** (Projects sanctioned before 1997 with original project cost of Rs.100 crore or more where financial closure was not formally documented): For such projects sanctioned prior to 1997, where the date of financial closure had not been formally documented, an independent Group was constituted with experts from the term lending institutions as well as outside experts in the field to decide on the deemed date of completion of projects. The Group, based on all material and relevant facts and circumstances, has decided the deemed date of completion of the project, on a project-by-project basis. In such cases, the asset may be treated as *standard asset for a period not exceeding two years beyond the deemed date of completion of the project, as decided by the Group*. Banks, which have extended finance towards such projects, may approach the lead financial institutions to which a copy of the independent Group’s report has been furnished for obtaining the particulars relating to the deemed date of completion of project concerned.

**Category III** (Projects sanctioned before 1997 with original project cost of less than Rs.100 crore where financial closure was not formally documented): In these cases, sanctioned prior to 1997, where the financial closure was not formally documented, the date of completion of the project would be as originally envisaged at the time of sanction. In such cases, *the asset may be treated as standard asset only for a period not exceeding two*
In all the three foregoing categories, in case of time overruns beyond the aforesaid period of two years, the asset should be classified as substandard regardless of the record of recovery and provided for accordingly.

As regards the projects 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. In such cases, if the date of commencement of commercial production extends beyond a period of six months after the date of completion of the project, as originally envisaged at the time of initial financial closure of the project, the account should be treated as a substandard asset. However, for Infrastructure projects alone, w.e.f. March 31, 2008, if the date of commencement of commercial production extends beyond a period of two years after the date of completion of the project, as originally envisaged, the account should be treated as substandard.

It is, however, clarified that in terms of aforesaid paragraph, a project can remain classified as "standard" asset only if both the following conditions are satisfied:

i. the delay in commencement of commercial production is not beyond six months (two years in case of Infrastructure projects) from the date of completion of the project, as originally envisaged at the time of initial financial closure of the project,

ii. the principal and interest on the loans are regularly serviced during the six month or two year period, as the case may be.

5.9.13. iii Recognition of income in projects under implementation: Banks may recognize income on accrual basis in respect of the above three categories of projects under implementation, which are classified as ‘standard’. Banks should not recognise income on accrual basis in respect of the above three categories of projects under implementation which are classified as a ‘substandard’ asset. Banks may recognise income in such accounts only on realisation on cash basis. Consequently, banks which have wrongly recognised income in the past should reverse the interest if it was recognised
as income during the current year or make a provision for an equivalent amount if it was recognised as income in the previous year(s). As regards the regulatory treatment of ‘funded interest’ recognised as income and ‘conversion into equity, debentures or any other instrument’ banks should adopt the following:

Funded Interest: Income recognition in respect of the NPAs, regardless of 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 realisation and not if the amount of interest overdue has been funded. If, however, the amount of funded interest is recognised 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 recognised as income, should be fully provided for.

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.

5.9.14 Takeout Finance

Takeout finance is the product emerging in the context of the funding of long-term 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 pre-determined basis. In view of the time-lag 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 recognise 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 take over by taking over institution. As and when the asset is taken over by the 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.

5.10 RBI Guidelines for NPAs Recognition: (Table 5.1)

<table>
<thead>
<tr>
<th>Loans &amp; advances</th>
<th>Guidelines applicable wef</th>
<th>Guidelines applicable wef</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>31-03-2001</td>
<td>31-3-2004</td>
</tr>
<tr>
<td>Term loan interest and principal</td>
<td>180 days</td>
<td>90 days</td>
</tr>
<tr>
<td>Overdraft/credit A/c</td>
<td>Remains out of order</td>
<td>Remains out of order</td>
</tr>
<tr>
<td>Bill purchased and discounted remains overdue</td>
<td>180 days</td>
<td>90 days</td>
</tr>
<tr>
<td>Agricultural loan interest and/or instalments remains overdue</td>
<td>Two harvest seasons but not exceeding two and half years</td>
<td>Two harvest seasons but not exceeding two and half years</td>
</tr>
<tr>
<td>Other accounts-any amount to Be received remains overdue</td>
<td>180 days</td>
<td>90 days</td>
</tr>
</tbody>
</table>

5.11 PROVISIONING FOR NPA

5.11.1 General Introduction: 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.

5.11.2 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 earlier. 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 substandard assets, doubtful assets and loss assets as below:
5.12 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.

5.13 Doubtful assets

5.13.i. 100 percent 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 and the realisable value is estimated on a realistic basis.

5.13. ii. In regard to the secured portion, provision may be made on the following basis, at the rates ranging from 25 percent to 100 percent of the secured portion depending upon the period for which the asset has remained doubtful:

Provision requirement (Table 5.2)

<table>
<thead>
<tr>
<th>Period for which the advance has remained in ‘doubtful’ category</th>
<th>Provision requirement (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to one year</td>
<td>20 (25% since 2011)</td>
</tr>
<tr>
<td>One to three years</td>
<td>30 (40% since 2011)</td>
</tr>
<tr>
<td>More than three years</td>
<td>100 (100% since 2011)</td>
</tr>
</tbody>
</table>

(Note: Figures in brackets as given as per RBI Circular dated 18th May 2011)
The following table would highlight the position as per the latest norm announced on May 2011) Latest norms on Provisioning (Table 5.3)

<table>
<thead>
<tr>
<th>Asset Category</th>
<th>Revised</th>
<th>Existing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Substandard (Secured) (Remains NPA for 12 months)</td>
<td>15%</td>
<td>10%</td>
</tr>
<tr>
<td>Substd (Unsecured)</td>
<td>25%</td>
<td>20%</td>
</tr>
<tr>
<td>Doubtful (remains unpaid for 1 year)</td>
<td>25%</td>
<td>20%</td>
</tr>
<tr>
<td>Doubtful upto 3 years</td>
<td>40%</td>
<td>30%</td>
</tr>
<tr>
<td>Beyond 3 years</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>Restructured advances (classified as std)</td>
<td>2%</td>
<td>1%</td>
</tr>
</tbody>
</table>

5.13. iii. Banks are permitted to phase the additional provisioning consequent upon the reduction in the transition period from substandard to doubtful asset from 18 to 12 months over a four year period commencing from the year ending March 31, 2005, with a minimum of 20% each year.

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.

5.14 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 per cent, i.e., a total of 20 per cent on the outstanding balance. The provisioning requirement for unsecured ‘doubtful’ assets is 100 per cent. Unsecured
exposure is defined as an exposure where the realisable 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.

(iii) In order to enhance transparency and ensure correct reflection of the unsecured advances in Schedule 9 of the banks' balance sheet, it is advised that the following would be applicable from the financial year 2009-10 onwards:

a) For determining the amount of unsecured advances for reflecting in schedule 9 of the published balance sheet, the rights, licenses, authorisations, 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) 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.

5.15 Standard assets

(i) As a countercyclical measure, the provisioning requirements for all types of standard assets stands amended as below, w.e.f November 05, 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 per cent;

(b) All other loans and advances at 0.40 per cent

(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-a-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 w.e.f November 05, 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.

5.16 Prudential norms on creation and utilization of floating provisions

5.16.1 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.

5.16.2 Principle for utilisation of floating provisions by banks

i. The floating provisions should not be used for making specific provisions as per the extant prudential guidelines in respect of nonperforming assets or 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.
ii. To facilitate banks' 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.

iii. In terms of the Agricultural Debt Waiver and Debt Relief Scheme, 2008, lending institutions 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 and 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 onetime measure, to utilise, at their discretion, the Floating Provisions held for 'advances' portfolio, only to the extent of meeting the interest / charges referred to above.

5.16.3 Accounting

Floating provisions cannot be reversed by credit to the profit and loss account. They can only be utilised for making specific provisions in extraordinary circumstances as mentioned above. Until such utilisation, these provisions, till the year 2008-09, could have either been netted off from gross NPAs to arrive at disclosure of net NPAs, or treated as part of Tier II capital within the overall ceiling of 1.25 % of total risk weighted assets.

However, from the year 2009-10 onwards, Floating Provisions cannot be netted from gross NPAs to arrive at net NPAs, but can only be reckoned as part of Tier II capital subject to the overall ceiling of 1.25% of total Risk Weighted Assets.
5.16 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.

5.17. 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.

5.18 Provisions on Leased Assets

5.18.i) Substandard assets

a) 10 percent of the sum of the net investment in the lease and the unrealised 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.

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

5.18. ii) Doubtful assets

100 percent of the extent to which, the finance is not secured by the realisable value of the leased asset. Realisable value is to be estimated on a realistic basis. In addition to the above provision, provision at the rates mentioned should be made on the sum of the net investment in the lease and the unrealsed portion of finance income net of finance charge.
component of the secured portion, depending upon the period for which asset has been doubtful (Table 5.4-Provision for doubtful leased assets)

<table>
<thead>
<tr>
<th>Period for which the advance has remained in ‘doubtful’ category</th>
<th>Provision requirement (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to one year</td>
<td>20 (25% since 2011)</td>
</tr>
<tr>
<td>One to three years</td>
<td>30 (40% since 2011)</td>
</tr>
<tr>
<td>More than three years</td>
<td>100 (100% since 2011)</td>
</tr>
</tbody>
</table>

5.18. iii) 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 unrealised portion of finance income net of finance charge component should be provided for.

5.19 Guidelines for Provisions under Special Circumstances

5.19.1 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 finalised 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 /06.02.31/20042005 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.

5.19.2 Advances 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.

5.19.3 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.

5.19.4 Advances covered by ECGC guarantee

In the case 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, realisable 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:

**Example No:1 (Table 5.5)- ECGC guarantee.**

<table>
<thead>
<tr>
<th>Outstanding Balance</th>
<th>Rs. 4 lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>ECGC Cover</td>
<td>50 percent</td>
</tr>
<tr>
<td>Period for which the advance has remained doubtful</td>
<td>More than 3 years remained doubtful (as on March 31, 2004)</td>
</tr>
<tr>
<td>Value of security held (worth of Rs.)</td>
<td>Rs. 1.50 lakhs</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Provision required to be made</th>
</tr>
</thead>
</table>
Outstanding balance | Rs. 4.00 lakhs
---|---
Less: Value of security held | Rs. 1.50 lakhs
Unrealised balance | Rs. 2.50 lakhs
(-) ECGC Cover (50% of unrealisable balance) | Rs. 1.25 lakhs
Net unsecured balance | Rs. 1.25 lakhs
Provision for unsecured portion of advance | Rs. 1.25 lakhs (at 100 percent of unsecured portion)
Provision for secured portion of advance (as on March 31, 2005) | Rs. 0.90 lakhs (at 60 percent of the secured portion)
Total provision to be made (as on March 31, 2005) | Rs. 2.15 lakhs

5.19.5 Advance covered by CGTSI guarantee

In case the advance covered by CGTSI guarantee becomes nonperforming, 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 nonperforming advances. Two illustrative examples are given below:

**EXAMPLE 2 (Table 5.6) CGTSME Cover**

<table>
<thead>
<tr>
<th>Asset classification status:</th>
<th>Doubtful – More than 3 years (as on March 31, 2004)</th>
</tr>
</thead>
<tbody>
<tr>
<td>CGTSI Cover</td>
<td>75% of the amount outstanding or 75% of the unsecured amount or Rs. 18.75 lakh, whichever is the least</td>
</tr>
<tr>
<td>Realisable value of Security</td>
<td>Rs. 1.50 lakh</td>
</tr>
<tr>
<td>Balance outstanding</td>
<td>Rs. 10.00 lakh</td>
</tr>
</tbody>
</table>

**Provision Required**

(as on March 31, 2005)
### Less Realisable value of security

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
<th>Provision @ 60%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rs. 1.50 lakh</td>
<td>Rs. 0.90 lakh @ 60%</td>
<td></td>
</tr>
</tbody>
</table>

### Unsecured amount

- Rs. 8.50 lakh

### Less CGTSI cover (75%)

- Rs. 6.38 lakh

### Net unsecured and uncovered portion:

- Rs. 2.12 lakh

Total Provision: 1.80 lakhs

### EG 2: Asset classification status

- Doubtful – More than 3 years (as on March 31, 2005)

### CGTSI Cover

- 75% of the amount outstanding or 75% of the unsecured amount or Rs.18.75 lakh, whichever is the least

### Realisable value of security

- Rs.10.00 lakh

### Provision required (31st March 05)

- Rs 10 lakh @100%

### Balance outstanding

- Rs. 40.00 lakh

### Less Realisable value of security

- Rs. 10.00 lakh

### Unsecured amount

- Rs. 30.00 lakh

### Less CGTSI cover (75%)

- Rs. 18.75 lakh

### Net unsecured portion

- Rs. 11.25 lakh

Rs. 11.25 lakh @100%

5.19.6 **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.
5.19.7 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.

5.19 .8 Provisioning for country risk

Banks shall make provisions, with effect from the year ending 31 March 2003, 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:
Table 5.7- Provisioning for Country risk

<table>
<thead>
<tr>
<th>Risk category</th>
<th>ECGC Classification</th>
<th>Provisioning Requirement%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insignificant</td>
<td>A1</td>
<td>0.25</td>
</tr>
<tr>
<td>Low</td>
<td>A2</td>
<td>0.25</td>
</tr>
<tr>
<td>Moderate</td>
<td>B1</td>
<td>5</td>
</tr>
<tr>
<td>High</td>
<td>B2</td>
<td>20</td>
</tr>
<tr>
<td>Very high</td>
<td>C1</td>
<td>25</td>
</tr>
<tr>
<td>Restricted</td>
<td>C2</td>
<td>100</td>
</tr>
<tr>
<td>Off credit</td>
<td>D</td>
<td>100</td>
</tr>
</tbody>
</table>

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.
Banks 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).

5.19.9 **Excess Provisions on sale of Standard Asset / NPAs**

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

(b) 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.11/21.06.001/2008-09** dated July 1, 2008 on Prudential guidelines on Capital Adequacy and Market Discipline - Implementation of New Capital Adequacy Framework (NCAF) and paragraph 2.1.1.2.C of Master Circular **DBOD.No.BP.BC.2/21.01.002/2008-09** dated July 1, 2008 on Prudential Norms on Capital adequacy - Basel I Framework.

5.19.10 **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.

5.19.11 **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.

5.19.12 **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 & 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.

5.20. Writing off of NPAs

5.20.1 In terms of Section 43(D) of the Income Tax Act 1961, income by way of interest in relation to such categories of bad and doubtful debts as may be prescribed having regard to the guidelines issued by the RBI in relation to such debts, shall be chargeable to tax in the previous year in which it is credited to the bank’s profit and loss account or received, whichever is earlier.

5.20.2 This stipulation is not applicable to provisioning required to be made as indicated above. In other words, amounts set aside for making provision for NPAs as above are not eligible for tax deductions.

5.20.3 Therefore, the banks should either make full provision as per the guidelines or write-off such advances and claim such tax benefits as are applicable, by evolving appropriate methodology in consultation with their auditors / tax consultants. Recoveries made in such accounts should be offered for tax purposes as per the rules.

5.20.4 Write-off at Head Office Level

Banks may write-off advances at Head Office level, even though the relative advances are still outstanding in the branch books. However, it is necessary that provision is made as per the classification accorded to the respective accounts. In other words, if an advance is a loss asset, 100 percent provision will have to be made there for.
TABLE 5.8 Details of RBI Circulars on Prudential Norms, NPAs (Note: The list contains the latest circulars)

<table>
<thead>
<tr>
<th>S. No</th>
<th>Circular No</th>
<th>Date of Issue</th>
<th>Subject of Circular</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>RB/2008-09/514/09.03.01/08-09/UBD/PCB/73/9.14.000</td>
<td>29.06.09</td>
<td>Prudential treatment of different types of provisions in respect of loan portfolios</td>
</tr>
<tr>
<td>2</td>
<td>RB/2008-09/512,511/09.03.01/08-09/UBD/PCB/73/9.14.000</td>
<td>26.06.09</td>
<td>Agricultural Debt Waiver and prudential norms, asset classification and Capital adequacy</td>
</tr>
<tr>
<td>3</td>
<td>DBOD.No.BP-BC 64/21.04.48/09-10 dated 01-12-09</td>
<td>14-01-10</td>
<td>Provisioning coverage Ratio -70% of gross Npas</td>
</tr>
<tr>
<td>4</td>
<td>RBI/10-11/368</td>
<td>14-01-10</td>
<td>End use of funds monitoring</td>
</tr>
<tr>
<td>5.</td>
<td>RBI/10-11/500</td>
<td>21-06-2010</td>
<td>Compromise/one time settlement of Npas</td>
</tr>
<tr>
<td>6</td>
<td>RBI/09-10/499</td>
<td>18-06-2010</td>
<td>Credit flow to agriculture/Waiver of Margin/security requirement</td>
</tr>
<tr>
<td>7.</td>
<td>RBI/09-10/424/DBODno BP.BC.98/21-04.141/09-10.</td>
<td>23.04.2010</td>
<td>Prudential norms on Income recognition /Asset classification-Projects under implementation</td>
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<td>RBI/09-10/421</td>
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<td>Agricultural Debt Waiver and Relief 08</td>
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<td>RBI/09-10/401</td>
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