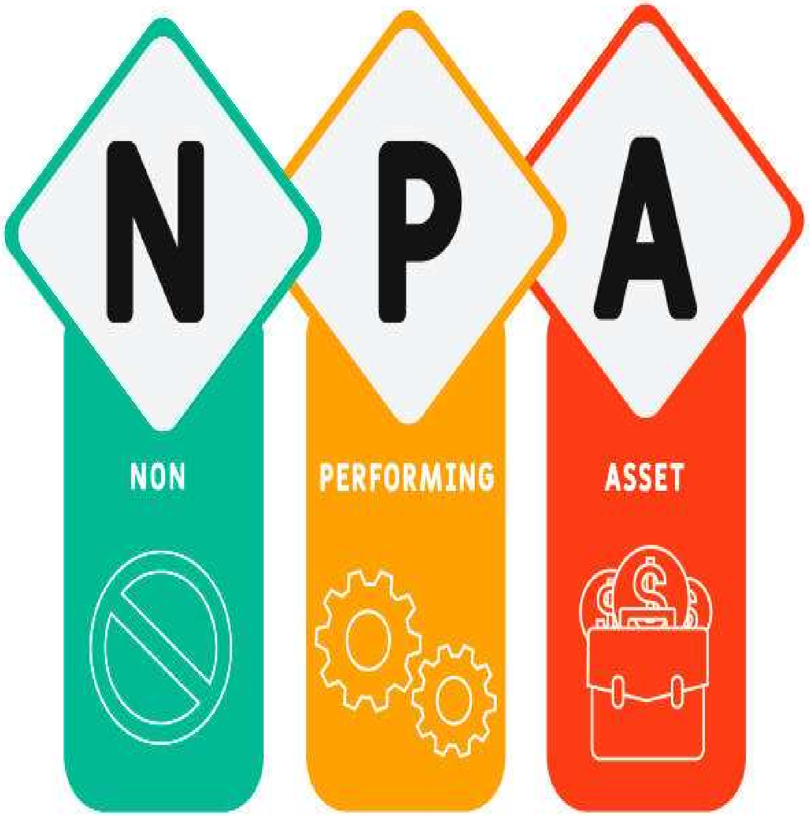
INCOME RECOGNITION, ASSET CLASSIFICATION (IRAC) AND PROVISIONING NORMS

(RBI Master Circular No. DBR.No.BP.BC.2/21.04.048/2015-16 Dated July 1, 2015)
(RBI circular Ref. No. DoS.CO.PPG./SEC.03/11.01.005/2020-21 Dated September 14, 2020)

भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

Banks are Advised for Automation of NPA Accounts by 30 June 2021



BANKING DIGEST

IRAC NORMS - INTRODUCTION

- In line with the international practices and On recommendations of Narsimham Committee on Financial Sector Reforms **PRUDENTIAL ACCOUNTING NORMS** have been Implemented in Banks.

- **PRUDENTIAL ACCOUNTING NORMS**
  - Income Recognition
  - Asset Classification
  - Provisioning

PRUDENTIAL NORMS

- The policy of income recognition should 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.
- Also, the provisioning should be made on the basis of the classification of assets based on the period for which the asset has remained non-performing and the availability of security and the realisable value thereof.
- Banks are urged to ensure that while granting loans and advances, realistic repayment schedules may be fixed on the basis of cash flows with borrowers.
- This would go a long way to facilitate prompt repayment by the borrowers and thus improve the record of recovery in advances.

AUTOMATION OF IRAC NORMS AND PROVISIONING PROCESSES IN BANKS

- Banks were advised to have appropriate IT system in place for identification of Non-Performing Assets (NPA) and generation of related data/returns, both for regulatory reporting and bank's own MIS requirements.
- It was observed that the processes for NPA identification, income recognition, provisioning and generation of related returns in many banks are not yet fully automated.
- Now RBI issued circular Dated September 14, 2020 on Automation of Income Recognition, Asset Classification and Provisioning processes in banks.
- In order to ensure the completeness and integrity of the automated Asset Classification, Provisioning calculation and Income Recognition processes, banks are advised to put in place / upgrade their systems to conform to the following guidelines latest by June 30, 2021.

As per the norms coverage are as under:

- All borrowal accounts, including temporary overdrafts, irrespective of size, sector or types of limits, shall be covered in the automated IT based system (System) for asset classification, upgradation, and provisioning processes. Banks' investments shall also be covered under the System.
- Asset classification rules shall be configured in the System, in compliance with the regulatory stipulations.
- Calculation of provisioning requirement shall also be System based as per pre-set rules for various categories of assets, value of security as captured in the System and any other regulatory stipulations issued from time to time on provisioning requirements.
- In addition, income recognition/derecognition in case of impaired assets (NPAs/NPIs) shall be system driven and amount required to be reversed from the income account should be obtained from the System without any manual intervention.
- **Frequency:** The System based asset classification shall be an ongoing exercise for both down-gradation and up-gradation of accounts. Banks should ensure that the asset classification status is updated as part of day end process.

DEFINITION OF NPA

An asset becomes non-performing when it ceases to generate income to the Bank, in case of:-

1. **Loan A/c (DL or TL)- Interest and/or installment of principal remain OVERDUE (when not paid on the due date fixed by the Bank) for a period of more than 90 Days.**
2. **Cash Credit or Overdraft A/c- The a/c remain OUT OF ORDER* for a period of more than 90 days.**

(i) The Balance is continuously more than S/L or D/L or

(ii) Where as on date of BS, there is no CREDIT in the a/c continuously for 90 days or credit is less than interest debited .

DEFINITION OF NPA

1. The Limit is not reviewed within 180 days from the due date of renewal.
2. Where stock statement has not been received for 90 days or more in case of CC accounts.
3. Bills- The bill remains overdue for a period of more than 90 days from due date of payment.
4. Direct Agricultural loans: Account becomes NPA when;

a) For short duration crops: Interest/instalment remaining overdue for 2 crop seasons &

b) For long duration crop: interest/installment remaining overdue for 1 crop season.

EXCEPTIONS

- **Staff Loans– except in exceptionally problematic cases like suit filed cases.**
- **Advances against Bank's own Term Deposits, NSCs, KVPs, IVPs, LIC policies as long as adequate margin is available.**
- **Advance Repayment.**
- ***However, advances against gold ornaments and other government securities, shares are not covered under this exemption.***

SALIENT POINTS

1. The credit facilities backed by the Guarantee of Central Govt. though overdue, may be treated as NPA only when the Govt. repudiates its guarantee when revoked.
2. The credit facilities backed by the Guarantee of State Govt. become NPA normally.
3. Classification will be done borrower-wise & not facility-wise.
3. In case of loans to PACS/FSS classification will be done facility-wise.
4. In the case of bank finance given for industrial projects, housing loan 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.
5. 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.

Projects under implementation

For all projects financed by the FIs/ banks, the 'Date of Completion' and the 'Date of Commencement of Commercial Operations' (DCCO), of the project should be clearly spelt out at the time of financial closure of the project and the same should be formally documented. These should also be documented in the appraisal note by the bank during sanction of the loan.

There are occasions when the completion of projects is delayed for legal and other extraneous reasons like delays in Government approvals etc. All these factors, which are beyond the control of the promoters, may lead to delay in project implementation and involve restructuring / reschedulement of loans by banks. Accordingly, the following asset classification norms would apply to the project loans before commencement of commercial operations.

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

1) Project Loans for infrastructure sector

2) Project Loans for non-infrastructure sector

For the purpose of these guidelines, 'Project Loan' would mean any term loan which has been extended for the purpose of setting up of an economic venture. Further, Infrastructure Sector is a sector as defined in extant Harmonised Master List of Infrastructure of RBI.

REVERSAL OF INCOME

If any advance, including bills purchased and discounted, becomes NPA, the entire interest accrued and credited to income account in the past periods, should be reversed if the same is not realised.

This will apply to State Government Guaranteed advances also.

In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed with respect to past periods, if uncollected.

ASSET CLASSIFICATION

(Standard Overdue Accounts)

Before a loan account turns into a NPA, banks are required to identify incipient stress in the account by creating three sub-categories under the Special Mention Account (SMA) category as given in the table below:

SMA Sub-categories	Basis for classification
SMA-0	Principal or interest payment not overdue for more than 30 days but account showing signs of incipient stress
SMA-1	Principal or interest payment overdue between 31-60 days
SMA-2	Principal or interest payment overdue between 61-90 day

ASSET CLASSIFICATION

(NPA Accounts)

Sub-Standard- Account which has remained in NPA category for a period of not more than 12 months. As to reliability these accounts show credit weakness and there is distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful- Account which remained in NPA category for more than 12 months. A loan classified as Doubtful has all the weaknesses inherent to Sub-Standard assets with added characteristic that the full recovery of the advance is highly improbable due to erosion of security value or fraud or such other reasons.

LOSS- Account where LOSS has been identified by the bank or Internal Auditors or External Auditors or by RBI Inspector but the amount has not been written off. It is an asset which is considered uncollectible although there may be some salvage or recovery value.

NPA - ASSET CLASSIFICATION

To Determine the correct Asset Classification of an NPA borrower TWO aspects are Important:

1. "NPA Since" Date and
2. "Value of Security"

NET OUTSTANDING (NOS): Total Outstanding less amount of Unrealised Interest (URI).

RVS DEFINITIONS

RVS: Value of Security (Realisable Value of Security) for the purpose of reckoning NPA is the sum total of the amounts of security available in each account of the borrower:

a) Value of Principal (Primary) Security,

b) Value of security, other than Primary Security,

c) Value of Credit/Cash Margin,

d) Value of Guarantee (only of the Nature of Guarantee) Cover obtaining in the account i.e., ECGC, DICGC CGTMSE, CGFMU, CGFSEL etc.

SUB-STANDARD ASSET CLASSIFICATION

1. Where NPA Since Date is up to 12 months from the Current Date :

a. Asset Code will be determined as Sub- Standard (Secured), except for as at ‘b’ below.

b. Asset Code will be determined as Sub-Standard (Unsecured), if the unsecured portion/RVS as stipulated & ascertained is not more than10% abinitio (Clean Personal Loan, Clean OD etc).

c. Asset Code will be determined as Doubtful I (D1), if erosion of RVS is more than 50% of the value accepted in the last inspection.

d. Asset Code will be determined as Loss, if erosion of RVS is more than 90% of the value accepted in the last inspection.

DOUBTFUL ASSET CLASSIFICATION

2. **<u>Where NPA Since Date is more than 12 months and up to 24 months from the current date:</u>**

   a. Asset code will be determined as Doubtful I (D1) if the RVS is not less than 10% of the NOS.

   b. Asset code will be determined as Loss, if the RVS is less than 10% of the NOS.

DOUBTFUL ASSET CLASSIFICATION

3. **Where NPA since Date is more than 24 months and up to 48 months from the current date:**

   a. Asset code will be determined as Doubtful II (D2), if the RVS is not less than 10% of the NOS.

   b. Asset code will be determined as Loss, if the RVS is less than 10% of the NOS.

4. **Where NPA since Date is more than 48 months from the current date:**

   a. Asset code will be determined as Doubtful III (D3).

   b. Asset code will be determined as Loss, if the RVS is less than 10% of the NOS.

CATEGORIES, CODE AND PERIODS OF NPA ASSETS

Category	Period in category
Sub-Standard (Secured)	Up to 1 year from NPA date
Sub-Standard (Unsecured)	Up to 1 year from NPA date
Doubtful I (D1)	Above 1 year to 2 years from NPA date
Doubtful II (D2)	Above 2 years to 4 years from NPA date
Doubtful III (D3)	More than 4 years from NPA date
Loss	No time limit

NPA PROVISIONING

NPA Category	Provision Amount (RBI Guide Lines)
Sub- Standard (Secured)	15% of Net Outstanding
Sub- Standard (Unsecured)	25% of Net Outstanding
Unsecured Exposures in respect of Infrastructure loan accounts where certain safeguards such as Escrow accounts are available	20% of Net Outstanding
Doubtful I (Fully secured by RVS)	25% of Net Outstanding
Doubtful I (Partly secured by RVS)	25% of RVS plus 100% of the unsecured Portion (NOS less RVS)
Doubtful II (Fully secured by RVS)	40% of net Outstanding
Doubtful II (Partly secured by RVS)	40% of RVS plus 100% of the Unsecured Portion (NOS less RVS)
Doubtful III	100% of net Outstanding
Loss	100% of net Outstanding

Calculation of Provision in Doubtful I (D1) Asset

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:

Outstanding Balance	Rs. 4 lakh
ECGC Cover	50 percent
Asset Classification	Doubtful I D1 (say as on March 31, 2021)
Value of security held	Rs. 1.50 lakh

Provision required to be made	
Outstanding balance	Rs. 4.00 lakh
Less: Value of security held	Rs. 1.50 lakh
Unrealised balance	Rs. 2.50 lakh
Less: ECGC Cover (50% of unrealisable balance)	Rs. 1.25 lakh
Net unsecured balance	Rs. 1.25 lakh
Provision for unsecured portion of advance	Rs. 1.25 lakh (@ 100 percent of unsecured portion)
Provision for secured portion of advance	Rs.0.375 lakh (@ 25 per cent of the secured portion)
Total provision to be made	Rs.1.625 lakh (as on March 31, 2021)

Calculation of Provision in Doubtful II (D2) Asset

Advance covered by CGTMSE: In case the advance covered by CGTMSE 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 non-performing assets. An illustrative example is given below:

Outstanding Balance	**Rs. 10 lakh**
CGTMSE Cover	75% of the amount outstanding or 75% of the unsecured amount, whichever is the least
Asset Classification	Doubtful II D2 (say as on March 31, 2021)
Value of security held	Rs. 1.50 lakh

Provision required to be made

Balance outstanding	Rs.10.00 lakh
Less: Value of security	Rs. 1.50 lakh
Unsecured amount	Rs. 8.50 lakh
Less: CGTMSE cover (75%)	Rs. 6.38 lakh
Net unsecured and uncovered portion:	Rs. 2.12 lakh
Provision for Secured portion @ 40% of Rs.1.50 lakh	Rs.0.60 lakh
Provision for Unsecured & uncovered portion @ 100% of Rs.2.12 lakh	Rs.2.12 lakh
Total provision required	Rs.2.72 lakh

PROVISIONING NORMS FOR STANDARD ASSETS

(i) The provisioning requirements for all types of standard assets stands as below. 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 Small and Micro Enterprises (SMEs) sectors at 0.25 percent;
b) Advances to Commercial Real Estate (CRE) Sector at 1.00 percent;
c) Advances to Commercial Real Estate – Residential Housing Sector (CRE - RH) at 0.75 percent;
d) Housing loans extended at teaser rates and restructured advances as per latest norms;
e) All other loans and advances not included in (a) (b) and (c) above at 0.40 percent.

PROVISIONING NORMS FOR STANDARD ASSETS

(ii) The provisions on standard assets should not be reckoned for arriving at net NPAs.

(iii) 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.

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.

Banking Digest

COMPUTATION OF NPA LEVELS

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

1) Gross Advances = Standard Asset Plus Gross NPA
2) Gross NPAs as a percentage of Gross Advances = Gross NPA/Gross Advances
3) Net Advances = Gross Advances - Deductions
4) Deductions = Provisions held in the case of NPA Accounts & RVS
5) Net NPAs = Gross NPAs minus Deductions
6) Net NPAs as percentage of Net Advances = Net NPAs/ Net Advances (in %).

GROSS & NET ADVANCES AND NPAS

	Particulars		Rs. in cr.
1	Standard Advances		1600
2	Gross NPAs		400
3	Gross Advances * (1+2)		2000
4	Gross NPA as a percentage of Gross Advances (2/3) (in %)		20
5	Deductions		152
	(i)	Provisions held in the case of NPA Accounts as per asset classification	150
	(ii)	DICGC / ECGC /CGTMSE claims received and held pending adjustment	1
	(iii)	Part payment received and kept in Sundry A/c, URI or any other similar A/c	1
6	Net Advances (3-5)		1848
7	Net NPAs {2-5 (i+ ii+ iii)}		248
8	Net NPAs as percentage of Net Advances (7/6) (in %)		13.42

* For the purpose of this Statement, 'Gross Advances' mean all outstanding loans and advances including advances for which refinance has been received but excluding rediscounted bills, and advances written off at Head Office level (Technical write off).

Banking Digest

For details information you may visit:

My website www.bankingdigests.com

Or RBI Circular

No. DBR.No.BP.BC.2/21.04.048/2015-16 Dated July 1, 2015
Ref. No. DoS.CO.PPG./SEC.03/11.01.005/2020-21 Dated September 14, 2020