

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**



JAIIB / CAIIB



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

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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.

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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**.

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As per the norms coverage of accounts 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.

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DEFINITION OF NPA

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

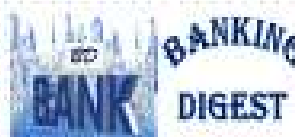
1. Loan A/c (DL or TL)- Interest and/or installment of principal remain OVERDUE (when not paid on the due date fixed by the Bank) for a period of more than 90 Days.
2. Cash Credit or Overdraft A/c- The a/c remain OUT OF ORDER* for a period of more than 90 days.

- (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 .

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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/installment remaining overdue for 2 crop seasons &
 - b) **For long duration crop**: interest/installment remaining overdue for 1 crop season.

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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.***

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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.

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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.

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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

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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).

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RVS DEFINITIONS

RVS: Value of Security (Realisable Value of Security) for the purpose of reckoning NPA is the sum total of the amounts entered in HCLM/SRM 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 21 Sub- Standard (Secured), except for as at 'b' below.
- b. Asset Code will be determined as 22 Sub-Standard (Unsecured), if the unsecured portion/RVS as stipulated & ascertained is not more than 10% abinitio (star clean Personal loan, clean OD etc).
- c. Asset Code will be determined as 31 Doubtful, if erosion of RVS is more than 50% of the value accepted in the last inspection.
- d. Asset Code will be determined as 40 Loss, if erosion of RVS is more than 90% of the value accepted in the last inspection.

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DOUBTFUL ASSET CLASSIFICATION

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

- a. Asset code will be determined as 31 Doubtful if the RVS is not less than 10% of the NOS.
- b. Asset code will be determined as 40 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 32 Doubtful, if the RVS is not less than 10% of the NOS.
- b. Asset code will be determined as 40 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 33 Doubtful.
- b. Asset code will be determined as 40 Loss, if the RVS is less than 10% of the NOS.

CATEGORIES, CODE AND PERIODS OF NPA ASSETS

Category	Assets Code	Period in category
Sub-Standard (Secured)	21	Up to 1 year from NPA date
Sub-Standard (Unsecured)	22	Up to 1 year from NPA date
Doubtful I (D1)	31	Above 1 year to 2 years from NPA date
Doubtful II (D2)	32	Above 2 years to 4 years from NPA date
Doubtful III (D3)	33	More than 4 years from NPA date
Loss	40	No time limit

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NPA ACCOUNT PROVISIONING

Asset Code	NPA Category	Provision Amount (RBI Guide Lines)
21	Sub- Standard (Secured)	15% of Net Outstanding
22	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
31	Doubtful I (Fully secured by RVS)	25% of Net Outstanding
31	Doubtful I (Partly secured by RVS)	25% of RVS plus 100% of the unsecured Portion (NOS less RVS)
32	Doubtful II (Fully secured by RVS)	40% of net Outstanding
32	Doubtful II (Partly secured by RVS)	40% of RVS plus 100% of the Unsecured Portion (NOS less RVS)
33	Doubtful III	100% of net Outstanding
40	Loss	100% of net Outstanding

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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.

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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.

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.

Advance covered by guarantees of Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) or Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH): In case the advance covered by CGTMSE or CRGFTLIH guarantee becomes nonperforming, no provision need be made towards the guaranteed portion.

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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 = $\frac{\text{Gross NPA}}{\text{Gross Advances}}$**
- 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 = $\frac{\text{Net NPAs}}{\text{Net Advances}}$ (in %).**

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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).

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