

RBI/2008-09/84

DBOD.No.BP.BC.20/21.04.048/2008-09

July 1, 2008

All Commercial Banks (excluding RRBs)

Dear Sir

**Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances**

Please refer to the Master Circular No. DBOD.BP.BC.12/21.04.048/2007-2008 dated July 2, 2007 consolidating instructions / guidelines issued to banks till June 30, 2007 on matters relating to prudential norms on income recognition, asset classification and provisioning pertaining to advances.

2. The Master Circular has now been suitably updated by incorporating instructions issued up to June 30, 2008 and is attached. It has also been placed on the RBI web-site (<http://www.rbi.org.in>). We advise that this revised Master Circular consolidates the instructions contained in the circulars mentioned in the Annex II.

Yours faithfully

(Prashant Saran)  
Chief General Manager-in-Charge

**MASTER CIRCULAR - PRUDENTIAL NORMS ON INCOME RECOGNITION, ASSET CLASSIFICATION AND PROVISIONING PERTAINING TO ADVANCES**

**TABLE OF CONTENTS**

1		<b>GENERAL</b>
2		<b>DEFINITIONS</b>
	2.1	Nonperforming assets
	2.2	'Out of Order' status
	2.3	'Overdue'
3		<b>INCOME RECOGNITION</b>
	3.1	Income recognition policy
	3.2	Reversal of income
	3.3	Appropriation of recovery in NPAs
	3.4	Interest Application
	3.5	Net NPAs
4		<b>ASSET CLASSIFICATION</b>
	4.1	Categories of NPAs
	4.1.1	Substandard Assets
	4.1.2	Doubtful Assets
	4.1.3	Loss Assets
	4.2	Guidelines for classification of assets
	4.2.3	Availability of security / net worth of borrower/ guarantor
	4.2.4	Accounts with temporary deficiencies
	4.2.5	Upgradation of loan accounts classified as NPAs
	4.2.6	Accounts regularised near about the balance sheet date
	4.2.7	Asset Classification to be borrower wise and not facility-wise
	4.2.8	Advances under consortium arrangements
	4.2.9	Accounts where there is erosion in the value of security
	4.2.10	Advances to PACS/FSS ceded to Commercial Banks
	4.2.11	Advances against Term Deposits, NSCs, KVP/IVP, etc
	4.2.12	Loans with moratorium for payment of interest
	4.2.13	Agricultural advances
	4.2.14	Government guaranteed advances
	4.2.15	Restructuring/ Rescheduling of Loans
	4.2.16	Corporate Debt Restructuring (CDR System)
	4.2.17	Debt Restructuring Mechanism for SMEs
	4.2.18	Projects under implementation
	4.2.19	Takeout Finance
	4.2.20	Post-shipment Supplier's Credit
	4.2.21	Export Project Finance
	4.2.22	Advances under rehabilitation approved by BIFR/ TLI
5		<b>PROVISIONING NORMS</b>
	5.1	General
	5.2	Loss assets
	5.3	Doubtful assets
	5.4	Substandard assets
	5.5	Standard assets
	5.6	Floating provisions
	5.7	Provisions on Leased Assets
	5.8	Guidelines for Provisions under Special Circumstances
6		Guidelines on sale of financial assets to Securitisation Company (SC)/ Reconstruction Company (RC)

	6.1		Scope
	6.2		Structure
	6.3		Financial assets which can be sold
	6.4		Procedure for sale of banks'/ FIs' financial assets to SC/ RC, including valuation and pricing aspects
	6.5		Prudential norms for banks/ FIs for the sale transactions
	6.6		Disclosure Requirements
	6.7		Related Issues
7			<b>GUIDELINES ON PURCHASE/SALE OF NON PERFORMING ASSETS</b>
	7.1		Scope
	7.4		Structure
	7.5		Procedure for purchase/ sale of non performing financial assets, including valuation and pricing aspects
	7.6		Prudential norms for banks for the purchase/ sale transactions
	7.7		Disclosure Requirements
8			<b>WRITING OFF OF NPAS</b>
			Annex -1
			Annex - 2

# **Master Circular - Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances**

## **1. GENERAL**

1.1 In line with the international practices and as per the recommendations made by the Committee on the Financial System (Chairman Shri M. Narasimham), the Reserve Bank of India has introduced, in a phased manner, prudential norms for income recognition, asset classification and provisioning for the advances portfolio of the banks so as to move towards greater consistency and transparency in the published accounts.

1.2 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 nonperforming and the availability of security and the realisable value thereof.

1.3 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.

1.4 With the introduction of prudential norms, the Health Code-based system for classification of advances has ceased to be a subject of supervisory interest. As such, all related reporting requirements, etc. under the Health Code system also cease to be a supervisory requirement. Banks may, however, continue the system at their discretion as a management information tool.

## **2. DEFINITIONS**

### **2.1 Non performing Assets**

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

2.1.2 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 2.2 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,
- 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.

2.1.3 Banks should, classify an account as NPA only if the interest charged during any quarter is not serviced fully within 90 days from the end of the quarter.

## 2.2 'Out of Order' status

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'.

## 2.3 '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.

## 3. INCOME RECOGNITION

### 3.1 Income Recognition Policy

3.1.1 The policy of income recognition has to be objective and based on the record of recovery. Internationally income from nonperforming assets (NPA) is not recognised 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.

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

3.1.3 Fees and commissions earned by the banks as a result of renegotiations or rescheduling of outstanding debts should be recognised on an accrual basis over

the period of time covered by the re-negotiated or rescheduled extension of credit.

3.1.4 If Government guaranteed advances become NPA, the interest on such advances should not be taken to income account unless the interest has been realised.

### 3.2 Reversal of income

3.2.1 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 realised. **This will apply to Government guaranteed accounts also.**

3.2.2 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.

#### 3.2.3 Leased Assets

The *finance charge* component of finance income [as defined in 'AS 19 Leases' issued by the Council of the Institute of Chartered Accountants of India (ICAI)] on the leased 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.

### 3.3 Appropriation of recovery in NPAs

3.3.1 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.

3.3.2 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.

### 3.4 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.

### 3.5 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.

## 4. ASSET CLASSIFICATION

### 4.1 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:

- i. **Substandard Assets**
- ii. **Doubtful Assets**
- iii. **Loss Assets**

#### 4.1.1 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.

#### 4.1.2 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.

#### 4.1.3 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.

### 4.2 **Guidelines for classification of assets**

4.2.1 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 realisation of dues.

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

#### 4.2.3 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 4. 2.9, as income recognition is based on record of recovery.

#### 4.2.4 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:

i) 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 borrowal account will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days even though the unit may be working or the borrower's financial position is satisfactory.

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

#### 4.2.5 Upgradation 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 non-performing and may be classified as 'standard' accounts. With regard to upgradation of a restructured/ rescheduled account which is classified as NPA contents of paragraphs 4.2.15 and 4.2.16 will be applicable.

#### 4.2.6 Accounts regularised near about the balance sheet date

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

#### 4.2.7 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.

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.

#### 4.2.8 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.

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

#### 4.2.10 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.

#### 4.2.11 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.

#### 4.2.12 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 instalment of principal or payment of interest on the respective due dates.

#### 4.2.13 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 instalment 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 raised, 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 as listed at items 1.1.1, 1.1.2, 1.1.3, 1.1.4, 1.1.5, 1.1.6 and 1.2.1, 1.2.2 and 1.2.3 of Master Circular on lending to priority sector. RPCD.

No.Plan. BC. 84 /04.09.01/ 2006-2007 dated 30 April 2007. An extract of the list of these items is furnished in the Annex I. In respect of agricultural loans, other than those specified in the Annex I and term loans given to non-agriculturists, identification of NPAs would be done on the same basis as non-agricultural advances, which, at present, is the 90 days delinquency norm.

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/ 2004-05 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 remains 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 instalments 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 SouthWest 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 effected. 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.

#### 4.2.14 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.

#### 4.2.15 Restructuring/ Rescheduling of Loans

- i. The stages, at which the restructuring/rescheduling/renegotiation of the terms of loan agreement could take place, can be identified as under:
  - a. before commencement of commercial production;
  - b. after commencement of commercial production but before the asset has been classified as sub standard,
  - c. after commencement of commercial production and after the asset has been classified as sub standard.

In each of the foregoing three stages, the rescheduling, etc., of principal and/or of interest could take place, with or without sacrifice, as part of the restructuring package evolved.

#### ii. Treatment of restructured standard accounts

- a. A rescheduling of the instalments of principal alone, at any of the aforesaid first two stages would not cause a standard asset to be classified in the sub standard category provided the loan/credit facility is fully secured.
- b. A rescheduling of interest element at any of the foregoing first two stages would not cause an asset to be downgraded to sub standard category subject to the condition that the amount of sacrifice, if any, in the element of interest, measured in present value terms, is either written off or provision is made to the extent of the sacrifice involved. For the purpose, the future interest due as per the original loan agreement in respect of an account should be discounted to the present value at a rate appropriate to

the risk category of the borrower (i.e., current PLR+ the appropriate credit risk premium for the borrower category) and compared with the present value of the dues expected to be received under the restructuring package, discounted on the same basis.

c. In case there is a sacrifice involved in the amount of interest in present value terms, as at (b) above, the amount of sacrifice should either be written off or provision made to the extent of the sacrifice involved.

iii. Treatment of restructured substandard accounts

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

b. A rescheduling of interest element would render a substandard asset eligible to be continued to be classified in sub standard category for the specified period subject to the condition that the amount of sacrifice, if any, in the element of interest, measured in present value terms, is either written off or provision is made to the extent of the sacrifice involved. For the purpose, the future interest due as per the original loan agreement in respect of an account should be discounted to the present value at a rate appropriate to the risk category of the borrower (i.e., current PLR + the appropriate credit risk premium for the borrower-category) and compared with the present value of the dues expected to be received under the restructuring package, discounted on the same basis.

c. In case there is a sacrifice involved in the amount of interest in present value terms, as at (b) above, the amount of sacrifice should either be written off or provision made to the extent of the sacrifice involved. Even in cases where the sacrifice is by way of write off of the past interest dues, the asset should continue to be treated as substandard.

iv. Upgradation of restructured accounts

The substandard accounts which have been subjected to restructuring etc., whether in respect of principal instalment or interest amount, by whatever modality, would be eligible to be upgraded to the standard category only after the specified period i.e., a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due, subject to satisfactory performance during the period. The amount of provision made earlier, net of the amount provided for the sacrifice in the interest amount in present value terms as aforesaid, could also be reversed after the one year period. During this one year period, the substandard asset will not deteriorate in its classification if satisfactory performance of the account is demonstrated during the period. In case, however, the satisfactory performance during the one year period is not evidenced, the asset classification of the restructured account would be governed as per the applicable prudential norms with reference to the pre-restructuring payment schedule.

v. General

a. The instructions contained in sub-paras (i) to (iv) above would be applicable to all type of credit facilities including working capital limits, extended to industrial units, provided they are fully covered by tangible securities.

b. As trading involves only buying and selling of commodities and the problems associated with manufacturing units such as bottleneck in commercial production, time and cost escalation etc. are not applicable to them, the guidelines contained in subparas (i) to (iv) above should not be applied to restructuring/ rescheduling of credit facilities extended to traders.

c. While assessing the extent of security cover available to the credit facilities, which are being restructured/ rescheduled, collateral security would also be reckoned, provided such collateral is a tangible security properly charged to the bank and is not in the intangible form like guarantee etc. of the promoter/ others.

d. Banks can not reschedule /restructure /renegotiate borrowal accounts with retrospective effect. The asset classification status as on the date of approval of the restructured package by the competent authority would be relevant to decide the asset classification status of the account after restructuring /rescheduling/renegotiation. In case there is undue delay in sanctioning a restructuring package and in the meantime the asset classification status of the account undergoes deterioration, it would attract supervisory intervention.

e. Banks are not expected to repeatedly restructure/ reschedule the amounts due to them unless there are very strong and valid reasons which warrant such repeated restructuring/rescheduling. Restructuring in all cases should be based on viability parameters. Any restructuring done without looking into cash flows of the borrower would invite supervisory concerns. The special asset classification status in terms of paragraphs (ii) and (iii) above shall be available only when the account is restructured for the first time, as already prescribed for restructuring under CDR mechanism, vide para 4.2.16 (G) below.

f. Normally restructuring can not take place unless alteration/changes in the original loan agreement are made with the formal consent/application of the debtor. However, the process of restructuring can be initiated by the bank in deserving cases subject to customer agreeing to the terms and conditions.

g. 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:

- i. 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.
- ii. Conversion into equity, debentures or any other instrument: The amount outstanding converted into other instruments would normally comprise principal and the interest components. If the amount of interest dues is converted into equity or any other instrument, and income is recognised in consequence, full provision should be made for the amount of income so recognised to offset the effect of such income recognition. Such provision would be in addition

to the amount of provision that may be necessary for the depreciation in the value of the equity or other instruments, as per the investment valuation norms. However, if the conversion of interest is into equity which is quoted, interest income can be recognised at market value of equity, as on the date of conversion, not exceeding the amount of interest converted to equity. Such equity must thereafter be classified in the "available for sale" category and valued at lower of cost or market value. In case of conversion of principal and /or interest in respect of NPAs into debentures, such debentures should be treated as NPA, ab initio, in the same asset classification as was applicable to loan just before conversion and provision made as per norms. This norm would also apply to zero coupon bonds or other instruments which seek to defer the liability of the issuer. On such debentures, income should be recognised only on realisation basis. The income in respect of unrealised interest which is converted into debentures or any other fixed maturity instrument should be recognised only on redemption of such instrument. Subject to the above, the equity shares or other instruments arising from conversion of the principal amount of loan would also be subject to the usual prudential valuation norms as applicable to such instruments.

h. Reversal of provision made for NPA is permitted when the account becomes a standard asset. The provision made in a restructured/rescheduled account towards interest sacrifice, may be reversed on satisfactory completion of all repayment obligations and the outstanding in the account is fully repaid. Banks should not re-compute the extent of sacrifice each year and make adjustments in the provisions made towards interest sacrifice.

i. While banks may consider accounts other than that of industrial units also for restructuring, such accounts would have to qualify the basic test of viability before it is considered for restructuring. However, these accounts would not qualify for the special asset classification status available to restructured 'standard' and restructured 'substandard' accounts as at sub-paras (ii) and (iii) above. The accounts which do not qualify for restructuring/rescheduling in terms of sub-paras (i) to (iii) above, will be subjected to the following prudential norms.

- i) These restructured/ rescheduled accounts would continue to age and migrate to the next asset classification status in the normal course. Banks should ensure that the amount of sacrifice, if any, in the element of interest both in term loans or working capital facilities, measured in present value terms, is either written off or provision is made to the extent of the sacrifice involved. For the purpose, the future interest due as per the original loan agreement in respect of an account should be discounted to the present value at a rate appropriate to the risk category of the borrower (i.e., current PLR + the appropriate credit risk premium for the borrower-category) and compared with the present value of the dues expected to be received under the restructuring package, discounted on the same basis.
- ii) These restructured/ rescheduled accounts, whether in respect of principal instalment or interest amount, by whatever modality, would be eligible to be upgraded to the standard category only after a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due under the revised terms, subject to satisfactory performance during the period. The amount of provision made earlier, net of the amount provided for the sacrifice in



the interest amount in present value terms as aforesaid, could also be reversed after the one year period.

j. Disclosures in the Notes on Account to the Balance Sheet pertaining to restructured/ rescheduled accounts apply to all accounts restructured/ rescheduled during the year. While banks should ensure that they comply with the minimum disclosures prescribed, they may make more disclosures than the minimum prescribed.

#### **4.2.16 Revised Guidelines on Corporate Debt Restructuring (CDR) Mechanism**

##### **A. Background**

i. Based on the experience in other countries like the U.K., Thailand, Korea, etc. of putting in place institutional mechanism for restructuring of corporate debt and need for a similar mechanism in India, a Corporate Debt Restructuring System was evolved, and detailed guidelines were issued vide circular DBOD No. BP.BC. 15/21.04.114/200001 dated August 23, 2001 for implementation by banks. Subsequently based on the recommendations made by the Working Group to make the operations of the CDR mechanism more efficient (Chairman: Shri Vepa Kamesam, Deputy Governor, RBI. The group was constituted pursuant to the announcement made by the Finance Minister in the Union Budget 2002-2003), and consultations with the Government, the guidelines on Corporate Debt Restructuring system were revised in terms of our circular DBOD No. BP.BC. 68/21.04.114/200203 dated February 5, 2003.

ii. A Special Group was constituted in September 2004 with Smt.S.Gopinath, Deputy Governor, RBI, as the Chairperson to review and suggest changes / improvements, if any, in the CDR mechanism. Based on the suggestions of the Special Group, and the feedback received on the draft guidelines, the CDR Guidelines have been further revised. The revised guidelines are in supersession of the extant guidelines outlined in the aforesaid circular dated February 5, 2003.

iii. One of the main features of the restructuring under CDR system is the provision of two categories of debt restructuring under the CDR system. Accounts, which are classified as 'standard' and 'substandard' in the books of the creditors, will be restructured under the first category (Category 1). Accounts which are classified as 'doubtful' in the books of the creditors would be restructured under the second category (Category 2).

The main features of the CDR mechanism are given below:

##### **B. Objective**

The objective of the Corporate Debt Restructuring (CDR) framework is to ensure timely and transparent mechanism for restructuring the corporate debts of viable entities facing problems, outside the purview of BIFR, DRT and other legal proceedings, for the benefit of all concerned. In particular, the framework will aim at preserving viable corporates that are affected by certain internal and external factors and minimize the losses to the creditors and other stakeholders through an orderly and coordinated restructuring programme.

##### **C. Structure**

CDR system in the country will have a three tier structure:

- CDR Standing Forum and its Core Group
- CDR Empowered Group
- CDR Cell

i. CDR Standing Forum

a) The CDR Standing Forum would be the representative general body of all financial institutions and banks participating in CDR system. All financial institutions and banks should participate in the system in their own interest. CDR Standing Forum will be a self-empowered body, which will lay down policies and guidelines, and monitor the progress of corporate debt restructuring.

b) The Forum will also provide an official platform for both the creditors and borrowers (by consultation) to amicably and collectively evolve policies and guidelines for working out debt restructuring plans in the interests of all concerned.

c) The CDR Standing Forum shall comprise of Chairman & Managing Director, Industrial Development Bank of India Ltd; Chairman, State Bank of India; Managing Director & CEO, ICICI Bank Limited; Chairman, Indian Banks' Association as well as Chairmen and Managing Directors of all banks and financial institutions participating as permanent members in the system. Since institutions like Unit Trust of India, General Insurance Corporation, Life Insurance Corporation may have assumed exposures on certain borrowers, these institutions may participate in the CDR system. The Forum will elect its Chairman for a period of one year and the principle of rotation will be followed in the subsequent years. However, the Forum may decide to have a Working Chairman as a wholetime officer to guide and carry out the decisions of the CDR Standing Forum. The RBI would not be a member of the CDR Standing Forum and Core Group. Its role will be confined to providing broad guidelines.

d) The CDR Standing Forum shall meet at least once every six months and would review and monitor the progress of corporate debt restructuring system. The Forum would also lay down the policies and guidelines including those relating to the critical parameters for restructuring (for example, maximum period for a unit to become viable under a restructuring package, minimum level of promoters' sacrifice etc.) to be followed by the CDR Empowered Group and CDR Cell for debt restructuring and would ensure their smooth functioning and adherence to the prescribed time schedules for debt restructuring. It can also review any individual decisions of the CDR Empowered Group and CDR Cell. The CDR Standing Forum may also formulate guidelines for dispensing special treatment to those cases, which are complicated and are likely to be delayed beyond the time frame prescribed for processing.

e) A CDR Core Group will be carved out of the CDR Standing Forum to assist the Standing Forum in convening the meetings and taking decisions relating to policy, on behalf of the Standing Forum. The Core Group will consist of Chief Executives of Industrial Development Bank of India Ltd., State Bank of India, ICICI Bank Ltd, Bank of Baroda, Bank of India, Punjab National Bank, Indian Banks' Association and Deputy Chairman of Indian Banks' Association representing foreign banks in India.

f) The CDR Core Group would lay down the policies and guidelines to be followed by the CDR Empowered Group and CDR Cell for debt restructuring. These guidelines shall also suitably address the operational difficulties experienced in the functioning of the CDR Empowered Group. The CDR Core Group shall also prescribe the PERT chart for processing of cases referred to the CDR system and decide on the modalities for enforcement of the time frame. The CDR Core Group shall also lay down guidelines to ensure that overoptimistic projections are not assumed while preparing / approving restructuring proposals especially with regard to capacity utilization, price of products, profit margin, demand, availability of raw materials, input-output ratio and likely impact of imports / international cost competitiveness.

ii. CDR Empowered Group

a) The individual cases of corporate debt restructuring shall be decided by the CDR Empowered Group, consisting of ED level representatives of Industrial Development Bank of India Ltd., ICICI Bank Ltd. and State Bank of India as standing members, in addition to ED level representatives of financial institutions and banks who have an exposure to the concerned company. While the standing members will facilitate the conduct of the Group's meetings, voting will be in proportion to the exposure of the creditors only. In order to make the CDR Empowered Group effective and broad based and operate efficiently and smoothly, it would have to be ensured that participating institutions / banks approve a panel of senior officers to represent them in the CDR Empowered Group and ensure that they depute officials only from among the panel to attend the meetings of CDR Empowered Group. Further, nominees who attend the meeting pertaining to one account should invariably attend all the meetings pertaining to that account instead of deputing their representatives.

b) The level of representation of banks/ financial institutions on the CDR Empowered Group should be at a sufficiently senior level to ensure that concerned bank / FI abides by the necessary commitments including sacrifices, made towards debt restructuring. There should be a general authorisation by the respective Boards of the participating institutions / banks in favour of their representatives on the CDR Empowered Group, authorizing them to take decisions on behalf of their organization, regarding restructuring of debts of individual corporates.

c) The CDR Empowered Group will consider the preliminary report of all cases of requests of restructuring, submitted to it by the CDR Cell. After the Empowered Group decides that restructuring of the company is prima-facie feasible and the enterprise is potentially viable in terms of the policies and guidelines evolved by Standing Forum, the detailed restructuring package will be worked out by the CDR Cell in conjunction with the Lead Institution. However, if the lead institution faces difficulties in working out the detailed restructuring package, the participating banks / financial institutions should decide upon the alternate institution / bank which would work out the detailed restructuring package at the first meeting of the Empowered Group when the preliminary report of the CDR Cell comes up for consideration.

d) The CDR Empowered Group would be mandated to look into each case of debt restructuring, examine the viability and rehabilitation potential of the Company and approve the restructuring package within a specified time frame of 90 days, or at best within 180 days of reference to the Empowered

Group. The CDR Empowered Group shall decide on the acceptable viability benchmark levels on the following illustrative parameters, which may be applied on a case-by-case basis, based on the merits of each case:

- Return on Capital Employed (ROCE),
- Debt Service Coverage Ratio (DSCR),
- Gap between the Internal Rate of Return (IRR) and the Cost of Fund (CoF),
- Extent of sacrifice.

e) The Board of each bank / FI should authorise its Chief Executive Officer (CEO) and / or Executive Director (ED) to decide on the restructuring package in respect of cases referred to the CDR system, with the requisite requirements to meet the control needs. CDR Empowered Group will meet on two or three occasions in respect of each borrowal account. This will provide an opportunity to the participating members to seek proper authorisations from their CEO / ED, in case of need, in respect of those cases where the critical parameters of restructuring are beyond the authority delegated to him / her.

f) The decisions of the CDR Empowered Group shall be final. If restructuring of debt is found to be viable and feasible and approved by the Empowered Group, the company would be put on the restructuring mode. If restructuring is not found viable, the creditors would then be free to take necessary steps for immediate recovery of dues and / or liquidation or winding up of the company, collectively or individually.

iii) CDR Cell

a) The CDR Standing Forum and the CDR Empowered Group will be assisted by a CDR Cell in all their functions. The CDR Cell will make the initial scrutiny of the proposals received from borrowers / creditors, by calling for proposed rehabilitation plan and other information and put up the matter before the CDR Empowered Group, within one month to decide whether rehabilitation is prima facie feasible. If found feasible, the CDR Cell will proceed to prepare detailed Rehabilitation Plan with the help of creditors; and if necessary, experts to be engaged from outside. If not found prima facie feasible, the creditors may start action for recovery of their dues.

b) All references for corporate debt restructuring by creditors or borrowers will be made to the CDR Cell. It shall be the responsibility of the lead institution / major stakeholder to the corporate, to work out a preliminary restructuring plan in consultation with other stakeholders and submit to the CDR Cell within one month. The CDR Cell will prepare the restructuring plan in terms of the general policies and guidelines approved by the CDR Standing Forum and place for consideration of the Empowered Group within 30 days for decision. The Empowered Group can approve or suggest modifications but ensure that a final decision is taken within a total period of 90 days. However, for sufficient reasons the period can be extended up to a maximum of 180 days from the date of reference to the CDR Cell.

c) The CDR Standing Forum, the CDR Empowered Group and CDR Cell

is at present housed in Industrial Development Bank of India Ltd. However, it may be shifted to another place if considered necessary, as may be decided by the Standing Forum. The administrative and other costs shall be shared by all financial institutions and banks. The sharing pattern shall be as determined by the Standing Forum.

d) CDR Cell will have adequate members of staff deputed from banks and financial institutions. The CDR Cell may also take outside professional help. The cost in operating the CDR mechanism including CDR Cell will be met from contribution of the financial institutions and banks in the Core Group at the rate of Rs.50 lakh each and contribution from other institutions and banks at the rate of Rs.5 lakh each.

D. Other features

i. Eligibility criteria

a) The scheme will not apply to accounts involving only one financial institution or one bank. The CDR mechanism will cover only multiple banking accounts / syndication / consortium accounts of corporate borrowers with outstanding fundbased and non-fund based exposure of Rs.10 crore and above by banks and institutions.

b) The Category 1 CDR system will be applicable only to accounts classified as 'standard' and 'substandard'. There may be a situation where a small portion of debt by a bank might be classified as doubtful. In that situation, if the account has been classified as 'standard' / 'substandard' in the books of at least 90% of creditors (by value), the same would be treated as standard / substandard, only for the purpose of judging the account as eligible for CDR, in the books of the remaining 10% of creditors. There would be no requirement of the account / company being sick, NPA or being in default for a specified period before reference to the CDR system. However, potentially viable cases of NPAs will get priority. This approach would provide the necessary flexibility and facilitate timely intervention for debt restructuring. Prescribing any milestone(s) may not be necessary, since the debt restructuring exercise is being triggered by banks and financial institutions or with their consent.

c) While corporates indulging in frauds and malfeasance even in a single bank will continue to remain ineligible for restructuring under CDR mechanism as hitherto, the Core group may review the reasons for classification of the borrower as wilful defaulter specially in old cases where the manner of classification of a borrower as a wilful defaulter was not transparent and satisfy itself that the borrower is in a position to rectify the wilful default provided he is granted an opportunity under the CDR mechanism. Such exceptional cases may be admitted for restructuring with the approval of the Core Group only. The Core Group may ensure that cases involving frauds or diversion of funds with malafide intent are not covered.

d) The accounts where recovery suits have been filed by the creditors against the company, may be eligible for consideration under the CDR system provided, the initiative to resolve the case under the CDR system is taken by at least 75% of the creditors (by value) and 60% of creditors (by number).

e) BIFR cases are not eligible for restructuring under the CDR system. However, large value BIFR cases, may be eligible for restructuring under the CDR system if specifically recommended by the CDR Core Group. The Core Group shall recommend exceptional BIFR cases on a case-to-case basis for consideration under the CDR system. It should be ensured that the lending institutions complete all the formalities in seeking the approval from BIFR before implementing the package.

ii. Reference to CDR system

a) Reference to Corporate Debt Restructuring System could be triggered by (i) any or more of the creditor who have minimum 20% share in either working capital or term finance, or (ii) by the concerned corporate, if supported by a bank or financial institution having stake as in (i) above.

b) Though flexibility is available whereby the creditors could either consider restructuring outside the purview of the CDR system or even initiate legal proceedings where warranted, banks / FIs should review all eligible cases where the exposure of the financial system is more than Rs.100 crore and decide about referring the case to CDR system or to proceed under the new Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 or to file a suit in DRT etc.

iii. Legal Basis

a) CDR is a non-statutory mechanism which is a voluntary system based on Debtor-Creditor Agreement (DCA) and Inter-Creditor Agreement (ICA). The Debtor-Creditor Agreement (DCA) and the Inter-Creditor Agreement (ICA) shall provide the legal basis to the CDR mechanism. The debtors shall have to accede to the DCA, either at the time of original loan documentation (for future cases) or at the time of reference to Corporate Debt Restructuring Cell. Similarly, all participants in the CDR mechanism through their membership of the Standing Forum shall have to enter into a legally binding agreement, with necessary enforcement and penal clauses, to operate the System through laid-down policies and guidelines. The ICA signed by the creditors will be initially valid for a period of 3 years and subject to renewal for further periods of 3 years thereafter. The lenders in foreign currency outside the country are not a part of CDR system. Such creditors and also creditors like GIC, LIC, UTI, etc., who have not joined the CDR system, could join CDR mechanism of a particular corporate by signing transaction to transaction ICA, wherever they have exposure to such corporate.

b) The Inter-Creditor Agreement would be a legally binding agreement amongst the creditors, with necessary enforcement and penal clauses, wherein the creditors would commit themselves to abide by the various elements of CDR system. Further, the creditors shall agree that if 75 per cent of creditors by value and 60 per cent of the creditors by number, agree to a restructuring package of an existing debt (i.e., debt outstanding), the same would be binding on the remaining creditors. Since Category 1 CDR Scheme covers only standard and substandard accounts, which in the opinion of 75 per cent of the creditors by value and 60 per cent of creditors by number, are likely to become performing after introduction of the CDR package, it is expected that all other creditors (i.e., those outside the minimum 75 per cent by value and 60 per cent by number) would be willing to participate in the entire CDR package, including the agreed additional financing.

#### Other Aspects

c) In order to improve effectiveness of the CDR mechanism a clause may be incorporated in the loan agreements involving consortium/syndicate accounts whereby all creditors, including those which are not members of the CDR mechanism, agree to be bound by the terms of the restructuring package that may be approved under the CDR mechanism, as and when restructuring may become necessary.

#### iv. Stand-Still Clause

a) One of the most important elements of Debtor-Creditor Agreement would be 'stand still' agreement binding for 90 days, or 180 days by both sides. Under this clause, both the debtor and creditor(s) shall agree to a legally binding 'standstill' whereby both the parties commit themselves not to take recourse to any other legal action during the 'standstill' period, this would be necessary for enabling the CDR System to undertake the necessary debt restructuring exercise without any outside intervention, judicial or otherwise. However, the standstill clause will be applicable only to any civil action either by the borrower or any lender against the other party and will not cover any criminal action. Further, during the standstill period, outstanding foreign exchange forward contracts, derivative products, etc., can be crystallised, provided the borrower is agreeable to such crystallisation. The borrower will additionally undertake that during the standstill period the documents will stand extended for the purpose of limitation and also that he will not approach any other authority for any relief and the directors of the borrowing company will not resign from the Board of Directors during the stand-still period.

b) During pendency of the case with the CDR system, the usual asset classification norms would continue to apply. The process of reclassification of an asset should not stop merely because the case is referred to the CDR Cell. However, if a restructuring package under the CDR system is approved by the Empowered Group, and the approved package is implemented within four months from the date of approval, the asset classification status may be restored to the position which existed when the reference to the Cell was made. Consequently, any additional provisions made by banks towards deterioration in the asset classification status during the pendency of the case with the CDR system may be reversed.

c) If an approved package is not implemented within four months after the date of approval by the Empowered Group, it would indicate that the success of the package is uncertain. In that case, the asset classification status of the account should not be restored to the position as on the date of reference to the CDR Cell.

v. Additional finance

a) Additional finance, if any, is to be provided by all creditors of a 'standard' or 'substandard account' irrespective of whether they are working capital or term creditors, on a pro-rata basis. In case for any internal reason, any creditor (outside the minimum 75 per cent and 60 per cent) does not wish to commit additional financing, that creditor will have an option in accordance with the provisions of para 4.2.16.D (vi).

b) The additional finance may be treated as 'standard asset', up to a period of one year after the first interest/ principal payment, whichever is earlier, falls due under the approved restructuring package. However, in the case of accounts where the existing facilities are classified as 'substandard' and 'doubtful', interest income on the additional finance should be recognised only on cash basis. If the restructured asset does not qualify for upgradation at the end of the above specified one year period, the additional finance shall be placed in the same asset classification category as the restructured debt.

c) The providers of additional finance, whether existing creditors or new creditors, shall have a preferential claim, to be worked out under the restructuring package, over the providers of existing finance with respect to the cash flows out of recoveries, in respect of the additional exposure.

vi. Exit Option

a) As stated in para 4.2.16.D (v)(a) a creditor (outside the minimum 75 per cent and 60 per cent) who for any internal reason does not wish to commit additional finance will have an option. At the same time, in order to avoid the "free rider" problem, it is necessary to provide some disincentive to the creditor who wishes to exercise this option. Such creditors can either (a) arrange for its share of additional finance to be provided by a new or existing creditor, or (b) agree to the deferment of the first year's interest due to it after the CDR package becomes effective. The first year's deferred interest as mentioned above, without compounding, will be payable along with the last instalment of the principal due to the creditor.

b) In addition, the exit option will also be available to all lenders within the minimum 75 percent and 60 percent provided the purchaser agrees to abide by restructuring package approved by the Empowered Group. The exiting lenders may be allowed to continue with their existing level of exposure to the borrower provided they tie up with either the existing lenders or fresh lenders taking up their share of additional finance.

c) The lenders who wish to exit from the package would have the option to sell their existing share to either the existing lenders or fresh lenders, at an appropriate price, which would be decided mutually between the exiting lender and the taking over lender. The new lenders shall rank on par with the existing lenders for repayment and servicing of the dues since they have taken over the existing dues to the exiting lender.

d) In order to bring more flexibility in the exit option, One Time Settlement



can also be considered, wherever necessary, as a part of the restructuring package. If an account with any creditor is subjected to One Time Settlement (OTS) by a borrower before its reference to the CDR mechanism, any fulfilled commitments under such OTS may not be reversed under the restructured package. Further payment commitments of the borrower arising out of such OTS may be factored into the restructuring package.

vii. Conversion option

a) The CDR Empowered Group, while deciding the restructuring package, should decide on the issue regarding convertibility (into equity) option as a part of restructuring exercise whereby the banks / financial institutions shall have the right to convert a portion of the restructured amount into equity, keeping in view the statutory requirement under Section 19 of the Banking Regulation Act, 1949, (in the case of banks) and relevant SEBI regulations.

b) Equity acquired by way of conversion of debt / overdue interest under the CDR mechanism is allowed to be taken up without seeking prior approval from RBI, even if by such acquisition the prudential capital market exposure limit prescribed by the RBI is breached, subject to reporting such holdings to RBI, Department of Banking Supervision (DBS), every month along with the regular DSB Return on Asset Quality. However, banks will have to comply with the provisions of Section 19(2) of the Banking Regulation Act 1949.

c) Acquisition of non-SLR securities by way of conversion of debt is exempted from the mandatory rating requirement and the prudential limit on investment in unlisted non-SLR securities prescribed by the RBI, subject to periodical reporting to RBI in the aforesaid DSB return.

d) The relaxations allowed under paras 4.2.16.D (vii)(b)&(c) would be reviewed after a year.

viii. Category 2 CDR System

a) There have been instances where the projects have been found to be viable by the creditors but the accounts could not be taken up for restructuring under the CDR system as they fell under 'doubtful' category. Hence, a second category of CDR is introduced for cases where the accounts have been classified as 'doubtful' in the books of creditors, and if a minimum of 75% of creditors (by value) and 60% creditors (by number) satisfy themselves of the viability of the account and consent for such restructuring, subject to the following conditions:

i) It will not be binding on the creditors to take up additional financing worked out under the debt restructuring package and the decision to lend or not to lend will depend on each creditor bank / FI separately. In other words, under the proposed second category of the CDR mechanism, the existing loans will only be restructured and it would be up to the promoter to firm up additional financing arrangement with new or existing creditors individually.

ii) All other norms under the CDR mechanism such as the standstill clause, asset classification status during the pendency of

restructuring under CDR, etc., will continue to be applicable to this category also.

b) No individual case should be referred to RBI. CDR Core Group may take a final decision whether a particular case falls under the CDR guidelines or it does not.

c) All the other features of the CDR system as applicable to the First Category will also be applicable to cases restructured under the Second Category.

#### E. Creditors' Rights

All CDR approved packages must incorporate creditors' right to accelerate repayment and borrowers' right to prepay. The right of recompense should be based on certain performance criteria to be decided by the Standing Forum.

#### F. Prudential and Accounting Issues

i. Restructuring of corporate debts under CDR system could take place in the following stages:

a. before commencement of commercial production;

b. after commencement of commercial production but before the asset has been classified as 'substandard';

c. after commencement of commercial production and the asset has been classified as 'substandard' or 'doubtful'.

ii. Accounts restructured under CDR system, including accounts classified as 'doubtful' under Category 2 CDR, would be eligible for regulatory concession in asset classification and provisioning on writing off/providing for economic sacrifice stipulated in para 4.2.16.F(iii)(b) and 4.2.16.F(v)(b) below only if

a) Restructuring under CDR mechanism is done for the first time,

b) The unit becomes viable in 7 years and the repayment period for the restructured debts does not exceed 10 years,

c) Promoters' sacrifice and additional funds brought by them should be a minimum of 15% of creditors' sacrifice, and

d) Personal guarantee is offered by the promoter except when the unit is affected by external factors pertaining to the economy and industry.

iii. Treatment of 'standard' accounts restructured under CDR

a. A rescheduling of the instalments of principal alone, at any of the aforesaid first two stages [paragraph 4.2.16.F(i)(a) and (b) above] would not cause a standard asset to be classified in the substandard category, provided conditions (a) to (d) of Para 4.2.16.F(ii) are complied with and the loan / credit facility is fully secured.

b. A rescheduling of interest element at any of the foregoing first two stages provided conditions (i) to (iv) of Para 4.2.16.F(ii) are complied with would not cause an asset to be downgraded to substandard category on writing off/providing for the amount of sacrifice, if any, in the element of interest measured in present value terms. For this purpose, the sacrifice should be computed as the difference between the present value of future interest income reckoned based on the current BPLR as on the date of restructuring plus the appropriate term premium and credit risk premium for the borrower category on the date of restructuring and the interest charged as per the restructuring package discounted by the current BPLR as on the date of restructuring plus appropriate term premium and credit risk premium as on the date of restructuring.

iv. Moratorium under Restructuring

If a standard asset is taken up for restructuring before commencement of production and the restructuring package provides a longer period of moratorium on interest payments beyond the expected date of commercial production / date of commercial production vis-à-vis the original moratorium period, the asset can no more be treated as standard asset. It may, therefore, be classified as substandard. The same regulatory treatment will apply if a standard asset is taken up for restructuring after commencement of production and the restructuring package provides for a longer period of moratorium on interest payments than the original moratorium period.

v. Treatment of 'substandard' / 'doubtful' accounts restructured under CDR

a. A rescheduling of the instalments of principal alone, would render a substandard / 'doubtful' asset eligible to be continued in the substandard / 'doubtful' category for the specified period, [defined in sub para (b) below] provided the conditions (a) to (d) of Para 4.2.16.F(ii) are complied with and the loan / credit facility is fully secured.

b. A rescheduling of interest element would render a substandard / 'doubtful' asset eligible to be continued to be classified in substandard / 'doubtful' category for the specified period , i.e., a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due under the rescheduled terms, provided the conditions (a) to (d) of Para 4.2.16.F(ii) are complied with and the amount of sacrifice, if any, in the element of interest, measured in present value terms computed as per the methodology described in Para 4.2.16.F(iii)(b) is either written off or provision is made to the extent of the sacrifice involved.

vi. Treatment of Provision

a) Interest sacrifice involved in the amount of interest should be written off or provided for necessarily by debit to Profit & Loss account and held in a distinct account.

b) Sacrifice may be recomputed on each balance sheet date till satisfactory completion of all repayment obligations and full repayment of the outstanding in the account, so as to capture the changes in the fair value on account of changes in BPLR, term premium and the credit category of the borrower. Consequently, banks may provide for the shortfall in provision or reverse the amount of excess provision held in the distinct account.

c) The amount of provision made for NPA, may be reversed when the account is reclassified as a 'standard asset'.

d). In the event any security is taken against interest sacrifice, it should be valued at Re.1/till maturity of the security. This will ensure that the effect of charging off the economic sacrifice to the Profit & Loss account is not negated.

vii. Upgradation of restructured accounts

The substandard / doubtful accounts at Para 4.2.16.F(v) (a) & (b) above, which have been subjected to restructuring, etc. whether in respect of principal instalment or interest amount, by whatever modality, would be eligible to be upgraded to the standard category only after the specified period, i.e. a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due under the rescheduled terms, subject to satisfactory performance during the period.

viii) Asset classification status of restructured accounts

During the specified one year period, the asset classification of substandard / doubtful status accounts will not deteriorate if satisfactory performance of the account is demonstrated during the specified period. In case, however, the satisfactory performance during the specified period is not evidenced, the asset classification of the restructured account would be governed as per the applicable prudential norms with reference to the pre restructuring payment schedule. The asset classification would be bank specific based on record of recovery of each bank/FI, as per the existing prudential norms applicable to banks/FIs.

ix) Prudential norms on conversion

a) Where overdue interest is funded or outstanding principal and interest components are converted into equity, debentures, zero coupon bonds or other instruments and income is recognized in consequence, full provision should be made for the amount of income so recognized. Equity, debentures and other financial instruments acquired by way of conversion of outstanding principal and/ or interest should be classified in the AFS category and valued in accordance with the extant instructions on valuation of banks' investment portfolio except to the extent that (a) equity may be valued as per market value, if quoted (b) in cases where equity is not quoted, valuation may be at breakup value in respect of standard assets and in respect of substandard / doubtful assets, equity may be initially valued at Re1 and at breakup value after restoration / up gradation to standard category.

b) If the conversion of interest into equity, which is quoted, interest income can be recognized after the account is upgraded to the standard category at market value of equity, on the date of such up gradation, not exceeding the amount of interest converted into equity. If the conversion of interest is into equity, which is not quoted, interest income should not be recognized.

c) In case of conversion of principal and / or interest into equity, debentures, bonds, etc., such instruments should be treated as NPA *abinitio* in the same asset classification category as the loan if the loan's classification is substandard or doubtful on implementation of the restructuring package and provision should be made as per the norms. Consequently, income

should be recognized on these instruments only on realization basis. The income in respect of unrealised interest which is converted into debentures or any fixed maturity instruments, would be recognized only on redemption of such instruments.

d) Banks may reverse the provisions made towards income recognised at the time of conversion of accrued interest into equity, bonds, debentures etc. when the instrument goes out of balance sheet on sale/ realisation of value/maturity.

#### G. Asset classification of repeatedly restructured accounts

The regulatory concession in terms of paragraphs 4.2.16.F(iii) and 4.2.16.F(v) would not be available if the account is restructured for the second or more times. In case a restructured asset, which is a standard asset on restructuring, is subjected to restructuring on a subsequent occasion, it should be classified as substandard. If the restructured asset is a substandard or a doubtful asset and is subjected to restructuring, on a subsequent occasion its asset classification would be reckoned from the date when it became NPA on the previous occasion. However, such assets restructuring for the second or more time may be allowed to be upgraded to standard category after one year from the date of first payment of interest or repayment of principal whichever falls due earlier in terms of the current restructuring package subject to satisfactory performance.

#### H. Disclosure

Banks / FIs should also disclose in their published annual Balance Sheets, under "Notes on Accounts", the following information in respect of corporate debt restructuring undertaken during the year:

- a. Total number of accounts, total amount of loan assets and the amount of sacrifice in the restructuring cases under CDR.

[(a) = (b)+(c)+(d)]

- b. The number, amount and sacrifice in standard assets subjected to CDR.
- c. The number, amount and sacrifice in substandard assets subjected to CDR.
- d. The number, amount and sacrifice in doubtful assets subjected to CDR.

#### **4.2.17 Debt restructuring mechanism for Small and Medium Enterprises (SMEs)**

##### **A. Eligibility criteria**

- i. These guidelines would be applicable to the following entities, which are viable  
or potentially viable :
  - a) All non-corporate SMEs irrespective of the level of dues to banks.
  - b) All corporate SMEs, which are enjoying banking facilities from a single bank, irrespective of the level of dues to the bank.
  - c) All corporate SMEs, which have funded and non-funded outstanding up to Rs.10 crore under multiple/ consortium banking arrangement
- ii. Accounts involving wilful default, fraud and malfeasance will not be eligible for restructuring under these guidelines. However banks may review the reasons for classification of the borrower as wilful defaulter specially in old cases where the manner of classification of a borrower as wilful defaulter was not transparent and satisfy themselves that the borrower is in a position to rectify the wilful default provided he is granted an opportunity under the Debt Restructuring Mechanism for SMEs. Such exceptional cases may be admitted for restructuring with the approval of the Board of Directors of the banks only.
- iii. Accounts classified by banks as "Loss Assets" will not be eligible for restructuring.
- iv. In respect of BIFR cases banks should ensure completion of all formalities in seeking approval from BIFR before implementing the package.

##### **B. Viability criteria**

Banks may decide on the acceptable viability benchmark, consistent with the unit becoming viable in 7 years and the repayment period for restructured debt not exceeding 10 years.

##### **C. Prudential Norms for restructured accounts**

- i. Treatment of 'standard' accounts subjected to restructuring
  - a) A rescheduling of the instalments of principal alone, would not cause a standard asset to be classified in the substandard category, provided the borrower's outstanding is fully covered by tangible security. However, the condition of tangible security may not be made applicable in cases where the outstanding is up to Rs.5 lakh, since the collateral requirement for loans up to Rs 5 lakh has been dispensed with for SSI / tiny sector.
  - b) A rescheduling of interest element would not cause an asset to be downgraded to substandard category subject to the condition that the

amount of sacrifice, if any, in the element of interest, measured in present value terms, is either written off or provision is made to the extent of the sacrifice involved.

c) In case there is a sacrifice involved in the amount of interest in present value terms, as at (b) above, the amount of sacrifice should either be written off or provision made to the extent of the sacrifice involved.

ii. Treatment of 'substandard' / 'doubtful' accounts subjected to restructuring

a) A rescheduling of the instalments of principal alone, would render a 'sub-standard' / 'doubtful' asset eligible to continue in the 'substandard' / 'doubtful' category for the specified period ( as defined in paragraph 4.2.17 E below), provided the borrower's outstanding is fully covered by tangible security. However, the condition of tangible security may not be made applicable in cases where the outstanding is up to Rs.5 lakh, since the collateral requirement for loans up to Rs 5 lakh has been dispensed with for SSI / tiny sector.

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

c) Even in cases where the sacrifice is by way of write off of the past interest dues, the asset should continue to be treated as substandard / 'doubtful'.

iii. Treatment of Provision

a) Provision made towards interest sacrifice should be created by debit to Profit & Loss account and held in a distinct account. For this purpose, the future interest due as per the current BPLR in respect of an account should be discounted to the present value at a rate appropriate to the risk category of the borrower (i.e., current PLR + the appropriate term premium and credit risk premium for the borrower-category) and compared with the present value of the dues expected to be received under the restructuring package, discounted on the same basis.

b) Sacrifice may be recomputed on each balance sheet date till satisfactory completion of all repayment obligations and full repayment of the outstanding in the account, so as to capture the changes in the fair value on account of changes in BPLR, term premium and the credit category of the borrower. Consequently, banks may provide for the shortfall in provision or reverse the amount of excess provision held in the distinct account.

c) The amount of provision made for NPA, may be reversed when the account is reclassified as a 'standard asset'.

D. Additional finance

Additional finance, if any, may be treated as 'standard asset' in all accounts viz; standard, substandard, and doubtful accounts, up to a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due under the approved restructuring package. If the restructured asset does not qualify for upgradation at the end of the above period, additional finance

shall be placed in the same asset classification category as the restructured debt.

#### E. Upgradation of restructured accounts

The substandard / doubtful accounts, at para 4.2.17.C (ii) (a) & (b) above, which have been subjected to restructuring, whether in respect of principal instalment or interest, by whatever modality, would be eligible to be upgraded to the standard category after the specified period, i.e., a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due under the rescheduled terms, subject to satisfactory performance during the period.

#### F. Asset classification status

During the specified one year period, the asset classification status of rescheduled accounts will not deteriorate if satisfactory performance of the account is demonstrated during the period. In case, however, the satisfactory performance during the one year period is not evidenced, the asset classification of the restructured account would be governed as per the applicable prudential norms with reference to the pre-restructuring payment schedule. The asset classification would be bank specific, based on record of recovery of each bank, as per the existing prudential norms applicable to banks.

#### G. Repeated restructuring

The special dispensation for asset classification as available in terms of paragraphs 5, 6 and 7 above, shall be available only when the account is restructured for the first time.

#### H. Procedure

- i. Based on these guidelines, banks may formulate, with the approval of their Board of Directors, a debt restructuring scheme for SMEs. While framing the scheme, banks may ensure that the scheme is simple to comprehend and will, at the minimum, include parameters indicated in these guidelines.
- ii. The restructuring would follow a receipt of a request to that effect from the borrowing units.
- iii. In case of eligible SMEs which are under consortium/multiple banking arrangements, the bank with the maximum outstanding may work out the restructuring package, along with the bank having the second largest share.

#### I. Time frame

Banks should work out the restructuring package and implement the same within a maximum period of 60 days from date of receipt of requests.

#### J. Disclosure

The Debt Restructuring Scheme for SMEs should be displayed on the bank's website and also forwarded to SIDBI for placing on their web site.

Banks should also disclose in their published annual Balance Sheets, under "Notes on Accounts", the following information in respect of restructuring



undertaken during the year for SME accounts:

(a) Total amount of assets of SMEs subjected to restructuring.

$$[(a) = (b)+(c)+(d)]$$

(b) The amount of standard assets of SMEs subjected to restructuring.

(c) The amount of substandard assets of SMEs subjected to restructuring.

(d) The amount of doubtful assets of SMEs subjected to restructuring.

#### **4.2.18 Projects under implementation**

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. Recognising 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.

#### **Asset classification**

- ii. 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 years beyond the date of completion of the project as originally envisaged at the time of sanction.*

- iii. 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.
- iv. As regards the projects financed by the FIs/ banks **after 28<sup>th</sup> 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 sub-standard 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.

#### Income recognition

- v. Banks may recognise income on accrual basis in respect of the above three categories of projects under implementation, which are classified as 'standard'.
- vi. 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:

a) 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.

b) Conversion into equity, debentures or any other instrument: The amount outstanding converted into other instruments would normally comprise principal and the interest components. If the amount of interest dues is converted into equity or any other instrument, and income is recognised in consequence, full provision should be made for the amount of income so recognised to offset the effect of such income recognition. Such provision would be in addition to the amount of provision that may be necessary for the depreciation in the value of the equity or other instruments, as per the investment valuation norms. However, if the conversion of interest is into equity which is quoted, interest income can be recognised at market value of equity, as on the date of conversion, not exceeding the amount of interest converted to equity. Such equity must thereafter be classified in the "available for sale" category and valued at lower of cost or market value. In case of conversion of principal and /or interest in respect of NPAs into debentures, such debentures should be treated as NPA, ab initio, in the same asset classification as was applicable to loan just before conversion and provision made as per norms. This norm would also apply to zero coupon bonds or other instruments which seek to defer the liability of the issuer. On such debentures, income should be recognised only on realisation basis. The income in respect of unrealised interest which is converted into debentures or any other fixed maturity instrument should be recognised only on redemption of such instrument. Subject to the above, the equity shares or other instruments arising from conversion of the principal amount of loan would also be subject to the usual prudential valuation norms as applicable to such instruments.

#### Provisioning

- vii. 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.

#### 4.2.19 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 predetermined 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.

#### 4.2.20 Post-shipment Supplier's Credit

- i. In respect of post-shipment credit extended by the banks covering export of goods to countries for which the ECGC's cover is available, EXIM Bank has introduced a guarantee-cum-refinance programme whereby, in the event of default, EXIM Bank will pay the guaranteed amount to the bank within a period of 30 days from the day the bank invokes the guarantee after the exporter has filed claim with ECGC.
- ii. Accordingly, to the extent payment has been received from the EXIM Bank, the advance may not be treated as a nonperforming asset for asset classification and provisioning purposes.

#### 4.2.21 Export Project Finance

- i. In respect of export project finance, there could be instances where the actual importer has paid the dues to the bank abroad but the bank in turn is unable to remit the amount due to political developments such as war, strife, UN embargo, etc.
- ii. In such cases, where the lending bank is able to establish through documentary evidence that the importer has cleared the dues in full by depositing the amount in the bank abroad before it turned into NPA in the books of the bank, but the importer's country is not allowing the funds to be remitted due to political or other reasons, the asset classification may be made after a period of one year from the date the amount was deposited by the importer in the bank abroad.

#### 4.2.22 Advances under rehabilitation approved by BIFR/ TLI

Banks are not permitted to upgrade the classification of any advance in respect of which the terms have been renegotiated unless the package of renegotiated terms has worked satisfactorily for a period of one year. While the existing credit facilities sanctioned to a unit under rehabilitation packages approved by BIFR/term lending

institutions will continue to be classified as substandard or doubtful as the case may be, in respect of additional facilities sanctioned under the rehabilitation packages, the Income Recognition, Asset Classification norms will become applicable after a period of one year from the date of disbursement.

## **5 PROVISIONING NORMS**

### **5.1 General**

5.1.1 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.

5.1.2 In conformity with the prudential norms, provisions should be made on the nonperforming assets on the basis of classification of assets into prescribed categories as detailed in paragraphs 4 supra. Taking into account the time lag between an account becoming doubtful of recovery, its recognition as such, the 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:

### **5.2 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.

### **5.3 Doubtful assets**

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.

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

Period for which the advance has remained in 'doubtful' category	Provision requirement (%)
Up to one year	20
One to three years	30
More than three years	100

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.

#### 5.4 Substandard assets

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

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.

#### 5.5 Standard assets

(i) 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) residential housing loans beyond Rs. 20 lakh at 1 per cent;
- (c) advances to specific sectors, i.e., personal loans (including credit card receivables), loans and advances qualifying as Capital Market exposures, Commercial Real Estate loans, and Loans and advances to Non-deposit taking Systemically Important NBFCs

- at 2 per cent
- (d) all other advances not included in (a), (b) and (c) above, at 0.40 per cent.

(ii) In order to ensure continued and adequate availability of credit to highly productive sectors of the economy, the provisioning requirement for loans and advances to Asset Finance Companies ( as defined by DNBS, RBI from time to time), which are standard assets, shall remain unchanged at 0.40 %

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

(iv) 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.

## 5.6 Prudential norms on creation and utilisation of floating provisions

### 5.6.1 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.

### 5.6.2 Principle for utilisation of floating provisions by banks

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.

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.

### 5.6.3 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 can be netted off from gross NPAs to arrive at disclosure of net NPAs. Alternatively, they can be treated as part of Tier II capital within the overall ceiling of 1.25 % of total risk weighted assets.

### 5.6.4 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.

### 5.6.5 Provisions for advances at higher than prescribed rates

A bank may voluntarily make specific provisions for advances at rates which are higher than the rates prescribed under existing regulations 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.

## 5.7 **Provisions on Leased Assets**

### 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.

### 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 following rates should be made on the sum of the net investment in the lease and the unrealised portion of finance income net of finance charge component of the secured portion, depending upon the period for which asset has been doubtful:



<b>Period for which the advance has remained in 'doubtful' category</b>	<b>Provision requirement (%)</b>
Up to one year	20
One to three years	30
More than three years	100

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.

**5.8 Guidelines for Provisions under Special Circumstances**

5.8.1 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.

5.8.2 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.

5.8.3 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.

5.8.4 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

Outstanding Balance	Rs. 4 lakhs
ECGC Cover	50 percent
Period for which the advance has remained doubtful	More than 3 years remained doubtful (as on March 31, 2004)
Value of security held (excludes worth of Rs.)	Rs. 1.50 lakhs

Provision required to be made

Outstanding balance	Rs. 4.00 lakhs
Less: Value of security held	Rs. 1.50 lakhs
Unrealised balance	Rs. 2.50 lakhs
Less: 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 (@ 100 percent of unsecured portion)
Provision for secured portion of advance (as on March 31, 2005)	Rs.0.90 lakhs (@ 60 per cent of the secured portion)
Total provision to be made	Rs.2.15 lakhs (as on March 31, 2005)

5.8.5 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 I**

<b>Asset classification status:</b>	<b>Doubtful – More than 3 years (as on March 31, 2004)</b>	
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.1.50 lakh	
Balance outstanding	Rs.10.00 lakh	
<u>Less</u> Realisable value of security	Rs. 1.50 lakh	
Unsecured amount	Rs. 8.50 lakh	
<u>Less</u> CGTSI cover (75%)	Rs. 6.38 lakh	
Net unsecured and uncovered portion:	Rs. 2.12 lakh	
		<b><u>Provision Required</u></b> (as on March 31, 2005)
Secured portion	Rs.1.50 lakh	Rs. 0.90 lakh (@ 60%)
Unsecured & uncovered portion	Rs.2.12 lakh	Rs. 2.12 lakh (100%)
Total provision required		Rs. 3.02 lakh

**Example II**

<b>Asset classification status</b>	<b>Doubtful – More than 3 years (as on March 31, 2005)</b>	
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	
Balance outstanding	Rs.40.00 lakh	
<u>Less</u> Realisable value of security	Rs. 10.00 lakh	
Unsecured amount	Rs. 30.00 lakh	
<u>Less</u> CGTSI cover (75%)	Rs. 18.75 lakh	
Net unsecured and uncovered portion:	Rs. 11.25 lakh	
		<b><u>Provision Required</u></b> (as on March 31, 2005)
Secured portion	Rs.10.00 lakh	Rs. 10.00 lakh (@ 100%)
Unsecured & uncovered portion	Rs.11.25 lakh	Rs.11.25 lakh (100%)
Total provision required		Rs. 21.25 lakh

#### 5.8.6 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.

#### 5.8.7 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 becomes 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.

#### 5.8.8 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:

<b>Risk category</b>	<b>ECGC Classification</b>	<b>Provisioning Requirement (per cent)</b>
Insignificant	A1	0.25
Low	A2	0.25
Moderate	B1	5
High	B2	20
Very high	C1	25
Restricted	C2	100
Offcredit	D	100

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).

#### 5.8.9 Provisioning norms for sale of financial assets to Securitisation Company (SC) / Reconstruction company (RC)

(i) If the sale of financial assets to SC/RC, is at a price below the net book value (NBV) (i.e. book value less provisions held), the shortfall should be debited to the profit and loss account of that year.

(ii) If the sale is for a value higher than the NBV, the excess provision will not be reversed but will be utilized to meet the shortfall/loss on account of sale of other financial assets to SC/RC.

(iii) With a view to enabling banks to meet the shortfall, if any, banks are advised to build up provisions significantly above the minimum regulatory requirements for their NPAs, particularly for those assets which they propose to sell to securitisation/reconstruction companies.

#### 5.8.10 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 securitisation transactions undertaken in terms of our guidelines on securitisation dated February 1, 2006, should be fully provided for.

## **6. Guidelines on sale of financial assets to Securitisation Company (SC)/ Reconstruction Company (RC) (created under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002) and related issues**

### **6.1 Scope**

These guidelines would be applicable to sale of financial assets enumerated in paragraph 6.3 below, by banks/ FIs, for asset reconstruction/ securitisation under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

### **6.2 Structure**

The guidelines to be followed by banks/ FIs while selling their financial assets to SC/RC under the Act *ibid* and investing in bonds/ debentures/ security receipts offered by the SC/RC are given below. The prudential guidelines have been grouped under the following headings:

- i) Financial assets which can be sold.
- ii) Procedure for sale of banks'/ FIs' financial assets to SC/ RC, including valuation and pricing aspects.
- iii) Prudential norms, in the following areas, for banks/ FIs for sale of their financial assets to SC/ RC and for investing in bonds/ debentures/ security receipts and any other securities offered by the SC/RC as compensation consequent upon sale of financial assets:
  - a) Provisioning / Valuation norms
  - b) Capital adequacy norms
  - c) Exposure norms
- iv) Disclosure requirements

### **6.3 Financial assets which can be sold**

A financial asset may be sold to the SC/RC by any bank/ FI where the asset is:

- i) A NPA, including a non-performing bond/ debenture, and
- ii) A Standard Asset where:
  - (a) the asset is under consortium/ multiple banking arrangements,
  - (b) at least 75% by value of the asset is classified as non-performing asset in the books of other banks/FIs, and
  - (c) at least 75% (by value) of the banks / FIs who are under the consortium / multiple banking arrangements agree to the sale of the asset to SC/RC.

**6.4. Procedure for sale of banks'/ FIs' financial assets to SC/ RC, including valuation and pricing aspects**

(a) The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) allows acquisition of financial assets by SC/RC from any bank/ FI on such terms and conditions as may be agreed upon between them. This provides for sale of the financial assets on 'without recourse' basis, i.e., with the entire credit risk associated with the financial assets being transferred to SC/ RC, as well as on 'with recourse' basis, i.e., subject to unrealized part of the asset reverting to the seller bank/ FI. Banks/ FIs are, however, directed to ensure that the effect of the sale of the financial assets should be such that the asset is taken off the books of the bank/ FI and after the sale there should not be any known liability devolving on the banks/ FIs.

(b) Banks/ FIs, which propose to sell to SC/RC their financial assets should ensure that the sale is conducted in a prudent manner in accordance with a policy approved by the Board. The Board shall lay down policies and guidelines covering, *inter alia*,

- i. Financial assets to be sold;
- ii. Norms and procedure for sale of such financial assets;
- iii. Valuation procedure to be followed to ensure that the realisable value of financial assets is reasonably estimated;
- iv. Delegation of powers of various functionaries for taking decision on the sale of the financial assets; etc.

(c) Banks/ FIs should ensure that subsequent to sale of the financial assets to SC/RC, they do not assume any operational, legal or any other type of risks relating to the financial assets sold.

- (d) (i) Each bank / FI will make its own assessment of the value offered by the SC / RC for the financial asset and decide whether to accept or reject the offer.
- (ii) In the case of consortium / multiple banking arrangements, if 75% (by value) of the banks / FIs decide to accept the offer, the remaining banks / FIs will be obligated to accept the offer.
- (iii) Under no circumstances can a transfer to the SC/ RC be made at a contingent price whereby in the event of shortfall in the realization by the SC/RC, the banks/ FIs would have to bear a part of the shortfall.

(e) Banks/ FIs may receive cash or bonds or debentures as sale consideration for the financial assets sold to SC/RC.

(f) Bonds/ debentures received by banks/ FIs as sale consideration towards sale of financial assets to SC/RC will be classified as investments in the books of banks/ FIs.

(g) Banks may also invest in security receipts, Pass-through certificates (PTC), or other bonds/ debentures issued by SC/RC. These securities will also be classified as investments in the books of banks/ FIs.

(h) In cases of specific financial assets, where it is considered necessary, banks/ FIs may enter into agreement with SC/RC to share, in an agreed proportion, any surplus realised by SC/RC on the eventual realisation of the concerned asset. In such cases the terms of sale should provide for a report from the SC/RC to the bank/ FI on the value realised from the asset. No credit for the expected profit will be taken by banks/ FIs until the profit materializes on actual sale.

## **6.5. Prudential norms for banks/ FIs for the sale transactions**

### **(A) Provisioning/ valuation norms**

(a) (i) When a bank / FI sells its financial assets to SC/ RC, on transfer the same will be removed from its books.

(ii) If the sale to SC/ RC is at a price below the net book value (NBV) (i.e., book value less provisions held), the shortfall should be debited to the profit and loss account of that year.

(iii) If the sale is for a value higher than the NBV, the excess provision will not be reversed but will be utilized to meet the shortfall/ loss on account of sale of other financial assets to SC/RC.

(iv) When banks/ FIs invest in the security receipts/ pass-through certificates issued by SC/RC in respect of the financial assets sold by them to the SC/RC, the sale shall be recognised in books of the banks / FIs at the lower of:

- the redemption value of the security receipts/ pass-through certificates, and
- the NBV of the financial asset.

The above investment should be carried in the books of the bank / FI at the price as determined above until its sale or realization, and on such sale or realization, the loss or gain must be dealt with in the same manner as at (ii) and (iii) above.

(b) *The securities (bonds and debentures) offered by SC / RC should satisfy the following conditions:*

(i) The securities must not have a term in excess of six years.



- (ii) The securities must carry a rate of interest which is not lower than 1.5% above the Bank Rate in force at the time of issue.
  - (iii) The securities must be secured by an appropriate charge on the assets transferred.
  - (iv) The securities must provide for part or full prepayment in the event the SC / RC sells the asset securing the security before the maturity date of the security.
  - (v). The commitment of the SC / RC to redeem the securities must be unconditional and not linked to the realization of the assets.
  - (vi) Whenever the security is transferred to any other party, notice of transfer should be issued to the SC/ RC.
- (c) *Investment in debentures/ bonds/ security receipts/ Pass-through certificates issued by SC/ RC*

All instruments received by banks/FIs from SC/RC as sale consideration for financial assets sold to them and also other instruments issued by SC/ RC in which banks/ FIs invest will be in the nature of non SLR securities. Accordingly, the valuation, classification and other norms applicable to investment in non-SLR instruments prescribed by RBI from time to time would be applicable to bank's/ FI's investment in debentures/ bonds/ security receipts/PTCs issued by SC/ RC. However, if any of the above instruments issued by SC/RC is limited to the actual realisation of the financial assets assigned to the instruments in the concerned scheme the bank/ FI shall reckon the Net Asset Value (NAV), obtained from SC/RC from time to time, for valuation of such investments.

(B) Capital Adequacy

For the purpose of capital adequacy, banks/ FIs should assign risk weights as under to the investments in debentures/ bonds/ security receipts/ PTCs issued by SC/ RC and held by banks/ FIs as investment:

- i) Risk weight for credit risk: 100%.
  - ii) Risk weight for market risk: 2.5 %
- Applicable risk weight = (i) + (ii)

(C) Exposure Norms

Banks/ FIs' investments in debentures/ bonds/ security receipts/PTCs issued by a SC/RC will constitute exposure on the SC/RC. As only a few SC/RC are being set up now, banks/ FIs' exposure on SC/RC through their investments in debentures/ bonds/security receipts/PTCs issued by the SC/ RC may go beyond their prudential exposure ceiling. In view of the extra ordinary nature of event, banks/ FIs will be allowed, in the initial years, to exceed prudential exposure ceiling on a case-to-case basis.

## **6.6. Disclosure Requirements**

Banks/ FIs, which sell their financial assets to an SC/ RC, shall be required to make the following disclosures in the Notes on Accounts to their Balance sheets:

### Details of financial assets sold during the year to SC/RC for Asset Reconstruction

- a. No. of accounts
- b. Aggregate value (net of provisions) of accounts sold to SC / RC
- c. Aggregate consideration
- d. Additional consideration realized in respect of accounts transferred in earlier years
- e. Aggregate gain / loss over net book value.

## **6.7. Related Issues**

- (a) SC/ RC will also take over financial assets which cannot be revived and which, therefore, will have to be disposed of on a realisation basis. Normally the SC/ RC will not take over these assets but act as an agent for recovery for which it will charge a fee.
- (b) Where the assets fall in the above category, the assets will not be removed from the books of the bank/ FI but realisations as and when received will be credited to the asset account. Provisioning for the asset will continue to be made by the bank / FI in the normal course.

## **7. Guidelines on purchase/ sale of Non - Performing Financial Assets**

In order to increase the options available to banks for resolving their non performing assets and to develop a healthy secondary market for nonperforming assets, where securitisation companies and reconstruction companies are not involved, guidelines have been issued to banks on purchase / sale of NonPerforming Assets. Since the sale/purchase of nonperforming financial assets under this option would be conducted within the financial system the whole process of resolving the non performing assets and matters related thereto has to be initiated with due diligence and care warranting the existence of a set of clear guidelines which shall be complied with by all entities so that the process of resolving nonperforming assets by sale and purchase of NPAs proceeds on smooth and sound lines. Accordingly guidelines on sale/purchase of nonperforming assets have been formulated and furnished below. The guidelines may be placed before the bank's /FI's /NBFC's Board and appropriate steps may be taken for their implementation.

### **Scope**

7.1 These guidelines would be applicable to banks, FIs and NBFCs purchasing/ selling non performing financial assets, from/ to other banks/FIs/NBFCs (excluding securitisation companies/ reconstruction companies).

7.2 A financial asset, including assets under multiple/consortium banking arrangements, would be eligible for purchase/sale in terms of these guidelines if it is a nonperforming asset/non performing investment in the books of the selling bank.

7.3 The reference to 'bank' in the guidelines on purchase/sale of nonperforming financial assets would include financial institutions and NBFCs.

### **Structure**

7.4 The guidelines to be followed by banks purchasing/ selling nonperforming financial assets from / to other banks are given below. The guidelines have been grouped under the following headings:

- i) Procedure for purchase/ sale of non performing financial assets by banks, including valuation and pricing aspects.
- ii) Prudential norms, in the following areas, for banks for purchase/ sale of non performing financial assets:
  - a) Asset classification norms
  - b) Provisioning norms
  - c) Accounting of recoveries
  - d) Capital adequacy norms
  - e) Exposure norms
- iii) Disclosure requirements

### **7.5 Procedure for purchase/ sale of non performing financial assets, including valuation and pricing aspects**

- i) A bank which is purchasing/ selling nonperforming financial assets should ensure that the purchase/ sale is conducted in accordance with a policy approved by the Board. The Board shall lay down policies and guidelines covering, *inter alia*,
  - a) Non performing financial assets that may be purchased/ sold;
  - b) Norms and procedure for purchase/ sale of such financial assets;
  - c) Valuation procedure to be followed to ensure that the economic value of financial assets is reasonably estimated based on the estimated cash flows arising out of repayments and recovery prospects;
  - d) Delegation of powers of various functionaries for taking decision on the purchase/ sale of the financial assets; etc.
  - e) Accounting policy

ii) While laying down the policy, the Board shall satisfy itself that the bank has adequate skills to purchase non performing financial assets and deal with them in an efficient manner which will result in value addition to the bank. The Board should also ensure that appropriate systems and procedures are in place to effectively address the risks that a purchasing bank would assume while engaging in this activity.

iii) Banks should, while selling NPAs, work out the net present value of the estimated cash flows associated with the realisable value of the available securities net of the cost of realisation. The sale price should generally not be lower than the net present value arrived at in the manner described above. (Same principle should be used in compromise settlements. As the payment of the compromise amount may be in instalments, the net present value of the settlement amount should be calculated and this amount should generally not be less than the net present value of the realisable value of securities.)

iv) The estimated cash flows are normally expected to be realised within a period of three years and at least 10% of the estimated cash flows should be realized in the first year and at least 5% in each half year thereafter, subject to full recovery within three years.

v) A bank may purchase/sell nonperforming financial assets from/to other banks only on 'without recourse' basis, i.e., the entire credit risk associated with the nonperforming financial assets should be transferred to the purchasing bank. Selling bank shall ensure that the effect of the sale of the financial assets should be such that the asset is taken off the books of the bank and after the sale there should not be any known liability devolving on the selling bank.

vi) Banks should ensure that subsequent to sale of the non performing financial assets to other banks, they do not have any involvement with reference to assets sold and do not assume operational, legal or any other type of risks relating to the financial assets sold. Consequently, the specific financial asset should not enjoy the support of credit enhancements / liquidity facilities in any form or manner.

vii) Each bank will make its own assessment of the value offered by the purchasing bank for the financial asset and decide whether to accept or reject the offer.

viii) Under no circumstances can a sale to other banks be made at a contingent price whereby in the event of shortfall in the realization by the purchasing banks, the selling banks would have to bear a part of the shortfall.

ix) A nonperforming asset in the books of a bank shall be eligible for sale to other banks only if it has remained a nonperforming asset for at least two years in the books of the selling bank.

x) Banks shall sell nonperforming financial assets to other banks only on cash basis. The entire sale consideration should be received upfront and the asset can be taken out of the books of the selling bank only on receipt of the entire sale consideration.

xi) A nonperforming financial asset should be held by the purchasing bank in its books at least for a period of 15 months before it is sold to other banks. Banks should not sell such assets back to the bank, which had sold the NPFA.

(xii) Banks are also permitted to sell/buy homogeneous pool within retail non-performing financial assets, on a portfolio basis provided each of the nonperforming financial assets of the pool has remained as nonperforming financial asset for at least 2 years in the books of the selling bank. The pool of assets would be treated as a single asset in the books of the purchasing bank.

xiii) The selling bank shall pursue the staff accountability aspects as per the existing instructions in respect of the nonperforming assets sold to other banks.

#### **7.6. Prudential norms for banks for the purchase/ sale transactions**

##### **(A) Asset classification norms**

(i) The nonperforming financial asset purchased, may be classified as 'standard' in the books of the purchasing bank for a period of 90 days from the date of purchase. Thereafter, the asset classification status of the financial asset purchased, shall be determined by the record of recovery in the books of the purchasing bank with reference to cash flows estimated while purchasing the asset which should be in compliance with requirements in Para 7.5 (iii).

(ii) The asset classification status of an existing exposure (other than purchased financial asset) to the same obligor in the books of the purchasing bank will continue to be governed by the record of recovery of that exposure and hence may be different.

(iii) Where the purchase/sale does not satisfy any of the prudential requirements prescribed in these guidelines the asset classification status of the financial asset in the books of the purchasing bank at the time of purchase shall be the same as in the books of the selling bank. Thereafter, the asset classification status will continue to be determined with reference to the date of NPA in the selling bank.

(iv) Any restructure/reschedule/rephrase of the repayment schedule or the estimated cash flow of the nonperforming financial asset by the purchasing bank shall render the account as a nonperforming asset.

(B) Provisioning norms

Books of selling bank

i) When a bank sells its nonperforming financial assets to other banks, the same will be removed from its books on transfer.

ii) If the sale is at a price below the net book value (NBV) (i.e., book value less provisions held), the shortfall should be debited to the profit and loss account of that year.

iii) If the sale is for a value higher than the NBV, the excess provision shall not be reversed but will be utilised to meet the shortfall/ loss on account of sale of other nonperforming financial assets.

Books of purchasing bank

The asset shall attract provisioning requirement appropriate to its asset classification status in the books of the purchasing bank.

(C) Accounting of recoveries

Any recovery in respect of a nonperforming asset purchased from other banks should first be adjusted against its acquisition cost. Recoveries in excess of the acquisition cost can be recognised as profit.

(D) Capital Adequacy

For the purpose of capital adequacy, banks should assign 100% risk weights to the nonperforming financial assets purchased from other banks. In case the nonperforming asset purchased is an investment, then it would attract capital charge for market risks also. For NBFCs the relevant instructions on capital adequacy would be applicable.

(E) Exposure Norms

The purchasing bank will reckon exposure on the obligor of the specific financial asset. Hence these banks should ensure compliance with the prudential credit exposure ceilings (both single and group) after reckoning the exposures to the obligors arising on account of the purchase. For NBFCs the relevant instructions on exposure norms would be applicable.

## 7.7. Disclosure Requirements

Banks which purchase nonperforming financial assets from other banks shall be required to make the following disclosures in the Notes on Accounts to their Balance sheets:

A. Details of nonperforming financial assets purchased:

(Amounts in Rupees crore)

1. (a) No. of accounts purchased during the year  
(b) Aggregate outstanding
2. (a) Of these, number of accounts restructured during the year  
(b) Aggregate outstanding

B. Details of nonperforming financial assets sold:

(Amounts in Rupees crore)

1. No. of accounts sold
2. Aggregate outstanding
3. Aggregate consideration received

C. The purchasing bank shall furnish all relevant reports to RBI, CIBIL etc. in respect of the nonperforming financial assets purchased by it.

## 8. Writing off of NPAs

8.1 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.

8.2 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.

8.3 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.

#### **8.4 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 therefor.



**Relevant extract of the list of direct agricultural advances, from the Master Circular  
on lending to priority sector - RPCD. No. Plan. BC. 84 /04.09.01/ 2006-07  
dated 30 April 2007**

<b>DIRECT FINANCE</b>		
<b>1.1</b>	<b>Finance to individual farmers [including Self Help Groups (SHGs) or Joint Liability Groups (JLGs), i.e. groups of individual farmers, provided banks maintain disaggregated data on such finance] for Agriculture</b>	
	<b>1.1.1</b>	Short-term loans for raising crops, i.e. for crop loans. This will include traditional / non-traditional plantations and horticulture.
	<b>1.1.2</b>	Advances up to Rs. 10 lakh against pledge/hypothecation of agricultural produce (including warehouse receipts) for a period not exceeding 12 months, irrespective of whether the farmers were given crop loans for raising the produce or not.
	<b>1.1.3</b>	Working capital and term loans for financing production and investment requirements for agriculture.
	<b>1.1.4</b>	Loans to small and marginal farmers for purchase of land for agricultural purposes.
	<b>1.1.5</b>	Loans to distressed farmers indebted to non-institutional lenders, against appropriate collateral or group security.
	<b>1.1.6</b>	Loans granted for pre-harvest and post-harvest activities such as spraying, weeding, harvesting, grading, sorting, processing and transporting undertaken by individuals, SHGs and cooperatives in rural areas.
<b>1.2</b>	<b>Finance to others [such as corporates, partnership firms and institutions] for Agriculture</b>	
	<b>1.2.1</b>	Loans granted for pre-harvest and post harvest activities such as spraying, weeding, harvesting, grading, sorting and transporting.
	<b>1.2.2</b>	Finance up to an aggregate amount of Rs. one crore per borrower for the purposes listed at 1.1.1, 1.1.2, 1.1.3 and 1.2.1 above.
	<b>1.2.3</b>	One-third of loans in excess of Rs. one crore in aggregate per borrower for agriculture.

**ANNEX - 2**

(Cf. para 2 of the covering circular)

**List of Circulars consolidated by the Master Circular on IRAC Norms**

<b>Sl. No.</b>	<b>Circular No.</b>	<b>Date</b>	<b>Subject</b>	<b>Para No. of the MC</b>
1	RBI/2007-08/316  DBOD.BP.BC.82/21.04.048/2007-08	08.05.2008	Prudential Norms on Asset Classification Pertaining to Advances - Infrastructure Projects under Implementation and Involving Time Overrun	4.2.18 (iv)
2	RBI/2007-2008/152  DBOD.No.BP.BC.34/21.04.048/2007-08	04.10.2007	Guidelines on Purchase / Sale of Non Performing Assets	7.5 (iii)
3	RBI/2006-2007/396  DBOD.No.BP.BC.97/21.04.048/2006-07	16.05.2007	Guidelines on Purchase / Sale of Non Performing Assets	7.5 (iii)
4	RBI/2006-2007/320  DBOD.No.BP.BC.76/21.04.048/2006-07	12.04.2007	Prudential Norms on Income Recognition, Asset Classification and Provisioning Pertaining to Advances - Projects Involving Time Overrun	4.2.18 (iv)
5	RBI/2006-07/287  DBOD.No.BP.BC.68/21.04.048/2006-07	13.03.2007	Prudential Norms on Creation and Utilisation of Floating Provisions	4.6.2
6	RBI/ 2006-2007/240  DBOD.No.BP.BC.53/21.04.048/2006-2007	31.01.2007	Third Quarter Review of the Annual Statement on Monetary Policy for the year 2006-07 - Provisioning Requirement for Standard Assets and Risk Weights for Capital Adequacy	5.5 (i)
7	RBI/2006-07/65  DBOD.No.BP.BC.21/21.04.048/2006-2007	12.07.2006	Annual Policy Statement for the year 2006-07 - Additional Provisioning Requirement for Standard Assets	5.5 (i)
8	RBI/200506/421 DBOD.NO.BP.BC.89/ 21.04.048/ 2005-06	22.06.2006	Prudential norms on creation and utilization of floating provisions	5.6

9	RBI/200506/394 DBOD.NO.BP.BC.85/ 21.04.048/ 2005-06	29.05.2006	Annual Policy Statement for the year 2006-07: Additional Provisioning Requirement for Standard Assets	5.5(i)
10	RBI/RRBI/200506/ DBOD.NO.BP.BC.45 /21.0421.04.048/2005 -06	10.11.2005	Revised Guidelines on Corporate Debt Restructuring(CDR) Mechanism	4.2.16
11	RBI/2005-06/ 206 DBOD.NO.BP.BC.46 /21.0421.04.048/2005-06	10.11.2005	Debt restructuring mechanism for Small and Medium Enterprises (SMEs)	4.2.17.A (ii)
12	RBI/200506/198 DBOD.NO.BP.BC.40/ 21.04.048/ 2005-06	04.11.2005	MidTerm Review of Annual Policy Statement for the year 200506: Additional Provisioning Requirement for Standard Assets	5.5(i)
13	RBI/200506/159 DBOD.NO.BP.BC. 34 /21.04.132/2005-06	08.09.2005	Debt restructuring mechanism for Small and Medium Enterprises (SMEs) - Announcement made by the Union Finance Minister	4.2.17
14	RBI/200506/54 DBOD.NO.BP.BC.16/ 21.04.048/ 2005-06	13.07.2005	Guidelines on purchase/sale of Non performing Assets	7
15	RBI No.200405/140 DBOD.BP.BC.34/21.0 4.048/2004-05	26.08.2004	Repayment schedule of rural housing loans	4.2.13(vi)
16	RBI No.200405/118 DBOD.BP.BC.29/21.04.048/ 2004-05	13.08.2004	Prudential norms – State Government guaranteed exposures	4.2.14
17	RBI/2004/266 RPCD No. Plan.BC 92/04.09.01/2003-04	24.06.2004	Flow of credit to Agriculture	4.2.13 (iv)
18	RBI/2004/264 DBOD No. BP.BC 102/21.04.048/2003-04	24.06.2004	Prudential Norms for Agricultural Advances	2.1.2(iv), (v) 4.2.10, 4.2.13(i)
19	RBI/2004/261 DBOD No. BP.BC 99/21.04.048/2003-04	21.06.2004	Additional Provisioning Requirement for NPAs	5.3(ii), 5.7(ii), 5.8.5, 5.8.6

20	RBI/2004/254	17.06.2004	Prudential Guidelines on Unsecured Exposures	5.4, 5.7(1)
	DBOD No. BP.BC 97/21.04.141/2003-04			
21	RBI/2004/253	17.06.2004	Country Risk Management Guidelines	5.8.9
	DBOD No. BP.BC 96/21.04.103/2003-04			
22	DBOD No. BP.BC 96/21.04.048/2002-03	23.04.2003	Guidelines on sale of financial assets to Securitisation / reconstruction company and related issues	5.8.10, 6
23	DBOD BP.BC. NO. 74/21.04.048/2002-2003	27.02.2003	Projects under implementation involving time overrun	4.2.18
24	DBOD No. BP.BC. 71/21.04.103/2002-2003	19.02.2003	Risk Management Systems in Banks – Guidelines on Country Risk Management	5.8.9
25	DBOD BP.BC. No. 69/21.04.048/2002-03	10.02.2003	Upgradation of loan accounts classified as NPAs	4.2.5
26	DBOD. BP.BC No. 44/21.04.048/2002-03	30.11.2002	Agricultural loans affected by natural calamities	4.2.13
27	DBOD No.BP.BC. 108/ 21.04.048/2001-2002	28.05.2002	Income recognition, asset classification and provisioning on advances - treatment of projects under implementation involving time overrun	4.2.18
28	DBOD No.BP.BC. 101/ 21.01.002/ 2001-02	09.05.2002	Corporate Debt Restructuring	4.2.16
29	DBOD No.BP.BC. 100/ 21.01.002/ 2001-02	09.05.2002	Prudential norms on asset classification	4.1.2
30	DBOD No.BP.BC. 59/ 21.04.048/2001-2002	22.01.2002	Prudential norms on income recognition, asset classification and Provisioning agricultural advances	4.2.13(i)
31	DBOD No.BP.BC. 25/ 21.04.048/2000-2001	11.09.2001	Prudential norms on income recognition, asset classification and provisioning	4.2.15 (v)

32	DBOD No.BP.BC. 15 / 21.04.114/2000-2001	23.08.2001	Corporate Debt Restructuring	4.2.16
33	DBOD No.BP.BC. 132/ 21.04.048/2000-2001	14.06.2001	Income Recognition, Asset Classification and Provisioning for Advances	4.2.2, 4.2.4, 4.2.6, 4.2.7(ii), 4.2.8, 4.2.9, 5.8.8
34	DBOD No. BP.BC. 128/ 21.04.048/2000-2001	07.06.2001	SSI Advances Guaranteed by CGTSI – Riskweight and provisioning norms	5.8.6
35	DBOD No. BP. BC. 116  /21.04.048/ 2000-2001	02.05.2001	Monetary & Credit  Policy Measures 2001-02	2.1.2
36	DBOD No. BP. BC. 98/ 21.04.048/ 2000-2001	30.03.2001	Treatment of Restructured Accounts	4.2.15
37	DBOD No. BP. BC. 40 / 21.04.048/ 2000-2001	30.10.2000	Income Recognition, Asset Classification and Provisioning Reporting of NPAs to RBI	3.5
38	DBOD.No.BP.BC.161/21.04. 0 48/ 2000	24.04.2000	Prudential Norms on Capital Adequacy, Income Recognition, Asset Classification and Provisioning, etc.	5.5
39	DBOD.No.BP.BC.144/21.04. 0 48/ 2000	29.02.2000	Income Recognition, Asset Classification and Provisioning and Other Related Matters and Adequacy Standards - Takeout Finance	4.2.19, 5.8.7
40	DBOD.No.BP.BC.138/21.04. 0 48/ 2000	07.02.2000	Income Recognition, Asset Classification and Provisioning Export Project Finance	4.2.21
41	DBOD.No.BP.BC.103/21.04. 0 48/ 99	21.10.99	Income Recognition, Asset Classification and Provisioning Agricultural Finance by Commercial Banks through Primary Agricultural Credit Societies	4.2.10
42	DBOD.No.FSC.BC.70/24.01. 001/ 99	17.07.99	Equipment Leasing Activity Accounting/ Provisioning Norms	3.2.3, 5.7

43	DBOD.No.BP.BC.45/21.04.04 8/99	10.05.99	Income Recognition Asset Classification and Provisioning Concept of Commencement of Commercial Production	4.2.15
44	DBOD.No.BP.BC.120/21.04.04 8/ 98	29.12.98	Prudential norms on Income Recognition, Asset Classification and Provisioning Agricultural Loans Affected by Natural Calamities	4.2.13(ii) & (iii)
45	DBOD.No.BP.BC.103/21.01.002/ 98	31.10.98	Monetary & Credit Policy Measures	4.1.1, 4.1.2, 5.5
46	DBOD.No.BP.BC.17/21.04.04 8/98	04.03.98	Prudential Norms on Income Recognition, Asset Classification and Provisioning Agricultural Advances	4.2.13
47	DOS. No. CO.PP. BC.6/11.01.005/ 9697	15.05.97	Assessments relating to asset valuation and loan loss provisioning	5.1.1
48	DBOD.No.BP.BC.29/21.04.04 8/97	09.04.97	Income Recognition Asset Classification and Provisioning Agricultural Advances	4.2.13
49	DBOD.No.BP.BC.14/21.04.048/97	19.02.97	Income Recognition Asset Classification and Provisioning Agricultural Advances	4.2.13
50	DBOD.No.BP.BC.9/21.04.048 /97	29.01.97	Prudential Norms Capital Adequacy, Income Recognition Asset Classification and Provisioning	4.2.4, 4.2.5, 4.2.8, 4.2.9
51	DBOD.No.BP.BC.163/21.04.04 8/ 96	24.12.96	Classification of Advances with Balance less than Rs. 25,000/	4.1
52	DBOD.No.BP.BC.65/21.04.048/96	04.06.96	Income Recognition Asset Classification and Provisioning	4.2.8
53	DBOD.No.BP.BC.26/21.04.048/96	19.03.96	NonPerforming Advances Reporting to RBI	3.5

54	DBOD.No.BP.BC.25/21.04.0 48/96	19.03.96	Income Recognition Asset Classification and Provisioning	4.2.8, 4.2.14, 7.4
55	DBOD.No.BP.BC.134/21.04. 0 48/ 95	20.11.95	EXIM Bank's New Lending Programme Extension of Guarantee cum Refinance to Commercial Bank in respect of Post shipment Supplier's Credit	4.2.20
56	DBOD.No.BP.BC.36/21.04.0 48/95	03.04.95	Income Recognition Asset Classification and Provisioning	3.2.2, 3.3, 4.2.20, 5.8.1(i)(ii)
57	DBOD.No.BP.BC.134/21.04. 0 48/ 94	14.11.94	Income Recognition Asset Classification Provisioning and Other Related Matters	4.2.20, 5.8.1
58	DBOD.No.BP.BC.58/21.04.0 4 894	16.05.94	Income Recognition Asset Classification and Provisioning and Capital Adequacy Norms - Clarifications	5.8.5
59	DBOD.No.BP.BC.50/21.04.0 48/94	30.04.94	Income Recognition Asset Classification and Provisioning	5.8.5
60	DOS.BC.4/16.14.001/9394	19.03.94	Credit Monitoring System - Health Code System for Borrowal Accounts	1.3
61	DBOD.No.BP.BC.8/21.04.04 3 /94	04.02.94	Income Recognition, Provisioning and Other Related Matters	3.1.2, 3.4, 4.2.11, 4.2.22, 5.8.2, 5.8.3, 5.8.4
62	DBOD.No.BP.BC.195/21.04. 0 48/ 93	24.11.93	Income Recognition, Asset Classification and Provisioning Clarifications	4.2.14
63	DBOD.No.BP.BC.95/21.04.0 48/93	23.03.93	Income Recognition, Asset Classification, Provisioning and Other Related Matters	3.2, 5, 7
64	DBOD.No.BP.BC.59/21.04.0 4 392	17.12.92	Income Recognition, Asset Classification and Provisioning Clarifications	3.2.1, 3.2.2, 4.2.7(i), 4.2.8, 4.2.9(ii), 4.2.12, 4.2.13, 4.2.14, 4.2.16

65	DBOD.No.BP.BC.129/21.04.0 4392	27.04.92	Income Recognition, Asset Classification,	1.1, 1.2, 2.1.1, 2.2,
			Provisioning and Other Related Matters	3.1.1,3.1.3, 4.1, 4.1.1,
				4.1.2, 4.1.3,
				4.2, 5.1, 5.2,
				5.3, 5.4
66	DBOD.No.BP.BC.42/C.469 (W)90	31.10.90	Classification of Non Performing Loans	3.1.1
67	DBOD.No.Fol.BC.136/C.249 85	07.11.85	Credit Monitoring System - Introduction of Health Code for Borrowal Accounts in Banks	1.3
68	DBOD.No.BP.BC.35/21.01.0 02/99	24.04.99	Monetary & Credit Policy Measures	4.2.11 4.2.15
69	DBOD.No.FSC.BC.18/24.01.001/ 9394	19.02.94	Equipment Leasing, Hire Purchase, Factoring, etc. Activities	2.1, 3.2.3