

CHART SHOWING PROVISIONS REQUIRED BASED ON CATEGORISATION OF ADVANCES ACCOUNTS (BORROWER-WISE) AS AT 31.3.2008.

The branches are required to categorise advances for the purpose of making provisions as per RBI prudential norms, as per the following Chart.

<u>Classification</u>	<u>Stipulated/ Prudential level of provision</u>	<u>Remarks</u>
a. Standard	<p>0.25% on aggregate outstanding SME/ Direct agricultural advances</p> <p>1.00% on Residential housing loans each beyond Rs.20 lacs</p> <p>2.00% on personal loans(including credit card receivables), capital market exposures, commercial real estate loans and loans to Systemically Important NBFCs - ND)</p> <p>0.40% for others</p>	<p>Refer RBI Circulars for accelerated provisioning for loans to specific sectors and for the residue Standard Advances.</p> <p>Allowance for security/guarantee cover, even if available, is not to be considered for recommending provision, which is to be computed on the gross funded advances.</p>
b. Sub-standard	<p>20% in respect of the gross aggregate outstanding funded exposure where the total security falls short of 10% of the total funded and unfunded exposure</p> <p>10% of the residue gross funded exposure</p>	<p>Allowance for security/guarantee cover, even if available, is not to be considered for recommending provision, which is to be computed on the gross funded advances.</p> <p>Refer E II for illustrations of methodology for making provisions, based on exposures</p>
c. Doubtful:	<p>100% on unsecured portion plus on secured portion as under:</p>	<p>Deficit=Advance minus [Security + Proportionate amount of credit guarantee cover, if available Credit Guarantee of CGTSI/ECGC/DICGC only Borrower/ other Guarantors' worth should not be considered.</p> <p>Realisable value of security should be taken on realistic basis.</p>
Upto I year	20%	
One to three years	30%	
More than 3 years	100% wef 31.3.207	
d. Loss (determined as such based on examination of accounts including by statutory auditors/ RBI/ or Bank inspection)	100% to be provided/ written off	<p>Accounts which require full provision fall under this category, except for unappropriated cash recovery. Advances classified as doubtful for more than 3 years on or after 1-4-2004 are also akin to Loss Assets and require 100% provision (see Note 4)</p>
e. Projects under implementation - FITL/	100% of income recognised earlier; and provision made earlier not to be reversed	Refer Para 4.2.14 for stages/time of restructuring and classification, which, if covered by security fully in

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Investments and -upgraded restructured accounts	100% of provision made earlier while NPA {Paras 4.2.14(g)(i) and (ii)} Sacrifice on restructuring must be computed and or provided for in the year of sacrifice {Paras 4.2.14 (ii)(b) and (c)}.	which,if covered by security fully in substandard, also continues in the same classification. Such accounts cannot be upgraded till one year of satisfactory performance.
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*NBFC with an asset size of Rs.100 crore or more as per the last audited balance sheet

- Notes :**
1. As at 31.3.2008 most of the banks would have no credit guarantee cover of DICGC.
 2. An account once classified as NPA would remain in Sub-Standard category for 12 months, unless the status is reversed, or the same becomes doubtful or 'loss' .
 3. On examination of the individual advances accounts, the Borrower needs to be given the status as per the most adverse category determined in any credit facility.

All accounts of sole proprietors shall have the same categorization. If a partner of a firm is NPA, the firm and all firms in which he is partner will be NPAs; and if the firm is NPA, all the partners are to be considered as NPAs.
 4. Classification of borrower may get accelerated as "doubtful" or "loss" without reference to the normal time-lag stipulated, where there is serious impairment or significant erosion in the value of realisable security, as assessed by the bank/ valuers/RBI; and the borrower may get categorized as "Doubtful" or loss if such erosion exceeds 50% or 90% or due to fraud
 5. In case of NPAs (including sub-standard assets) each with balance of Rs.5 crores and above, reliance may be placed on:
 - a) stock audit by external agencies, which audit/valuation is mandatory once a year; and
 - b) valuation of collaterals, which the bank must get done once every three years.
 6. Restructuring/reschedulement/renegotiation cannot be done retrospectively and would require serious review, if done frequently; and the same must be on the basis of viability.
 7. It may be noted that provision will have to be made in respect of both the secured (10%) and unsecured(additional 10%) exposures (after considering funded and non-funded exposures) in the cases of borrowers identified as Sub Standard.

Thus, valuation of the security would become relevant in such accounts.

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The following illustrations would help in understanding the methodology to be adopted.

<u>EXPOSURES</u> (Tangible)		<u>S E C U R I T Y A S S E S S E D</u>						
Nature	Amount(Rs)	I	II	III	IV	V	VI	VII
FUNDED	100	129	99	39	19	# 10	# 8	# @ 2
UNFUNDED	200	21	21	21	21	21	21	19
TOTAL (Rs)	300	150	120	60	40	31	29	21
Security(%) to Total Exposure		50	40	20	13.33	10.33	9.66	7
Provision required (based on % of funded)		10	10	10	10	10	20	20

Notes:

- I, II, III, IV, V, VI, VII represent individual borrowers
- @ It may be noted that the assessed security in funded exposure is only 2% (i.e., less than 10% criteria adopted to treat the asset as a Loss Asset as per Para 4.2.8(ii) of the Prudential Norms, but the same cannot be done as the assessed security will also reckon that held in Unfunded exposures (Rs. 19); the assessed total security, being more than 10% of the funded exposure (Rs.21 i.e. Rs.2 + Rs.19) .

<u>EXPOSURES</u>		<u>S E C U R I T Y A S S E S S E D(Tangible)</u>						
Nature	Amount(Rs)	I	II	III	IV	V	VI	VII
FUNDED	200	251	111	51	31	# 22	# @ 18	10
UNFUNDED	100	9	9	9	9	9	9	9
TOTAL(Rs)	300	260	120	60	40	31	27	19
Security(%) to Total Exposure		86.66	40	20	13.33	10.33	9	6.33
Provision required(Rs) (based on % of funded)		20	20	20	20	20	40	@@

Notes:

- I, II, III, IV, V, VI, VII represent borrowers
- @ It may be noted that the assessed security in funded exposure is only 9% (i.e., less than 10% criteria adopted to treat the asset as a Loss Asset as per Para 4.2.8(ii) of the Prudential Norms, but the same cannot be done as the assessed security will also reckon that held in Unfunded exposures (Rs. 9); the assessed total security, being more than 10% of the funded exposure (Rs.18 i.e. Rs.9 + Rs.27 = 13.5% of funded exposure) . It would no doubt be clear that the Borrower would be a problem account, to be carefully examined, notwithstanding the technical prudential norms requiring 20% provision (Rs.20); and the account may require ad hoc or additional provision due to its inherent weaknesses.
- @@ Since the total assessed security is less than 10% of the funded exposure as well as the unfunded exposure, whether taken individually or in the aggregate, the Borrower will have to be classified as a Loss Asset, by virtue of the definition as per the prudential norms.

It would no doubt be clear that the Borrower would be a problem account, to be carefully examined, notwithstanding the technical prudential norms, and may require ad hoc, generic or additional provision due to its inherent weaknesses.

Additional provisioning consequent upon migration from the 18 to 12 month norm for retention as sub standard assets, having a cascading effect on the doubtful category (in each sub-category), is permitted to be phased out in a four year period commencing from 31-3-2005, subject to a minimum of 20% each year.

Income Recognition

Standard Advances

To be accrued by debit to parties

Non Performing Advances

**Upon identification of NPA – past accrued income to be derecognised if not realised
To be recognized on realization thereafter.**

E - III

Guidelines on purchase/ sale of Non performing Financial Assets

1. 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) 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
- iv) 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

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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.

- v) 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.
- vi) 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.
- vii) 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.
- viii) 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.
- ix) Banks shall sell non performing 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.
- x) A non performing 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.
- xi) Banks are also permitted to sell/buy homogeneous pool within retail nonperforming financial assets, on a portfolio basis provided each of the non performing 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.
- xii) The selling bank shall pursue the staff accountability aspects as per the existing instructions in respect of the non performing assets sold to other banks.
- xiii) 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

2. Prudential norms for banks for the purchase/ sale transactions

(A) Asset classification norms

- i) The non-performing 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 6.5 (iii).

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- 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 non performing 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 non performing 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.

Writing off of NPAs

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.
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.
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.
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.