

**OTHER CLARIFICATIONS ON ADVANCES:**

**1. Agricultural advances (List for direct advances given below\*)**

- a) In respect of direct advances granted for agricultural purposes, where interest and/or installment of principal remains overdue will be treated as Non Performing if in respect of:
- **short duration crops** the over dues are for two crop seasons; and
  - **long duration crops**, if the over dues are for one crop season

**Long Duration Crops** are those, with crop season longer than one year.

List of Direct advances include agricultural crops such as paddy, wheat, oilseeds, sugarcane etc. where interest/installment repayments are linked with harvest of the crop; purchase of agricultural implements/machinery/farm equipments/transportation vehicles, development of irrigation potential/reclamation of land, temporary sheds and structures etc.

***In respect of other activities like horticulture, floriculture or allied activities such as animal husbandry, poultry farming etc, assessment of NPA should be done as in case of other advances where 90 days is the delinquency norm.***

**\*List of Direct Agricultural Advances:**

**Direct Finance to Farmers for Agricultural purposes**

Short-term Loans for raising crops i.e. crop loans. In addition, advances upto Rs.5 lakh to farmers against Pledge/Hypothecation of agricultural produce (including warehouse receipts) for a period not exceeding 12 months, where the farmers were given crop loans for raising the produce, provided the borrowers draw credit from one bank.

Medium and long-term loans (**provided directly to farmers** for financing production and development needs).

- i) **Purchase of agricultural implements and machinery**
- a) **Purchase of agricultural implements** – Iron ploughs, harrows, hose, land-levellers, bundformers, hand tools, sprayers, dusters, hay-press, sugarcane crushers, thresher machines, etc.
  - b) **Purchase of farm machinery** – Tractors, trailers, power tillers, tractor accessories viz. disc ploughs, etc.
  - c) Purchase of trucks, mini-trucks, jeeps, pick-up vans, bullock carts and other transport equipment, etc. to assist the transport of agricultural inputs and farm products.
  - d) Transport of agricultural inputs and farm products.
  - e) Purchase of plough animals.

ii) **Development of irrigation potential through –**

- a) Construction of shallow and deep tube wells, tanks, etc. and purchase of drilling units.
- b) Constructing, deepening, clearing of surface wells, boring of wells, electrification of wells, purchase of oil engines and installation of electric motor and pumps.
- c) Purchase and installation of turbine pumps, construction of field channels (open as well as underground), etc.
- d)
- e) Construction of lift irrigation project.
- f) Installation of sprinkler irrigation system.
- g) Purchase of generator sets for energisation of pumpsets used for agricultural purposes.

iii) **Reclamation and land Development Schemes-**

Bunding of farm lands, leveling of land, terracing, conversion of fry paddy lands into wet irrigable paddy lands, wasteland development, development of farm drainage, reclamation of soil lands and prevention of salinisation reclamation of ravine lands, purchase of bulldozers, etc.

iv) **Construction of farm buildings and structures, etc.-**

Bullock sheds, implement sheds, tractor and truck sheds, farm stores, etc.

v) **Construction and running of storage facilities-**

Construction and running of warehouses, godowns, soils and loans granted to farmer for establishing cold storages used for storing own produce.

vi) **Production and processing of hybrid seeds for crops.**

vii) **Payment of irrigation charges, etc.**

Charges for hired water from wells and tube wells, canal water charges, maintenance and upkeep of oil engines and electric motors, payment of labour charges, electricity charges, marketing charges, service charges to Customs Service Units, payment of development cess, etc.

viii) **Other types of direct finance to farmers**

a) **Short-term Loans –**

To traditional/non traditional plantations and horticulture

b) **Medium and Long Term Loans**

- i) Development loans to all plantations, horticulture, forestry and wasteland.
- ii) Financing of small and marginal farmers for purchase of land for agricultural purposes.

b) **Agricultural Loans Affected by Natural Calamities**

The asset classification of agricultural advances affected by natural calamities which have impaired the repayment capacity of the farmers, could be changed by grant of relief measures by re-schedulement of the repayment period and by sanction of fresh loans, and such advances would not be NPA to be governed by the fresh terms of sanction. Thereafter, if these become overdue for two harvest seasons (not exceeding two half years), such advances should be treated as NPA.

Advances to farmers as on 31-3-2005 who have suffered production and income losses due to successive natural calamities, i.e., draught, flood etc., may have been the subject matter of rescheduling pursuant to the State Governments declaring the districts as calamity affected. Such loans could be rescheduled for a period of 5 years at current interest rates, with a two year moratorium period. The restructuring could be done only for the overdue installments/ interest, and fresh loans can be given to these farmers, to be treated as current dues and not NPAs till the lapse of the moratorium period. Thereafter the norms applicable to agricultural loans shall apply in the normal course.

Similarly, in case of relief measures in drought affected areas for kharif crops 2002-03, the principal amount of loan could be converted into term loan repayable over a minimum period of five years in case of small and marginal farmers and four years in case of other farmers. Interest due in the current financial year was also be deferred and no interest was to be charged on such deferred interest. GOI has decided to waive the first instalment (20% of such deferred interest), which was reimbursed by GOI.

**After charging interest in the accounts for 31<sup>st</sup> March 2003, the outstandings in the accounts were to be transferred to deferred term loan accounts separately for interest amount (aggregate for September 02 and March 03), and the principal amount, and treated as current dues.**

In case the Branch has such loans, the basis of classification thereof should be checked with reference to the Head Office instructions as also the RBI circular invoked.

## **2. Classification of Advances:**

### **a) Asset Classification to be borrower- wise and not facility –wise**

- i) It is the borrower that is to be treated as NPA and not the particular facility or part thereof which has become irregular.
- ii) Debits arising out of devolvement of letters of credit or invoked guarantees, even if parked in a separate account, should be treated as part of the borrower's principal operating account for the purpose of application of prudential norms on income recognition, asset classification and provisioning.

### **b) Security / net worth of borrower / guarantor**

The income recognition / asset classification norms are based on record of recovery only. Thus availability of security or the net worth of the borrower / guarantor should not be the criteria for treating an advance as Performing of or Non performing.

- c) There may be instances of accounts, which are classified under Sub-Standard for the first time, yet the Bank is forced to resort to legal action including filing of suit, as a matter of prudence for safeguarding Bank's interest. This is mostly resorted to where the documents are getting time barred and/or pre-empting the borrowers from disposing off the securities. The Branch Auditors should understand the classification under Sub-Standard category, notwithstanding the fact that the account is suit filed. From 31-3-2005 onwards, the sub standard advances are required to be split up between the secured and unsecured exposures for the purpose of provisioning.

### 3. Restructuring/Rescheduling of Loans

- a) As per RBI prudential norms the restructuring/rescheduling/renegotiation of the terms of the loan agreement can take place in any one of the following stages:

**Stage 1-** Before commencement of commercial production.

**Stage 2-** After commencement of commercial production, but before the asset has been classified as Sub-Standard.

**Stage 3-** After commencement of the commercial production and the asset has been classified as Sub-Standard.

In each of the foregoing 3 stages, the rescheduling etc. of principal and/ or of interest can take place with or without sacrifice as part of the restructuring package. The prudential treatment of the accounts subject to restructuring/ rescheduling/ renegotiation of terms is governed by the following terms:

**A *rescheduling of 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 or the sub-standard category to be down-graded, provided the loan is fully secured by tangible securities.**

**A *rescheduling of the interest element* at any of the first two stages would not cause an asset to be downgraded to sub-standard category, if the amount of sacrifice, if any, in the element of interest measured in present value terms is either written off or provided for by the Bank.**

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+ appropriate 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.

A rescheduling of the installment of principal alone of an account coming under Stage 3 above would not change the classification of the account from the Sub-standard category provided the loan/credit facility is fully secured. Similarly, the restructured Sub-standard account can continue to remain in Sub-standard category **subject to the sacrifice amount, if any, arising out of reschedulement of interest element measured in present value terms is written off or provided for.**

**Upgradation** is possible only after a period of one year after the date when the first payment of interest/installment, whichever is earlier, falls due subject to satisfactory performance during the period.

**The above instructions are applicable to all types of credit facilities including working capital limits extended to industrial units and not for credit facilities extended to traders.** For assessing the value of security available, only the tangible securities properly charged to the Bank will be reckoned as available and that in intangible form like guarantees etc. of the promoter/ others will not be taken into account.

As regards “Funded Interest” recognized as income and “conversion into equity or other securities Para4.2.14(v)(g) (i) and (ii) requires that:

- i) **funded interest** recognized as income is to be fully provided, and income recognition must be on realization basis, and not if the amount overdue has been funded; and

- iii) **funded interest converted into equity, debentures and other instruments** - full provision is to be made for the in addition to the depreciation on the related securities. The securities should be categorized as “Available for Sale” at lower

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of cost or market. In case of conversion of the NPAs to debentures, these must be treated as NPAs and income recognized on realization. Income earlier recorded and converted into securities must be taken on redemption. The loans and securities must have the same classification as NPAs.

b) **Accounts restructured under CDR:**

Reference may also be made to Master Circular in respect of the revised guidelines on Corporate Debt Restructuring (CDR) mechanism.

- c) Attention is drawn to ***Master Circular with regard to Debt restructuring mechanism for Small and Medium Enterprises (SMEs)***, with regard to which also Notes on the annual Accounts must have additional disclosures on lending to SMEs which are defined as undertakings in which investment in plant and machinery exceeds investment limit of SSI sector (Rs.1 crore or Rs. 5 crore, as the case may be) and up to Rs.10 crore.

d) **Projects under Implementation:**

As per the Circular, asset classification continues to be linked with the date of completion of project. For the purpose of determining the date when the project ought to be completed, projects have grouped into three categories:

Type	Category	Treatment
Category I	Projects where financial closure had been achieved and formally documented.	Asset may be treated as Standard for a period not exceeding 2 years beyond the date of completion of the project as originally envisaged at the time of initial financial closure. In respect of a project financed after 1997 where financial closure has not been formally documented, treatment would be as per Category III below.
Category II	Projects sanctioned before 1997 with original project cost of Rs.100 crores or more where financial closure was not formally documented.	Asset may be treated as Standard for a period not exceeding 2 years beyond the deemed date of completion of the project as decided by the group constituted by the FIs. Details to be obtained from the Lead FI.
Category III	Projects sanctioned before 1997 with original project cost of less than Rs.100 crores was not formally documented.	Asset may be treated as Standard for a period not exceeding 2 years beyond the date of completion of the project as originally envisaged at the time of sanction.

In all the aforesaid 3 categories, the asset must be classified as substandard irrespective of the record of recovery if there has been a time overrun beyond the period of 2 years and provision has to be made. If as per RBI guidelines the account gets upgraded to 'standard', income can be accrued.

In case of all future sanctions involving project finance, the date of commencement of commercial production should be clearly spelt out. If the date of commencement of



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covered by any other guarantee cover/Government guarantee, are not eligible for cover. Credit facilities which have been sanctioned against collateral security and/or third part guarantee are also not covered under the scheme.

Guarantee Cover	75% of the defaulted principal amount in respect of Term Loan and/or outstanding fund based working capital inclusive of interest (when account becomes NPA or as on date of filing of the suit whichever is earlier), subject to maximum of Rs.18.75 lakhs per borrower.
Guarantee Fee	A one time Guarantee Fee @ 2.5% of the credit facility sanctioned (comprising Term Loan and/or fund based working capital facility – such as CC, OD, bills purchased or discounted etc.) shall be paid upfront to the Trust, provided that the lending institution applies for the guarantee cover within a period of 90 days from the date of the first disbursement.
Service Fee	The annual service fee @ 1% per annum on the outstanding amount to the debit of the borrower's account covered under the scheme as on March 31 of each year is payable within 60 days i.e. on or before May 31 of that year, failing which penal interest @ 4% OBR per annum from 1 <sup>st</sup> June onwards for the period of delay shall be charged by the Trust.

Consequently, in case of advances in doubtful category, this should not be considered for provision.

### **6. HOUSING FINANCE**

**The Circular deals with:**

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### a. **Direct Housing Finance**

Such finance covers individuals and groups of individuals, including co-operative societies, where Banks are free to evolve their own guidelines with the Board approval as regards security, margin, age of the dwelling units, repayments etc.

Such finance includes for:

- buying / constructing a second house by a person already owning a house for self occupation,
- buying a house for letting it out due to the borrower's posting outside the headquarters or accommodation provided by the employer,
- buying the tenanted house in which he resides, or
- purchase of a plot intended to be constructed upon, based on self declaration.
- carrying out additions/alterations/repairs to an already financed house, as supplementary finance, including on the basis of a second/pari passu charge where others have financed the dwelling unit.

### b. **Indirect Housing Finance**

Such finance comprises term loans to finance institutions, housing boards, public housing agencies primarily for augmenting supply of serviced land and constructed units, on the basis of time-bound utilization (houses to be constructed within three years).

Lending can be to Housing Intermediary Agencies (Housing Finance Institutions, Housing Boards and private builders)

### c. **Housing Loans under the Priority Sector**

Direct and indirect finance shall be within the prescribed limits ranging from Rs. lac to Rs. 15 lacs.

Investments in special Bonds, including to NHB, HUDCO are not to be reckoned as under Priority Sector with effect from 1-4-2006.

### d. **R.B.I. Refinance** – No finance is eligible for refinance from RBI.

### e. **Construction activities not eligible for Bank Credit**

### f. **Reporting**

### g. **Opening of Specialized Housing Finance branches**

### h. **Home Loan Account Scheme (HLAS) for National Housing Bank**

### i. **Risk Weight on Housing Finance**

### j. **Terms and conditions for Banks Investments in Mortgage backed securities (MBS)**

## 7. **PRIORITY SECTOR LENDING**

Priority sector broadly comprises:

- a. **Agriculture** – direct and indirect
- b. **Small scale industries** – ancillary industries, tiny enterprises and indirect finance to SSI sector, loans for setting up of industrial estates
- c. **Other activities/borrowers** (such as small business, retail trade, small transport operators, professional and self employed persons, housing, education loans, micro credit etc.)

## 8. **LENDING TO SMALL AND MEDIUM ENTERPRISES SECTOR (SMEs):**

SME is defined as an undertaking in which investment in plant and machinery exceeds the investment limit of the SSI sector (Rs. 1 crore or Rs. 5 crore, as the case may be) and up to Rs. 10 crore. SSI financing is to be considered as PRIORITY SECTOR for the Balance Sheet sub classification and disclosure and financing to the Medium Enterprises is not Priority Sector lending.

**Relief for potentially sick but viable SSI Units:**

**Interest on working capital** - Interest 1.5% below prevailing fixed/ PLR

**FITL** - Interest free

**Contingency Loan Assistance- Concessional rate allowed for working capital assistance**

**9. LIMITATIONS / RESTRICTIONS ON ADVANCES**

RBI, Master Circular has imposed certain statutory/regulatory and other restrictions on advances, inter-alia as regards :

**Advances against bank's Own Shares**

In terms of Section 20(1) of the Banking Regulation Act, 1949, a bank cannot grant any loans and advances on the security of its own shares.

**Advances to bank's Directors**

Section 20(1) of the Banking Regulation Act, 1949 also lays down the restrictions on loans and advances to the Directors and the firms in which they hold substantial interest.

The banks are prohibited from entering into any commitment for granting any loans or advances to or on behalf of any of its directors, or any firm in which any of its directors is interested as partner, manager, employee or guarantor, or any company (not being a subsidiary of the banking company or a company registered under Section 25 of the Companies Act, 1956, or a Government company) of which, or the subsidiary or the holding company of which any of the directors of the bank is a director, managing agent, manager, employee or guarantor or in which he holds substantial interest, or any individual in respect of whom any of its directors is a partner or guarantor.

'Loans or advances' **shall not** include any transaction which the Reserve Bank may specify by general or special order and certain exceptions as listed in the Circular.

***Restrictions on Power to Remit Debts***

Section 20A of the Banking Regulation Act, 1949 stipulates that notwithstanding anything to the contrary contained in Section 293 of the Companies Act, 1956, a banking company shall not, except with the prior approval of the Reserve Bank, remit in whole or in part any debt due to it by -

- (a) any of its directors, or
- (b) any firm or company in which any of its directors is interested as director, partner, managing agent or guarantor, or
- (c) any individual, if any of its director is his partner or guarantor.

**Restrictions on Holding Shares in Companies**

The banks should not hold shares in any company except as provided in sub-section (1) whether as **pledgee, mortgagee** or absolute owner, of an amount exceeding 30 percent of the paid-up share capital of that company or 30 percent of its own paid-up share capital and reserves, whichever is less.

The banks should not hold shares whether as **pledgee, mortgagee** or **absolute owner**, in any company in the management of which any managing director or manager of the bank is in any manner concerned or interested.

Accordingly, while granting loans and advances against shares, statutory provisions contained in Sections 19(2) and (3) should be strictly observed.

**Restrictions on Credit to Companies for Buy-back of their Securities**

The banks should not provide loans to companies for buy-back of shares/securities.

**REGULATORY RESTRICTIONS**

**Granting loans and advances to relatives of Directors**

No loans and advances should be granted to relatives of Bank's Chairman/Managing Director or other Directors, Directors (including Chairman/Managing Director) of other banks and their relatives, Directors of Scheduled Co-operative Banks and their relatives, Directors of Subsidiaries/Trustees of Mutual Funds/Venture Capital Funds set up by the financing banks or other banks as per details given below

***Lending to directors and their relatives on reciprocal basis***

Unless sanctioned by the Board of Directors/Management Committee, banks should not grant loans and advances aggregating Rs. 25 lakhs and above to -

directors (including the Chairman/Managing Director) of other banks \*;

- a) any firm in which any of the directors of other banks \* is interested as a partner or guarantor; and
- b) any company in which any of the directors of other banks \* holds substantial interest or is interested as a director or as a guarantor.

Unless sanctioned by the Board of Directors/Management Committee, banks should also not grant loans and advances aggregating Rs. 25 lakhs and above to -

- a) any relatives of their own Chairmen/Managing Directors or other Directors;
- b) any relatives of the Chairman/Managing Director or other directors of other banks \*;
- c) any firm in which any of the relatives as mentioned in (a) & (b) above is interested as a partner or guarantor; and
- d) any company in which any of the relatives as mentioned in (a) & (b) above hold substantial interest or is interested as a director or as a guarantor.

\* **including directors of Scheduled Co-operative Banks, directors of subsidiaries/trustees of mutual funds/venture capital funds.**

The proposals for credit facilities of an amount less than Rs.25 lakh to these borrowers may be sanctioned by the appropriate authority in the financing bank under powers vested in such authority, but the matter should be reported to the Board.

The Chairman/Managing Director or other director who is directly or indirectly concerned or interested in any proposal should disclose the nature of his interest to the Board when any such proposal is discussed.

The above norms relating to grant of loans and advances will equally apply to awarding of contracts.

The term 'loans and advances' will not include loans or advances against -

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- Government securities
  - Life insurance policies
  - Fixed or other deposits
  - Stocks and shares
  - Temporary overdrafts for small amount, i.e. upto Rs. 25,000/-
  - Casual purchase of cheques upto Rs. 5,000 at a time
  - Housing loans, car advances, etc. granted to an employee of the bank under any scheme applicable generally to employees.
- (i) Every borrower should furnish a declaration to the bank to the effect that
- a) (where the borrower is an individual) he is not a director or specified near relation of director of a banking company;
  - b) (where the borrower is a partnership firm) none of the partners is a director or specified near relation of a director of a banking company; and
  - c) (where the borrower is a joint stock company) none of its directors, is a director or specified near relation of a director of a banking company.
- (ii) The declaration should also give details of the relationship of the borrower to the director of the bank.

These guidelines should be duly brought to the notice of all directors and also placed before the bank's Board of Directors.

### **Restrictions on Grant of Loans & Advances to Officers and the Relatives of Senior Officers of Banks**

#### ***Loans & advances to officers of the bank***

*Loans and advances and award of contracts to relatives of senior officers of the bank*

Such transactions should also be reported to the Board.

The term 'Senior Officer' will refer to any officer in senior management level in Grade IV

In this context, banks may, *inter alia*, evolve a procedure to ascertain the interest of the relatives of a senior officer of the bank in any credit proposal/award of contract placed before the Board Committee or other appropriate authority of the financing bank

### **Restrictions on Grant of Financial Assistance to Industries producing/ Consuming Ozone Depleting Substances (ODS)**

### **Restrictions on Advances against Sensitive Commodities under Selective Credit Control (Refer Para 2.4)**

### **Restrictions on payment of commission to staff members/officers**

- **Loans and Advances against Shares, Debentures and Bonds**

The restrictions, *inter alia*, on loans and advances against shares and debentures, are:-

- (a) No loans to be granted against partly paid shares.
- (b) No loans to be granted to partnership/proprietorship concerns against the primary security of shares and debentures.
- (c) Banks and their subsidiaries should not undertake financing of 'Badla' transactions.

- **Advances against Money Market Mutual Funds**
- **Advances against Fixed Deposit Receipts (FDRs) Issued by Other Banks**
- **Loans against Certificate of Deposits (CDs)**

Banks cannot grant loans against CDs.

- **Bank Finance to Non-Banking Financial Companies (NBFCs)**
- **Bank Finance to Equipment leasing companies**
- **Financing Infrastructure/housing projects (Para 3.8)**
- **Issue of Bank Guarantees in favour of Financial Institutions**
- **Discounting/Rediscounting of Bills by Banks**

Bills covering purchase of raw material/inventory for production purpose and sale of goods should be discounted by banks. Bills covering payments of electricity charges, customs duty, hire-purchase/lease rental instalments, sale of securities and other type of financial accommodation should not be discounted by banks.

Accommodation bills should never be discounted by the banks.

Bills rediscount should be restricted to usance bills held by other banks.

- **Advances against Gold/Silver Bullion**
  - i) Banks should not grant any advance against gold bullion.
  - ii) Banks should desist from granting advances to the silver bullion dealers which are likely to be utilised for speculative purposes.
- **Loans and advances to Small Scale Industries**

SSI units having working capital limits of up to Rs 5 crore from the banking system are to be provided working capital finance computed on the basis of 20 percent of their projected annual turnover. The banks should adopt the simplified procedure in respect of all SSI units (new as well as existing).

- **Loan system for delivery of bank credit**

In the case of borrowers with working capital limit of Rs 10 crore or above (fund based) from the banking system, the minimum level of loan component shall be 80 percent. If the

borrower desires to avail of a higher percentage of loan component, this can be agreed to by the bank.

- **Working Capital Finance to Information Technology and software industry**
- **Bank finance for PSU disinvestments (refer Para 3.15)**

**10. EXPOSURE NORMS FOR CREDIT/INVESTMENTS**

Attention is drawn to the Master Circular, wherein as a prudential measure aimed at better risk management and avoidance of concentration of credit risks, the Reserve Bank of India has advised the banks to fix limits on their exposure to specific industry or sectors and has prescribed regulatory limits on banks' exposure to individual and group borrowers in India. In addition, banks are also required to observe certain statutory and regulatory exposure limits in respect of advances against / investments in shares, debentures and bonds. This circular deals with:

- a. Credit Exposures to Individual / Group Borrowers (Ceilings, Exemptions, Definitions and Review)
- b. Credit Exposure to Industry or Certain Sectors ( Internal Exposure Limits, Exposure to Leasing, Hire Purchase and Factoring Services, Exposure to Indian Joint Ventures / Wholly owned Subsidiaries Abroad, Exposure to Capital Market, Bank Loans for Financing Promoters' contributions, Risk Management and Internal Control System, Bridge Loans, Bank finance to employees to buy share of their own companies)
- c. Exposure Norms for Investments ( Ceiling on overall exposure to capital market, Underwriting of Corporate Shares and Debentures, Other matters on Underwriting Operations, Safety Net Schemes for Public Issues of Shares, Debentures, etc.)
- d. Limits on Exposure to Unsecured Guarantees and Unsecured Advances
- e. Application of prudential norms at group level / on consolidated Position.