PRUDENTIAL NORMS ON INCOME RECOGNITION, ASSET CLASSIFICATION

'Out of order'status

An out of order account is one in which the outstanding balance remains continuously in excess of the sanctioned limit/drawing power or the outstanding balance 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.

'**Overdue'**

Overdue is the unpaid amount due to the bank under any credit facility on due date.

Non-performing Assets

An asset (including a leased asset) ceases to generate income is treated as non performing asset (NPA). A Loan or an advance is classified as NPA as under:-

Nature of Facility	Parameters
Term Loan	Interest and/or instalment of principal remain overdue beyond 90 days
Overdraft/Cash Credit	Remains 'out of order' as indicated above
Bill Purchased/discounted	Remains overdue beyond 90 days
Crop Loans (short duration crops)	Instalment of principal or interest thereon remains overdue for 2 crop seasons
Crop Loans (Long duration crops)	Instalment of principal or interest thereon remains overdue for 1 crop season
Securitization transactions	Amount of liquidity facility remains outstanding beyond 90 days
Derivative transactions	Overdue receivables representing positive mark-to-market value of a derivative contract which remains unpaid beyond 90 days from specified due date for payment
Securitisation transaction	Liquidity facility remains outstanding for more than 90 days,

Banks are required to classify an account as NPA wherein the interest due and charged during any quarter is not serviced fully within 90 days from the end of the quarter.

INCOME RECOGNITION

- Income from NPA assets is to be recognized only when it is actually received. However, interest on advances against term deposits, NSC, IVPs, KVPs, and Life policies may be taken into income account on the due date provided adequate margin is available in the accounts.

- On an account (incl. bills purchased and discounted and Government guaranteed accounts) turning NPA, banks should reverse the interest already charged and not collected by debiting Profit and Loss account, and stop further application of interest. Likewise fees, commission and similar income in respect of past periods, if uncollected, need to be reversed.

- Interest realized 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.

- Banks may continue to record such accrued interest, but not realized, in a Memorandum account in their books which should not be taken into account for computing Gross Advances.

ASSET CLASSIFICATION

NPAs are being classified, based on the period for which the asset has remained non-performing and realisability of the dues, into three categories as under:-

No.	Category	Parameters
01.	Substandard Assets	* Remained NPA for a period not less than or equal to **one** year. *In such cases, the current net worth of the borrower/guarantor or market value of the security charged is not enough to ensure recovery of the bank's dues; * Likely to sustain some loss if deficiencies are not corrected.
02.	Doubtful Assets	*Remained in substandard category beyond 1 year; *Recovery - highly questionable and improbable.
03.	Loss Assets	*Asset considered uncollectible and of little value but not written off wholly by the bank. *Continuance as bankable assets

		although it may have some salvage or recovery value.

Guidelines for Classification

- NPA classification should be done taking into account the degree of credit weaknesses and availability of collateral security for realization of dues.
- Banks should avoid the tendency to delay or postpone identification of NPAs especially in respect of high value accounts;
- Availability of security/net worth of the borrower/guarantor should not be taken into account while identifying the NPA;
- Banks should not classify an advance account as NPA merely due to existence of some temporary aberration/deficiency such non-availability of adequate Drawing Power based on latest stock statement, over limit, non-submission of stock statement, renewal of account, etc.
- A working capital account would become NPA, if the irregularity continues beyond 90 days even though the unit would be working and its financial position is satisfactory.
- Regular and ad hoc limits are required to reviewed/regularized within 180 days from the due date/date of sanction; else, it is to be classified as NPA.
- A NPA Loan account, other than restructured and rescheduled, can be upgraded to standard assets upon payment of arrears of interest and principal.
- Asset classification should be on borrower-wise and not facility wise. In case one facility/investment of the borrower causes problem, all the facilities granted to the borrower are to be treated as NPA.
- Bills discounted facility under LC favouring a borrower need not be classified as NPA in case any other facility is NPA. However, in case of documents under LC are not accepted on presentation or non-payment of bills under the LC on due date by the LC issuing bank for any reason and the borrower fails to make good the amount immediately, the outstanding under the Bills discounted is also to be classified as NPA.
- In account where there is potential threat of recovery on account of erosion in value of security (50% or 10% of value assessed earlier or outstanding), non-availability of security, existence of other factors such as frauds committed by borrowers, etc. such asset should straightaway be classified as doubtful (50%) or loss (10%) asset as appropriate:
- Finance granted to PACS/FSS under the on-lending system, only that particular portion of credit in default to be classified as NPA.
- Advances against paper securities such as TDRs, NSCs eligible for surrender, IVPs, KVPs and life policies need not be treated as NPAs, provided adequate margin is available in the accounts.
- Loan with moratorium for payment of interest, the amount of interest would become overdue after the due date for payment of interest, if uncollected.
- In staff housing loan or similar other accounts where the interest is to be recovered after repayment of principal, such accounts would become NPA only when there is default in repayment of principal or interest on respective due dates.

- Advances backed by guarantee of Central Government though overdue may be treated as NPA only when the Government repudiates its guarantee when
invoked. However, 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.

Consortium Arrangement

Asset classification of accounts under consortium is to 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.

Projects under implementation (Classification of NPA)

For all projects financed by the FIs/ banks after **May 28, 2002**, the '**Date of Completion'** and the '**Date of Commencement of Commercial Operations' (DCCO**), of the project should be clearly spelt out at the time of financial closure of the project and the same should be formally documented. These should also be documented in the appraisal note by the bank during sanction of the loan.

Project Loans are classified into 2 categories viz. Project Loans for infrastructure sector and Project Loans for non-infrastructure sector.

Project Loans for Infrastructure Sector

- An infrastructure project loan would be classified as NPA before the date of commencement of commercial operations (DCCO) as per record of recovery (90 days) unless it is restructured and eligible for classification as standard asset.
- An infrastructure project would be classified as NPA if it fails to commence commercial operations within 2 years from the original DCCO.
- If a project loan classified as standard asset is restructured any time during the period up to two years from the original date of DCCO, it can be retained as a standard asset if the fresh DCCO is fixed and the account continues to be serviced as per the restructured terms subject to the application for restructuring should have been received before the expiry of period of two years from the original DCCO and when the account is still standard as per record of recovery.
- Delay in infrastructure projects involving court cases and projects in other than court cases, extension of DCCO up to another 2 years (beyond the existing extended period of 2 years i.e. total extension of 4 years) and up to another 1

year (beyond the existing extended period of 2 years i.e. total extension of 3 years) respectively is considered for treating them as NPA.

- In restructured infrastructure accounts where there is moratorium for payment of interest, interest income should not be booked on accrual basis beyond two years from the original DCCO, considering the high risk involved in such restructured accounts.

- Banks should maintain following provisions on such accounts as long as these are classified as standard assets in addition to provision for diminution in fair value as under:-

Particulars	Provisioning Requirement
The revised DCCO is within two years from the original DCCO prescribed at the time of financial closure.	0.40 per cent
The DCCO is extended beyond two years and up to four years or three years from the original DCCO, as the case may be, depending upon the reasons for such delay.	Project Loans restricted w.e.f. 01.06.13: 5.00% - from the date of such restructuring Till the revised DCCO or 2 years from the date of restructuring, whichever is later. Stock of project loans classified as restructured as on 01.06.13: 3.50% - w.e.f. 31.03.14 (spread over the four quarters of 2013-14). 4.25% - w.e.f. 31.03.2015 (spread over the four quarters of 2014-15). 5.00% - w.e.f. 31.03.2016 (spread over the four quarters of 2015-16. The above provisions will be applicable from the date of restructuring till the revised DCCO or 2 years from the date of restructuring,

	whichever is later.

The above guidelines further provide that mere extension of DCCO would not be considered as restructuring, if the revised DCCO falls within the period of two years from the original DCCO. In such cases the consequential shift in repayment period by equal or shorter duration (including the start date and end date of revised repayment schedule) than the extension of DCCO would also not be considered as restructuring provided all other terms and conditions of the loan remain unchanged. As such project loans will be treated as standard assets in all respects; they will attract standard asset provision of 0.40 per cent.

In case of infrastructure projects under implementation, where Appointed Date (as defined in the concession agreement) is shifted due to the inability of the Concession Authority to comply with the requisite conditions, change in DCCO need not be treated as 'restructuring', subject to following conditions:

a) The project is an infrastructure project under public private partnership model awarded by a public authority;
b) The loan disbursement is yet to begin;
c) The revised date of commencement of commercial operations is documented by way of a supplementary agreement between the borrower and lender and;
d) Project viability has been reassessed and sanction from appropriate authority has been obtained at the time of supplementary agreement.

Project Loans for Non-infrastructure Sector (Other than CRE Exposure)

- A loan for a non-infrastructure project will be classified as NPA during any time before commencement of commercial operations as per record of recovery (90 days overdue).
- If the non-infrastructure project fails to commence commercial operations within one year from the original DCCO, even if it is regular as per record of recovery, unless it is restricted and becomes eligible for classification as 'standard asset, it is to be treated as NPA.
- In case the delay in commencement of commercial operations extends beyond the period of one year from the date of completion as determined at the time of financial closure, banks can prescribe a fresh DCCO, and retain the "standard" classification by undertaking restructuring of accounts, provided the fresh DCCO does not extend beyond a period of two years from the original DCCO subject to, among others, that the restructuring application is received before the expiry of one year from the original DCCO, and when the account is still "standard" as per the record of recovery.
- In restructured accounts where there is moratorium for payment of interest, interest income should not be booked on accrual basis beyond two

years from the original DCCO, considering the high risk involved in such restructured accounts.

- Banks should maintain following provisions on such accounts as long as these are classified as standard assets in addition to provision for diminution in fair value as under:-
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Particulars	Provisioning Requirement
The revised DCCO is within one year from the original DCCO prescribed at the time of financial closure.	0.40 per cent
The DCCO is extended beyond one year and up to two years from the original DCCO prescribed at the time of financial closure.	Project Loans restricted w.e.f. 01.06.13: 5.00% - from the date of such restructuring for 2 years. Stock of project loans classified as restructured as on 01.06.13: 3.50% - w.e.f. 31.03.14 (spread over the four quarters of 2013-14). 4.25% - w.e.f. 31.03.2015 (spread over the four quarters of 2014-15). 5.00% - w.e.f. 31.03.2016 (spread over the four quarters of 2015-16. The above provisions will be applicable from the date of restructuring for 2 years.

The above guidelines further provide that mere extension of DCCO would not be considered as restructuring, if the revised DCCO falls within the period of two years from the original DCCO. In such cases the consequential shift in repayment period by equal or shorter duration (including the start date and end date of revised repayment schedule) than the extension of DCCO would also not be considered as restructuring provided all other terms and conditions of the loan remain unchanged. As such project loans will be treated as standard assets in all respects; they will attract **standard asset provision of 0.40%**.

Other Issues

Any change in the repayment schedule of a project loan caused due to an increase in the project outlay on account of increase in scope and size of the project, **would not be treated as restructuring if:**

- The increase in scope and size of the project takes place before commencement of commercial operations of the existing project.
- The rise in cost excluding any cost-overrun in respect of the original project is 25% or more of the original outlay.
- The bank re-assesses the viability of the project before approving the enhancement of scope and fixing a fresh DCCO.
- On re-rating, (if already rated) the new rating is not below the previous rating by more than one notch.

These guidelines would apply to those cases where the modification to terms of existing loans, as indicated above, are approved by banks from now onwards.

Project Loans for Commercial Real Estate (CRE)

Mere extension of DCCO for CRE projects would not be considered as restructuring, if the revised DCCO falls within the period of **one year** from the original DCCO and there is no change in other terms and conditions except possible shift of the repayment schedule and servicing of the loan by equal or shorter duration compared to the period by which DCCO has been extended. Such CRE project loans will be treated as standard assets in all respects for this purpose without attracting the higher provisioning applicable for restructured standard assets.

Income Recognition

Banks may recognize income on accrual basis in respect of standard projects under implementation and may not recognize income in respect of substandard projects. Banks are required to reverse the interest recognized in past wrongly. Full provision should be made for "Funded Interest" in respect of NPA projects recognized as income.

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 so converted to equity.

Take out Finance

Take out Finance is such that 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. Under Take out Finance, possibility of default, in view of the time-lag involved in taking-over, may take place. In such cases, the norms of asset classification will have to be followed by the concerned lending bank/financial institution and they should not recognize income on accrual basis, but only on actual receipt. Bank/FI should also make suitable provision pending the takeover by other institution. **Upon takeover of the account, the provision could be reversed.** But the taking over institution is required to make provision in its books treating it as NPA from the actual date of becoming NPA even though the account was not in its books as on that date.

Post-shipment Supplier's Credit

Post shipment Supplier's Credit under the EXIM Bank Guarantee-cum-refinance programme, the extent of payment received from the EXIM Bank, need not be treated as a non-performing asset for asset classification and provisioning purposes.

Export Project Finance

In the event of the export proceeds in respect of export project finance is held up due to political developments in the importer's country, 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.

Advances under rehabilitation approved by BIFR/ TLI

In case of a unit under rehabilitation package approved by BIFR/Term Lending Institution, the existing credit facilities continue to be classified as substandard or doubtful as the case may be. Asset classification norms would be applicable in respect of additional facilities sanctioned under the package after a period of one year from the date of disbursement.

PROVISIONING NORMS

In conformity with the prudential norms, and on the basis of classification of assets, taking into account the time lag between an account becoming doubtful of recovery, its recognition as such, the realization of the security, as also the erosion over time in the value of security charged to the bank, banks are required to make provisions on funded outstanding on global loan portfolio basis. as under:-

No.	Category	Sector	Provision requirement
01.	Standard Assets	*Agriculture & Small & Micro Enterprises (SME) *Medium Enterprises *Commercial Real Estate (CRE)	*0.25% of funded O/s. *0.40% of funded O/s.

		*Commercial Real Estate – Residential Housing Sector (CRE-RH) *Housing Loans at teaser rates *Restructured Accounts (existing) *Restructured Accounts (New) *under moratorium	*1.00% of funded O/s. *0.75% of funded O/s. *2.00% during teaser rate period and 0.40% after 1 year of rate reset. *For restructured advances 2.75% for first 2 years from date of restructuring. *NPA restructured account @2.75% in the first year from the date of upgradation to standard category. *5% - w.e.f. 01.06.13 in phased manner as under:- 3.50% - w.e.f. 31.3.14. 4.25% - w.e.f. 31.3.15. 5.00% - w.e.f. 31.3.16. (spread over 4 quarters each year) *2.75% for moratorium period and further 2 years (total 4 years)
02.	Substandard Assets	*All sectors *Unsecured Advances	*15%of o/stg. without making any allowance for ECGC and security available.

			*Additional 10% i.e. total 25% and for infrastructure loans & total 20% provided Escrow mechanism is available.
03.	Doubtful Assets	*All sectors *Covered by ECGC (realizable value of securities to be deducted **first** to arrive ECGC guaranteed amount	*Secured portion 25/40/100% upto 1year/1-3 years/more than 3 years respectively. *Unsecured portion – 100% *Net of ECGC guaranteed & realizable value of security at the above rates.
04.	Loss Assets	All sectors	To be written off or 100% of the outstanding.

Other Issues

- It is mandatory to arrange for stock audit at annual intervals in respect of NPAs with balance of Rs. 5 crore and above. 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 respective Board of Directors.
- The provisions on standard assets should not be reckoned for arriving at net NPAs.
- The provisions towards Standard Assets need not be netted from gross advances.
- In case of advance covered by guarantees of Credit Guarantee Fund Trust For Micro And Small Enterprises (CGTMSE) or Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH) becomes non-performing, **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 (Illustrative example provided in the RBI M. Circular).

Provisioning Coverage Ratio (PCR)

PCR is essentially the ratio of provisioning to gross non-performing assets and indicates the extent of funds a bank has kept aside to cover loan losses. Banks are required to maintain their total provisioning coverage ratio, including floating provisions, at not less than 70% by 30th September 2010.

RBI, for having achieved the required PCR by majority of banks, has advised the banks that the surplus of the provision under PCR vis-a-vis as required as per prudential norms should be segregated into an account styled as "countercyclical provisioning buffer", computation of which has been provided in the RBI M. Circular dt. 01.07.13. This buffer will be allowed to be used by banks for making specific provisions for NPAs during periods of system wide downturn, with the prior approval of RBI.

Provisions on Leased Assets

<table>
<tr><td>No.</td><td>Category of Assets</td><td>Provision requirement</td></tr>
<tr><td>01.</td><td>Sub-standard</td><td>*15% of the sum of the net investment in the lease and the unrealized portion of finance income net of finance charge component.

*Additional 10% for unsecured lease exposure i.e. total 25%.</td></tr>
<tr><td>02.</td><td>Doubtful Assets</td><td>*100% of the finance not secured by the realizable value of the leased asset.
*Additional provision on the unrealised portion of finance income net of finance charge component of the secured portion as under:-
<table>
<tr><td>Period for which the advance remained in doubtful category</td><td>Provision (%)</td></tr>
<tr><td>Up to one year</td><td>25</td></tr>
<tr><td>One to three years</td><td>40</td></tr>
<tr><td>More than three years</td><td>100</td></tr>
</table></td></tr>
<tr><td>03.</td><td>Loss Assets</td><td>To be written off or 100% of the sum of the net investment in the lease and the unrealised portion of finance income net of finance charge component.</td></tr>
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Provision under Special Circumstances

a) Advances under rehabilitation package approved by BIFR/TL institutions

- Provision should continue to be made as per classification of assets as substandard or doubtful.

- Additional facilities sanctioned as per package, provision on additional facilities sanctioned be made for a period of one year from the date of disbursement including that of SSI units identified as sick and put under rehabilitation programme by banks.

b) Provision requirements based on assets classification status are applicable in respect of TDRs, NSC eligible for surrender, IVPs, KVPs, gold ornaments, government and other securities and LIC policies.

c) Amount held in Interest Suspense Account should be deducted from the relative advances and thereafter provisioning as per norms may be made on the net balance. Amount held in Interest Suspense account should not be reckoned as part of provisions

d) ECGC guaranteed doubtful assets, provision need only to be made on the balance in excess of the guaranteed amount by ECGC. While arriving the provision requirement, the realizable value of the security is first deducted from the outstanding balance.

Sale of Financial Assets to SC/RC

- Under the SARFAESI Act 2002, banks/FIs are permitted to sell financial assets to Securitization Companies (SC) and Reconstruction Companies (RC). A financial asset which can be sold to the SC/RC by any bank/ FI is:-

a) A NPA, including a non-performing bond/ debenture, and

b) A Standard Asset where:
   i) The asset is under consortium/multiple banking arrangements;
   ii) At least 75% of value of the asset is classified as NPA in the books of other banks/FIs; and
   iii) 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.

- The prudential guidelines have been grouped under various heads as under:-

a) Financial assets which can be sold.
b) Procedure for sale of banks'/ FIs' financial assets to SC/ RC, including valuation and pricing aspects.
c) 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**

- The financial assets when sold to SC/RC, the same will be removed from its books.
- If the sale price is below the Net Book Value (NBV) (i.e. book value less provision held), the shortfall should be debited to the profit and loss account of that year.
- It 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 etc.

i) The securities (bonds/debentures) offered by SC/RC should satisfy the following conditions viz.-

- The securities must **not** have a term in excess of six years.
- 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.
- The securities must be secured by an appropriate charge on the assets transferred.
- The securities must provide for part or full prepayment in the event the SC / RC sell the asset securing the security before the maturity date of the security.
- The commitment of the SC / RC to redeem the securities must be unconditional and not linked to the realization of the assets.
- Whenever the security is transferred to any other party, notice of transfer should be issued to the SC/ RC

ii) Investment in debentures/bonds/security receipts/Pass-through certificates issued by SC/RC

- 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.

Banks/FIs investment in SC/RC in debentures/bonds/security receipts/PTCs issued by SC/RC will constitute exposure on the SC/RC. As only a few SC/RC are being set up now, banks/ FIs will be allowed, in the initial years, to exceed prudential exposure ceiling on a case-to-case basis.

B. **Exposure**

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

Purchase & Sale of NPAs

Guidelines have been framed for undertaking purchase and sale of NPAs without involving SC/RC, as an option available, to develop a healthy secondary market

NPAs. The option would be conducted within the financial system and has to be initiated with due diligence and care.

- The guidelines are applicable to banks, FIs and NBFCs purchasing/ selling non performing financial assets, from/ to other banks/FIs/NBFCs (excluding SCs/RCs).
- A financial asset, including assets under multiple/consortium banking arrangements, would be eligible for purchase/sale in terms of the guidelines if it is a NPA/NPI in the books of the selling bank.
- The guidelines have been grouped under the following headings:

a) Procedure for purchase/ sale of non performing financial assets by banks, including valuation and pricing aspects.
b) Prudential norms for banks for purchase/ sale of non performing financial assets in areas viz.

    i) Asset classification norms
    ii) Provisioning norms
    iii) Accounting of recoveries
    iv) Capital adequacy norms
    iv) Exposure norms

c) Disclosure requirements

a) **Procedure for purchase/sale**

A bank which is purchasing/ selling non performing financial assets should ensure that the purchase/ sale is conducted in accordance with a policy approved by the Board. The policy generally include the norms and procedure of purchase, valuation procedure, delegation of powers, accounting procedure, etc. 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, etc.

b) **Prudential norms**

Asset classification norms:

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, etc.

The guidelines, provisioning norms, exposure norms, disclosure requirements, etc. are detailed in the RBI Master Circular dt. 01.07.13.

Write off of NPAs

In terms of Section 43(D) of the Income Tax Act 1961, interest income of NPAs 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. Banks may either make full provision as per the guidelines or write off such advances or claim such tax benefits as are applicable. Recoveries made in such accounts should be offered for tax purposes as per the rules.

Prudential guidelines on Restructuring of Advances

Objective of Restructuring

It may be observed that the basic objective of restructuring is to preserve economic value of units and not ever greening of problem accounts. This can be achieved by banks and the borrowers only by careful assessment of the viability, quick detection of weaknesses in accounts and a time-bound implementation of restructuring packages.

A restructured account is one where the bank grants concessions, which would not otherwise consider, taking into account the borrower's financial difficulty. Restructuring involves modification of terms of advance/securities, which would generally include, among others, alteration of repayment period / repayable amount/ the amount of instalments / rate of interest, etc. **Specified Period** means a period of one year from the date when the first payment of interest or instalment of principal falls due under the terms of restructuring package. The guidelines on restructuring issued by RBI are grouped in four categories as under:-

i) Restructuring of advances extended to industrial units.
ii) Restructuring of advances extended to industrial units under the Corporate Debt Restructuring (CDR) Mechanism
iii) Restructuring of advances extended to Small and Medium Enterprises (SME)
iv) Restructuring of all other advances.

Eligibility

■ Accounts classified under 'Standard', 'Substandard' and 'doubtful' categories.
■ Banks **cannot** reschedule / restructure / renegotiate borrowal accounts with **retrospective** effect. While a restructuring proposal is under consideration, the usual asset classification norms would continue to apply.
■ No account is taken up for restructuring by the banks unless the financial **viability** is established and there is a reasonable certainty of repayment from the borrower, as per the terms of restructuring package.
■ Borrowers indulged in frauds and malfeasance is **ineligible** for restructuring.
■ BIFR cases are not eligible for restructuring without their express approval. CDR Core Group in the case of advances restructured under CDR Mechanism /

the lead bank in the case of SME Debt Restructuring Mechanism and the individual banks in other cases, may consider the proposals for restructuring in such cases, after ensuring that all the formalities in seeking the approval from BIFR are completed before implementing the package.

Asset classification norms

Restructuring of advances could take place in the following stages:
■ Before commencement of commercial production / operation;
■ After commencement of commercial production / operation but before the asset has been classified as 'sub-standard';
■ After commencement of commercial production / operation and the asset has been classified as 'sub-standard' or 'doubtful'.

Upon restructuring:-

■ 'Standard assets' should be reclassified as 'sub-standard assets'
■ NPAs would continue asset classification as prior to restructuring and may slip into further lower asset classification categories with reference to the pre-restructuring repayment schedule.
■ All NPA accounts would be eligible for being reclassified as 'standard' category after observation of satisfactory performance during the '**specified' period**. Thereafter, the account would be governed as per the existing prudential norms with reference to repayment schedule.
■ Additional finance considered may be treated as 'standard asset' during the 'specified period. 'Any Interest income should be recognized only on cash basis in respect of accounts classified as 'substandard' or 'doubtful' at pre-restructuring stage.
■ A restructured standard asset is subjected to restructuring on a subsequent occasion; it should be classified as **substandard**. Similarly, a sub-standard or a doubtful restructured asset which is subjected to restructuring on a subsequent occasion, its asset classification will be reckoned from the date when it became NPA on the first occasion.
■ Interest income in respect of restructured **standard** asset can be recognized on **accrual basis**.
In case part of the outstanding principal amount is converted into debt or equity instruments as per the restructuring package, the asset so created will be classified in the same asset classification category in which the restructured advance has been classified.
■ The FITL / debt or equity instrument created by conversion of unpaid interest will be classified in the same asset classification category in which the restructured advance has been classified.

Provisioning Norms

Banks will hold provision in respect of restructured assets as per existing provisioning norms. The provisioning requirement is dealt suitably elsewhere in the Note.

<u>Risk Weights</u>

a) Restricted housing loans are to be risk weighted with a additional risk weight of 25 percentage points.

b) Corporate should be assigned a higher risk weight of 125% until satisfactory
performance under the revised payment schedule has been established for one year from the date when the first payment of interest / principal falls due under the revised schedule. (For details of risk weights "Basel III Capital Regulations" may be referred).

Assets Classification Benefits

a) An existing 'standard asset' will not be downgraded to the sub-standard category upon restructuring.

b) During the specified period, the asset classification of the sub-standard/doubtful accounts will not deteriorate upon restructuring, if satisfactory performance is demonstrated during the specified period **subject** to:-

i) The dues of the banks are fully secured except MSE borrowers where the outstanding is up to Rs.25 Lakh and infrastructure projects provided the cash flows generated from these projects are adequate for repayment of the advance, escrow mechanism for the cash flows available, and banks have a clear and legal first claim on these cash flows.

ii) The unit becomes viable in **8** years, if it is engaged in infrastructure activities, and in **5** years in the case of other units.

iii) The repayment period of the restructured advance including the moratorium, if any, does not exceed 15 years in the case of infrastructure advances and 10 years in the case of other advances other than restructured home loans.

iv) Promoters' sacrifice (contribution) and additional funds brought by them should be a minimum of 20% of banks' sacrifice or 2 per cent of the restructured debt, whichever is higher, upfront.

v) Promoter's contribution need not necessarily be brought in cash and can be brought in the form of de-rating of equity, conversion of unsecured loan brought by the promoter into equity and interest free loans.

vi) The restructuring under consideration is not a 'repeated restructuring'.

Miscellaneous

■ Decision regarding convertibility of part of restructuring package is to be taken by the bank keeping in view of the statutory requirement u/s 19 of BR Act 1949 and relevant SEBI guidelines.

■ Conversion of debt into preference shares should be done only as a last resort and such conversion of debt into equity/preference shares should, in any case, be restricted to a cap (say 10 per cent of the restructured debt). Further, any conversion of debt into equity should be done only in the case of listed companies.

■ Acquisition of equity shares / convertible bonds / convertible debentures in companies by way of conversion of debt / overdue interest can be done 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 to RBI.
■ 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, as prescribed by the RBI, subject to periodical reporting to the RBI.
■ Banks may consider incorporating in the approved restructuring packages creditor's rights to accelerate repayment and the borrower's right to pre pay. Further, all restructuring packages must incorporate 'Right to recompense' clause and it should be based on certain performance criteria of the borrower. In any case, minimum 75% of the recompense amount should be recovered by the lenders and in cases where some facility under restructuring has been extended below base rate, 100% of the recompense amount should be recovered.
■ Promoters' personal guarantee should be obtained in all cases of restructuring and corporate guarantee cannot be accepted as a substitute for personal guarantee. However, corporate guarantee can be accepted in those cases where the promoters of a company are not individuals but other corporate bodies or where the individual promoters cannot be clearly identified.

Disclosures

With the effect from the F/y 2012-13, banks are required to disclose in their published Balance Sheet under "Notes on Accounts", information relating to number and amount of advances restructured, and the amount of diminution in the fair value of the restructured advances as per the format provided in the Circular.

Broad benchmarks for the viability parameters

■ Return on capital employed should be at least equivalent to 5 year Government security yield plus 2 per cent.

■ The debt service coverage ratio should be greater than 1.25 within the 5 years period in which the unit should become viable and on year to year basis the ratio should be above 1. The normal debt service coverage ratio for 10 years repayment period should be around 1.33.

■ The benchmark gap between internal rate of return and cost of capital should be at least 1%..

■ Operating and cash break even points should be worked out and they should be comparable with the industry norms.

■ Trends of the company based on historical data and future projections should be comparable with the industry. Thus behaviour of past and future EBIDTA should be studied and compared with industry average.
■ Loan life ratio (LLR), as defined below should be 1.4, which would give a cushion of 40% to the amount of loan to be serviced.

■ Present value of total available cash flow (ACF) during the loan life period (including interest and principal)

■ LLR=

Maximum amount of loan

The entire Corporate Debt Restructuring (CDR) Mechanism and SME Debt Restructuring Mechanism are detailed in RBI Master Circular.

(Source: RBI M.Circular dt. 1.7.13)

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