IRAC Norms & NPA Provisioning

By Ketan D. Saiya
Chartered Accountant

Coverage

- *History*
- *Definition*
- *Classification of Asset*
- *Provisioning Norms*
- *Income Recognition Norms*
- *Few important circulars*
- *Some Issues*

DEFINITION

STANTARD ASSET OR PERFORMING ASSET

- Asset - Advances without any problem.
- Dose not disclose any Credit weakness
- Does not carry more than normal risk attached to business.
- Regularly generating Income.

Definition

- ***NON PERFORMING ASSET (NPA)***
- *When it ceases to generate Income for Bank.*
- *Non-performing as per criteria.*
- *Risk is Higher than Normal Risk.*
- *classify an account as NPA only if the installment /interest due and charged during any quarter is not serviced fully within 90 days from the end of the quarter.*

Identification of NPA

- *Bank should have internal system to identify NPA*
- *System to insure all doubts are cleared in* ***one month*** *from the date on which the account would have been classified as NPA.*

Defining a Non Performing Asset…

- ***Term Loan***
- *Interest and / or Installment remain 'overdue' for a period of more than 90 days.*
- ***Cash Credits and Overdrafts***
- The account remains "out of order " for a period of more than 90 days.

Out of Order

- *-Outstanding balance remains continuously in excess of sanctioned limit / drawing power. OR*
- *-There are no credits continuously for 90 days. OR*
- *-Credits In such period are not enough to cover the interest debited during the same period.*

Out of Order

- ***Important Points***
- *-Examine Drawing Power Calculations*
- *-Examine stock statement of last one year*
- *-Verify Changes in DP In computer.*
- *-Is stock statement is older than 3 month treat it as Out of Order.*
- *Practically if as on 31st March **15**, latest Stock statement available is of 30th September **14**, Treat NPA.*

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 .

Govt. Guaranteed/Others Advances

- Central Government

  Treat NPA if government repudiates its guarantee, when invoked.
- State Government

  Classify NPA in normal course, if the guarantee is invoked and remains in default for more than 90 days.
- If the amount to be received remains over due for a period of more than 90 days.

Bills Purchased / Discounted & Other Accounts

- Remains over due unpaid for a period of more than 90 days from the due date of bill.

For All facilities

- The Bank classify the account as NPA If installment of principal/ interest due & charged is not serviced fully within 90 Days from the end of Quarter.

Securitisation Transaction

- 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.

Derivative Transactions

- In respect of derivative transactions, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment

Agricultural Advances

- Agricultural Advances are to be bifurcated in two types advances.
  - Advances for long duration Crops. (Crops Season longer than One year)
  - Advances for short duration Crops.
- Treated NPA, If interest and / or installment remains over due
  - for two crop season in case of short term advances
  - more than one crop season in case long term season.
- Agricultural loan affected by natural calamities like Tsunami.

Advance secured against term deposits, NSC, KVP, IVP, & LIP.

- *Need not be treated as NPA.*

  -Income recognised if sufficient margin available.
- Advance against GOLD
  - Apply NPA Norms
- Advance against RBI Bonds
  - Advance not allowed

Advance against shares

- Verify market value of shares available as securities
- See prescribe margin for D.P. Calculation (Minimum Margin 50%)
- Apply NPA Norms
- Decide the status

CLASSIFICATION OF ASSET

- ***Substandard Asset:***
  - *Classified as NPA for a period not exceeding **12 months***
  - *In such cases, such an asset will have well defined credit weaknesses that jeopardize the liquidation of the debt and are characterized by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.*

CLASSIFICATION OF ASSET

- ***Doubtful Asset:***
  - *Asset remained as NPA for a period exceeding 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.*

CLASSIFICATION OF ASSET

- ***Loss Asset:***
  - *Asset where loss has been identified by the bank, external or internal auditors or RBI inspectors.*
  - *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.*

Classification based on erosion in value of security of Advances

- *Irrespective of the age of the NPA, As guided in the circular, on account of erosion in value of the security Account can be classified as doubtful or loss as under:*

- ***Value of Security Classification suggested***

  If value of security is less then:- 50% Doubtful Asset

  If value of security is less then:- 10% Loss Asset

Guidelines for classification of assets

- 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 realization of dues.

Guidelines for classification of assets

- 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.

Guidelines for classification of assets

Availability of security / net worth of borrower/ guarantor.

- ➔ Except, Accounts where there is erosion in the value of security/frauds committed by borrowers

Guidelines for classification of assets

- Upgradation of loan accounts classified as NPAs.
- Accounts regularized near about the balance sheet date.
- Asset Classification to be borrower-wise and not facility wise.
- Advances under consortium arrangements.
- Advances to PACS/FSS ceded to Commercial Banks.

Guidelines for classification of assets

- Advances against Term Deposits, NSCs, KVP/IVP, etc.
- Loans with moratorium for payment of interest.
- Agricultural advances.
- Government guaranteed advances.

PROVISIONING NORMS

- **General**
  - 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.

PROVISIONING NORMS

- **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.
- **Doubtful assets**
  - 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.

PROVISIONING NORMS

- **Doubtful assets**
  - In regard to the secured portion, provision may be made on the following basis, at the rates ranging from 25% to 100 % 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	25
One to three years	40
More than three years	100

PROVISIONING NORMS

- 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.

PROVISIONING NORMS

- **Substandard assets**
  - A general provision of 15 % (previous Year 10 %) 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%, i.e., a total of 25% (Previous year 20%) on the outstanding balance. The provisioning requirement for unsecured 'doubtful' assets is 100 per cent.

PROVISIONING NORMS

- **Substandard assets……………..**
  - Infrastructure Loan account where escrow is available would attract provision of 20% Instead of provision of 25 %
  - To avail above benefits, Bank should have mechanism escrow the cash flow and should have first claim on Escrow.

PROVISIONING NORMS

- **Standard Assets……………….**
  - SME and Agricultural Advances @ 0.25%
  - To Commercial Real Estate @ 1%
  - To Commercial Real Estate – Residential Housing Sector (CRE - RH) at 0.75 %
  - Other Advances 0.40%

Housing Loan at Treasure Rates ……

- Housing Loans where interests rates are lower in first few years and after few years, rate of interest is increased, such housing loans would attract higher provisioning as under:
  - For Standard 2% (instead of 0.40%) Para 5.9.13
  - Provision Rates would be normal once Interest rates are higher in such loan account.

Restructured Advances ……

– Restructured Advances would attract 0.40% to 5% provision in first two years from date of restructuring. (Para 4.2.15.3)

PROVISIONING NORMS

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.

Disclosure of Advances with Intangible collateral securities

- *As per para 5.4. (iii) of the Master Circular :*
  - *From Financial Year 2009-10*
  - *The advances to project with security as Rights, Licenses, authorization etc, charged to bank as collateral should not be reckoned as tangible securities and same to be disclosed as unsecured advances .*
  - *Exception to above is project under BOT where bank has enforceable and irrevocable rights to collect toll.*
  - *The Bank should disclose the value of such intangible value of security in notes to accounts.*

PROVISIONING NORMS

– 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:

PROVISIONING NORMS

- **Additional Provisions for NPAs at higher than prescribed rates:**
  - The regulatory norms for provisioning represent the minimum requirement. A bank may voluntarily make specific provisions for advances at rates which are higher than the rates prescribed under existing regulations, to provide for estimated actual loss in collectible amount, 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. The additional provisions for NPAs, like the minimum regulatory provision on NPAs, may be netted off from gross NPAs to arrive at the net NPAs (Para 5.7)

INCOME RECOGNIOTION

INCOME RECOGNIOTION

- **STANDARD ASSETS**
  – *On Mercantile basis*
- **NON PERFORMING ASSET**
  – *On Realisation basis*
  – *Reversal of unrealised interest* + other income if uncollected.

Appropriation of recovery in NPAs

- 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.
- 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.

Thank You