Credit Control and Other Measures

November 2001

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All primary (Urban) Co-operative Banks

Income Recognition, Asset Classification and Provisioning

I. Treatment of Restructured Accounts

In terms of paragraph (ii) of Annexure II of our Circular UBD. No. I&L. 38/ J. 1-92/93 dated 9 February 1993, an account where the terms of the loan agreement regarding interest and principal have been renegotiated or rescheduled after commencement of production should be classified as sub-standard and should remain in such category for atleast two years of satisfactory performance under the renegotiated or rescheduled terms. In the case of sub-standard and doubtful assets, rescheduling does not entitle a bank to upgrade the quality of advance automatically unless there is satisfactory performance under the rescheduled/ renegotiated terms. However, considering the position that though the unit may have commenced production, the level and volume of production reached immediately after the date of completion of the project is often not adequate to generate sufficient cash flow to service the loan and that some lead time is required to stabilise production, we have vide our circular UBD.No.BSD.1.2/ 12.05.05.1999/2000 dated July 28, 1999, decided to leave the matter to the Board of Directors of the concerned banks as the financing bank is monitoring the implementation of the project and is in a better position to judge whether the unit has stabilised commercial production and there is a need for rescheduling of the loan. The matter has been further reviewed and it has been decided to effect certain changes in the norms relating to restructuring/ rescheduling/renegotiation of terms of the standard and sub-standard loan assets as detailed in the following paragraphs.

2. In the context of restructuring of the accounts, the following stages at which the restructuring/ rescheduling/renegotiation of the terms of loan agreement could take place, can be identified:

(a) before commencement of commercial production;

(b) after commencement of commercial production but before the asset has been classified as sub-standard;

(c) after commencement of commercial production and the asset has been classified as sub-standard.

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

3. The prudential treatment of the accounts, subjected to restructuring/rescheduling/renegotiation of terms, would be governed by the following

norms:

3.1 Treatment of restructured standard accounts

(a) A rescheduling of the instalments of **principal alone**, at any of the aforesaid first two stages would not cause a standard asset to be classified in the substandard category provided the loan/ credit facility is fully secured.

(b) A rescheduling of **interest element** at any of the foregoing first two stages would not cause an asset to be downgraded to sub-standard category subject to the condition that the amount of sacrifice, if any, in the element of interest, is either written off or provision is made to the extent of the sacrifice involved.

3.2 Treatment of restructured sub-standard accounts

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

(b) A rescheduling of interest element would render a sub-standard asset eligible to be **continued** to be classified in **sub-standard** category for the specified period subject to the condition that the amount of sacrifice, if any, in the element of interest, is either written off or provision is made to the extent of the sacrifice involved.

The sub-standard accounts at 3.2(a) and (b), which have been subjected to restructuring, etc. whether in respect of principal instalment or interest amount, by whatever modality would be eligible to be upgraded to the standard category only after the specified period, i.e. a period of one year after the date when the first payment of interest or of principal, whichever is earlier, falls due, subject to satisfactory performance during the period. The amount of provision made earlier, net of the amount provided for the sacrifice in the interest amount could also be reversed after the one-year period.

During this one-year period, the sub-standard asset will not deteriorate in its classification if satisfactory performance of the account is demonstrated during the period. In case, however, the satisfactory performance during the one year period is not evidenced, the asset classification of the restructured account would be governed as per the applicable prudential norms with reference to the **pre-restructuring payment schedule**.

4. Applicability

4.1 The foregoing norms for restructuring, etc. would be applicable to standard and sub-standard assets only, in supersession of the existing RBI norms in respect of such assets in so far as they relate to restructuring/ rescheduling/renegotiation of the terms of the loan agreement. All other prudential guidelines relating to income recognition, asset classification and provisioning would remain unaltered.

4.2 The foregoing changes in the norms would be applicable only to standard and sub-standard accounts which are subjected to restructuring/rescheduling/ renegotiation of terms subsequent to the date of issue of these instructions. However, banks would have the **option** to adopt the foregoing norms for the standard and sub-standard accounts which have been subjected to restructuring/rescheduling/renegotiation of terms even prior to issue of these instructions but during the financial year 2000-01.

4.3 The above instructions would be applicable to all types of credit facilities, including working capital limits extended to industrial units, provided they are fully covered by tangible securities.

4.4 As trading involves only buying and selling commodities and the problems associated with manufacturing units such as bottle-neck in commercial production, time and cost escalation, etc. are not applicable to them, these guidelines should not be applied to restructuring/rescheduling of credit facilities extended to traders.

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

5. General

All standard and sub-standard accounts subjected to restructuring, etc., and covered under paragraph 3 above, would continue to be eligible for fresh financing of funding requirements, by the lenders as per their normal policy parameters and eligibility criteria.

II. Recognition of Income on Investments Treated as NPAs

The investments are also subject to the prudential norms on income recognition. Therefore, banks should not book income on accrual basis in respect of any security irrespective of the category in which it is included, where the interest/principal is in arrears for more than 180 days.