Prudential norms on Capital Adequacy, Income Recognition, Asset Classification and Provisioning etc.

BP. BC. 164/21.04.048/2000

April 24, 2000

All Commercial Banks
(excluding RRBs)

Dear Sir

Prudential norms on Capital Adequacy,
Income Recognition, Asset Classification
and Provisioning etc.

1. Risk Weight on Securities Guaranteed by State Governments
In terms of instructions contained in item 4 of paragraph 2 (d) of our Circular DBOD No BP BC 103/21.01.002/98 dated October 31, 1998, banks are required to assign risk weight of 2.5 per cent for market risk for their investment in securities where payment of interest and repayment of principal are guaranteed by State Governments. However, in case of default in interest/principal by the State Government banks are required to assign 100 per cent risk weight on investment in all the securities issued or guaranteed by that State Government. The position has since been reviewed and it has been decided that banks need to assign risk weight of 100 per cent **only on those State Government guaranteed securities issued by the defaulting entities and not on all the securities issued or guaranteed by that State Government.**

Banks are further advised to pay due regard to the record of particular State Government in honouring their guarantees while processing any further requests for loans to PSUs in that State on the strength of State Government guarantee.

2. Sick SSI Units under rehabilitation
In terms of paragraph 3 of Circular DBOD No. BP BC 36/21.04.048/95 dated April 3, 1995, advances granted to units which are placed under rehabilitation package approved by BIFR/Term Lending Institutions (TLIs) are treated as NPAs and provisions are required to be made. However, for additional credit facilities sanctioned to units under rehabilitation package approved by BIFR/TLI, provision need not be made for a period of one year from the date of disbursement. In other words, our guidelines on income recognition, asset classification and provisioning will apply to such additional credit facilities only after a period of one year from the date of disbursement.

Banks have been representing that the above relaxation is not available in respect of additional credit facilities granted under the rehabilitation package/nursing programme prepared by banks themselves or under consortium arrangements. On a review of the matter, it has been decided that **no provision need be made for a period of one year in respect of additional credit facilities granted to SSI units which are identified as sick (as defined in para 5 (a) of RPCD Circular No. PFNFS. BC. 99/ 06.02.031/92-93 dated April 17, 1993) and where rehabilitation packages/nursing programmes have been drawn by the banks themselves or under consortium arrangements .**

3. Provision on Standard Assets
A reference is invited to para 3 of our Circular DBOD No. BP.BC.101/ 21.04.048/99 dated 18 October 1999 regarding provision on Standard Assets. In the light of suggestions received from banks in regard to treatment and accounting of provision on Standard Assets, our instructions are partially modified as under:

- The general provision of 0.25 per cent on Standard Assets should be made on global portfolio basis and not on domestic advances alone.
- Provisions towards Standard Assets need not be netted from gross advances as advised earlier but shown separately as "Contingent Provisions against Standard Assets", under "Other Liabilities and Provisions - Others" in Schedule No. 5 of the balance sheet.
- The above contingent provision will not be eligible for inclusion in Tier II Capital.

4. Advances against Book Debt
In terms of instructions contained in para 4 of our Circular DBOD No. BP. BC.24/21.04.048/99 dated 30 March 1999, banks are required to show advances against Book Debt under item B (i)- "Secured by tangible assets" of Schedule 9. Although such advances are secured, it is likely that they may not be fully secured by tangible assets. Hence, banks may now indicate separately in Schedule 9 that item B (i) includes "Advances against Book Debts" as shown below:

Advances – (Schedule 9)
B (i) Secured by tangible assets *
(* includes advances against Book Debt)

5. Investment Fluctuation Reserve Account
In terms of instructions contained in paragraph 1 of our circular DBOD No. BP.BC.24/21.04.048/99 dated 30 March 1999 the amount held in "Investment Fluctuation Reserve Account" could be utilised to meet, in future, the depreciation requirement on investment in securities. In this connection, it is clarified that the extra provision needed in the event of a depreciation in the value of the investments should be debited to the Profit and Loss Account and if required, an equivalent amount may be transferred from the 'Investment Fluctuation Reserve Account' to the Profit and Loss Account as a **'below the line'** item after determining the profit for the year.

6. The above instructions are applicable for finalising the balance sheet for the year ended March 31, 2000 and onwards.

7. Please acknowledge receipt.

Yours faithfully
(C.R. Muralidharan)
General Manager

Endt. DBOD.No.BP.2250 /21.04.048/2000 of date.

Copy to addressees (as per list).
(A.K. Khound)
Deputy General Manager