Monetary and Credit Policy Measures 2001-2002

May 2, 2001

DBOD. No. BP. BC.116 /21.04.048/2000-2001

All Scheduled Commercial Banks
(excluding RRBs)

Dear Sir,

Monetary and Credit Policy Measures 2001-2002

Please refer to Governor's letter No. MPD.BC. 206/07.01.279/2000-01 dated April 19, 2001 enclosing a copy of the statement on "Monetary and Credit Policy for the year 2001-2002". The guidelines in regard to certain policy measures are given below:

1. Income Recognition, Asset Classification and Provisioning
A. Asset Classification – Adoption of 90 days norm

a) At present, a loan is classified as non-performing when the interest and/or instalment of principal remain overdue for a period of more than 180 days as against the international best practice of 90 days payment delinquency. With a view to moving towards international best practices and to ensure greater transparency, it has been decided to adopt the 90 days norm from the year ending March 31, 2004. Accordingly, with effect from March 31, 2004, a non-performing asset (NPA) shall be a loan or an advance where;

i) interest and/or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan,

ii) the account remains 'out of order' for a period of more than 90 days, in respect of an Overdraft/Cash Credit (OD/CC),

iii) the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,

iv) interest and/or instalment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purposes, and

v) any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

b) The banks are, therefore, required to chalk out an appropriate transition path for smoothly moving over to the 90 days norm. As a facilitating measure, banks should move over to charging of interest at monthly rests, by April 1, 2002. However, the date of classification of an advance as NPA should not be changed on account of charging of interest at monthly rests. Banks should, therefore, continue to classify an account as NPA only if the interest charged during any quarter is not serviced fully within 180 days from the end of the quarter with effect from April 1, 2002 and 90 days from the end of the quarter with effect from March 31, 2004. Banks would have to substantially upgrade their existing Management Information System (MIS) for collecting data on loans, where the interest and/or instalment of principal remain overdue for a period of more than 90 days in order to crystallise NPAs on a 90 days norm. Banks should commence making additional provisions for such loans,

starting from the year ending March 31, 2002, which would strengthen their balance sheets and ensure smooth transition to the 90 days norm by March 31, 2004. Banks are, therefore, advised to work out necessary modalities and submit their action plans early and in any case by December 31, 2001 after approval by their Boards to RBI. The implementation of the plans will be monitored by RBI on a half-yearly basis.

B. <u>Provisioning Requirements:</u>

In terms of extant prudential regulations, banks are required to make provisions as under in respect of various categories of assets.

Asset Classification	Provision requirements
Standard assets	0.25%,
Substandard assets	10%
Doubtful assets	between 20 per cent to 50 per cent of the secured portion depending on the age of NPA, and 100% of the unsecured portion.

We have been constantly reviewing the regulatory requirements in respect of prudential provisions and it is proposed to gradually enhance provisioning requirements in future. Considering that higher loan loss provisioning adds to the overall financial strength of the banks and the stability of the financial sector, banks are urged to voluntarily set apart provisions much above the minimum prudential levels as a desirable practice.

2. <u>Credit Exposure to Individual / Group Borrowers</u>

It was announced in the Mid-term Review of October 2000 that a review of current practices regarding credit exposure limits vis-à-vis international practices shows that there are certain issues which require further consideration. The first relates to the concept of `capital funds'; second relates to the scope of the measurement of credit exposure, in particular, the coverage of non-fund and other off-balance sheet exposures; and the third relates to the level of exposure limit itself. Taking into account the complexities involved, and based on the comments and suggestions received from the banks on the issues, it has been decided to effect the following changes.

a) <u>Concept of Capital Funds</u>

Internationally, exposure ceilings are computed in relation to total capital as defined under capital adequacy standards (Tier I and Tier II Capital). Taking into account the best international practices, it has been decided to adopt the concept of capital funds as defined under capital adequacy standards for determining exposure ceiling uniformly both by domestic and foreign banks, effective from March 31, 2002. The exposure ceiling limits applicable from April 1, 2002 would be based on the capital funds in India as computed above.

b) <u>Measurement of Credit Exposure</u>

i) At present, in respect of non fund based credit limits, only 50% of such limits or outstandings, whichever is higher, is needed to be taken into account for computing the extent of exposure. In line with international best practices, it has been decided that non-fund based exposures should also be reckoned at 100 per cent with effect from April 1, 2003.

ii) At present, derivative products such as Forward Rate Agreements (FRAs) and Interest Rate Swaps (IRSs) are also captured for computing exposure by applying the conversion factors to notional principal amounts as per the original exposure method prescribed in Annexure 1 and 2 of our circular MPD. BC. 187/07.01.279/1999-2000 dated July 7, 1999. It has been decided that, effective from April 1, 2003, banks should also include forward contracts in foreign exchange and other derivative products like currency swaps, options, etc. at their replacement cost value in determining individual/ group borrower exposure. The methodology to be adopted by banks for arriving at the replacement cost value is being advised separately.

c) Level of Exposure Limit

As the concept of capital funds has been broadened to represent total capital (Tier I and Tier II), it has been decided to adjust the exposure ceiling for single borrower from the existing 20 per cent to 15 per cent of capital funds effective from March 31, 2002. Similarly, the group exposure limits will be adjusted effective from March 31, 2002, to 40 per cent of capital funds. In case of financing for infrastructure projects, the limit is extendable by another 10 per cent, i.e., up to 50 per cent.

Please acknowledge receipt.

Yours faithfully,
sd/
(M.R.Srinivasan)
Chief General Manager-in-charge.