Treatment of Restructured Accounts

DBOD.No.BP.BC.98/ 21.04.048/ 2000-01

March 30, 2001

All Commercial Banks
(excluding RRBs and LABS)

Dear Sir,

Treatment of Restructured Accounts

Please refer to paragraph 3 of our circular DBOD.No.BP.BC.82/21.04.048/2000-01 dated February 26, 2001 advising banks that the instructions relating to the regulatory treatment of restructured accounts would be conveyed shortly. The matter has since been examined and we advise as under.

2. In terms of our circular DBOD.No.BP.BC.129/21.04.043-92 dated April 27, 1992, read with DBOD.No.BP.BC.35/21.01.002/99 dated April 24, 1999, banks were advised, *inter alia*, that a standard asset 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 at least one year of satisfactory performance under the renegotiated or rescheduled terms. In the case of sub-standard and doubtful assets also, rescheduling does not entitle a bank to upgrade the quality of advance automatically unless there is satisfactory performance under the rescheduled/renegotiated terms. Further, in terms of circular DBOD.No.BP.BC.45/21.04.048/99 dated May 10, 1999, in cases where commercial production had commenced but not stabilized, it was left to the Board of Directors of banks to decide whether there is a need for rescheduling of the loan and treat the loan as standard asset subject to certain conditions stipulated therein. It has, however, been represented to us that the foregoing stipulations deter the banks from **restructuring of standard and sub-standard loan** assets even though the modification of terms might not jeopardise the assurance of repayment of dues from the borrower. The present norms have, therefore, been reviewed in the light of the international best practices and the BIS guidelines in the matter 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.**

3. 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 substandard.

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.

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

4.1 **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 sub standard 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, **measured in present value terms,** is either written off or provision is made to the extent of the sacrifice involved. For the purpose the future interest due as per the original loan agreement in respect of an account should be discounted to the present value at a rate appropriate to the risk category of the borrower (i.e., current PLR + the appropriate credit risk premium for the borrower-category) and compared with the present value of the dues expected to be received under the restructuring package, discounted on the same basis.

c. In case there is a sacrifice involved in the amount of interest in present value terms, as at (b) above, the amount of sacrifice should either be **written off or provision made** to the extent of the sacrifice involved.

4.2 **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, **measured in present value terms,** is either written off or provision is made to the extent of the sacrifice involved. For the purpose, the future interest due as per the original loan agreement in respect of an account should be discounted to the present value at a rate appropriate to the risk category of the borrower (i.e., current PLR + the appropriate credit risk premium for the borrower-category) and compared with the present value of the dues expected to be received under the restructuring package, discounted on the same basis.

c. In case there is a sacrifice involved in the amount of interest in present value terms, as at (b) above, the amount of sacrifice should either be written off or provision made to the extent of the sacrifice involved. Even in cases where the sacrifice is byway of write off of the **past** interest dues, the asset should continue to be treated as sub-standard.

The sub-standard accounts at 4.2 (a), (b) and (c) above, 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 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 in present value terms as aforesaid, 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.**

Applicability

5. The foregoing norms for restructuring, etc., would be applicable to standard and sub-standard assets only, in **supercession 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.

6. The foregoing changes in the norms would be applicable only to the standard and sub-standards accounts which are subjected to restructuring / rescheduling / renegotiation of terms during the current financial year and thereafter.

Disclosure

7. Banks should also disclose in their published Annual Accounts, under the Notes on Accounts, the following information in respect of restructuring, etc., undertaken during the year :

- total amount of loan assets subjected to restructuring, etc;
- the amount of standard assets subjected to restructuring, etc.; and
- the amount of sub-standard assets subjected to restructuring, etc.,

General

8. All standard and sub-standard accounts subjected to restructuring, etc., and covered under paragraph 4 above, would continue to be eligible for fresh financing of funding requirements, by the lenders as per their normal policy parameters and eligibility criteria.

9. Please acknowledge receipt.

Yours faithfully,

sd/-

(M. R. Srinivasan)
Chief General Manager-in-Charge