RBI/2004/254
DBOD No. BP. BC. No. 97 /21.04.141/2003-04

June 17, 2004

All Scheduled Commercial Banks
(excluding RRBs)

Dear Sir,

Annual Policy Statement for the year 2004-05 -
Prudential Guidelines on Unsecured Exposures

Please refer to paragraph 4(iii) of our circular DBOD NO. Sch. 666/ C.96Z-67-3 May 3, 1967 wherein it was stated that banks should limit their commitments by way of unsecured guarantees in such a manner that 20 per cent of a bank's outstanding unsecured guarantees plus the total of its outstanding unsecured advances should not exceed 15 per cent of its total outstanding advances. Over a period of time, certain types of unsecured guarantees and unsecured advances were allowed to be excluded from the total of unsecured guarantees or unsecured advances while applying the above norm.

2. In this connection, a reference is invited to Paragraph No. 116 of the annual policy Statement for the year 2004-05 dated May 18, 2004 (copy of the paragraph enclosed).

Withdrawal of extant limit

3. Banks have been requesting for flexibility in this regard considering the emerging shift towards financing borrowers based on estimated cash flows rather than placing reliance on collateral. It is further observed that banks are extending financial assistance to customers not only through the traditional 'loans and advances' route but also through the 'investment' route in the form of credit substitutes, viz. commercial papers, bonds, debentures etc.

4. Against this background and as a step towards further deregulation, it has been decided to withdraw the extant instructions on unsecured exposures to enable banks' Boards to formulate their own policies on unsecured exposures. Simultaneously, all exemptions allowed for computation of unsecured exposures also stand withdrawn.

Definitions

5. With a view to ensuring uniformity in approach and implementation, '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 charged to the bank and will not include intangible securities like guarantees, comfort letters etc.

Prudential provisioning norms

6. In terms of our guidelines on income recognition, asset classification and provisioning pertaining to advances, the extant provisioning requirement for substandard assets envisage provisioning at a flat rate of 10 percent on total outstanding without making allowance for DICGC/ECGC guarantee cover and security cover available. With the withdrawal of the extant prescribed limits, the unsecured exposures, as defined above, which are identified as 'substandard' would attract additional provision of 10 percent, i.e., a total of 20 percent on the outstanding balance. The provisioning requirement for unsecured 'doubtful' assets would remain unchanged at 100 percent.

7. A copy of these guidelines may be placed before the Board of Directors for formulating the bank's policy on unsecured exposures in the light of the credit risk management systems in the bank to monitor the impact of the various items of unsecured exposures.

Yours faithfully,

(C R Muralidharan)
Chief General Manager-in-Charge

Extract from Annual Policy Statement for the year 2004-05

"(b) Withdrawal of Limits on Unsecured Exposures

116. At present, banks are required to limit their commitments by way of unsecured exposure in such a manner that 20 per cent of a bank's outstanding unsecured guarantees plus the total of its outstanding unsecured advances should not exceed 15 per cent of its total outstanding advances. In order to extend further flexibility to banks on their loan policies, it is proposed:

- To withdraw the extant limit on unsecured exposures to enable banks' Boards to fix their own policy on unsecured exposures.
- Banks would be required to make an additional provision of 10 per cent, i.e., a total provision of 20 per cent of the total outstanding advances in the substandard category to cover expected loss on unsecured exposures.
- Provision at the level of 100 per cent for unsecured exposures in doubtful and loss categories will continue as hitherto."

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