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All Commercial Banks (excluding RRBs)
All India Term Lending and Refinancing Institutions
All Non Banking Financial Companies (including RNBCs)

Dear Sir,

Guidelines on purchase/sale of Non Performing Assets

In order to increase the options available to banks for resolving their non performing assets and to develop a healthy secondary market for non-performing assets, where securitisation companies and reconstruction companies are not involved, it has been decided to issue guidelines to banks on purchase / sale of Non-Performing Assets. Since the sale/purchase of non-performing financial assets under this option would be conducted within the financial system the whole process of resolving the non performing assets and matters related thereto has to be initiated with due diligence and care warranting the existence of a set of clear guidelines which shall be complied with by all entities so that the process of resolving non-performing assets by sale and purchase of NPAs proceeds on smooth and sound lines. Accordingly guidelines on sale/purchase of non-performing assets have been formulated and furnished in the Annexure. The guidelines may be placed before the bank's/FI's /NBFC's Board at the next meeting and appropriate steps may be taken for their implementation.

2. Please acknowledge receipt.

Yours faithfully,

(Prashant Saran)
Chief General Manager

Encls : As above.

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Annexure

Guidelines on purchase/ sale of Non Performing Financial Assets

Scope

1. These guidelines would be applicable to banks, FIs and NBFCs purchasing/ selling non performing financial assets, from/ to other banks/FIs/NBFCs (excluding securitisation companies/ reconstruction companies).

2. A financial asset, including assets under multiple/consortium banking arrangements, would be eligible for purchase/sale in terms of these guidelines if it is a non-performing asset/non performing investment in the books of the selling bank.

3. The reference to 'bank' in the guidelines would include financial institutions and NBFCs.

Structure

4. The guidelines to be followed by banks purchasing/ selling non-performing financial assets from / to other banks are given below. The guidelines have been grouped under the following headings:
    - i) Procedure for purchase/ sale of non performing financial assets by banks, including valuation and pricing aspects.
    - ii) Prudential norms, in the following areas, for banks for purchase/ sale of non performing financial assets:
        - a) Asset classification norms
        - b) Provisioning norms
        - c) Accounting of recoveries
        - d) Capital adequacy norms
        - e) Exposure norms
    - iii) Disclosure requirements

5. Procedure for purchase/ sale of non performing financial assets, including valuation and pricing aspects

i) A bank which is purchasing/ selling non-performing financial assets should ensure that the purchase/ sale is conducted in accordance with a policy approved by the Board. The Board shall lay down policies and guidelines covering, *inter alia*,

a) Non performing financial assets that may be purchased/ sold;
b) Norms and procedure for purchase/ sale of such financial assets;
c) Valuation procedure to be followed to ensure that the economic value of financial assets is reasonably estimated based on the estimated cash flows arising out of repayments and recovery prospects;
d) Delegation of powers of various functionaries for taking decision on the purchase/ sale of the financial assets; etc.
e) Accounting policy

ii) While laying down the policy, the Board shall satisfy itself that the bank has adequate skills to purchase non performing financial assets and deal with them in an efficient manner which will result in value addition to the bank. The Board should also ensure that appropriate systems and procedures are in place to effectively address the risks that a purchasing bank would assume while engaging in this activity.

iii) *The estimated cash flows are normally expected to be realised within a period of three years and not less than 5% of the estimated cash flows should be realized in each half year.*

iv) A bank may purchase/sell non-performing financial assets from/to other banks only on 'without recourse' basis, i.e., the entire credit risk associated with the non-performing financial assets should be transferred to the purchasing bank. Selling bank shall ensure that the effect of the sale of the financial assets should be such that the asset is taken off the books of the bank and after the sale there should not be any known liability devolving on the selling bank.

v) Banks should ensure that subsequent to sale of the non performing financial assets to other banks, they do not have any involvement with reference to assets sold and do not assume operational, legal or any other type of risks relating to the financial assets sold. Consequently, the specific financial asset should not enjoy the support of credit enhancements / liquidity facilities in any form or manner.

vi) Each bank will make its own assessment of the value offered by the purchasing bank for the financial asset and decide whether to accept or reject the offer.

vii) Under no circumstances can a sale to other banks be made at a contingent price whereby in the event of shortfall in the realization by the purchasing banks, the selling banks would have to bear a part of the shortfall.

viii) A non-performing asset in the books of a bank shall be eligible for sale to other banks only if it has remained a non-performing asset for at least two years in the books of the selling bank.

ix) Banks shall sell non-performing financial assets to other banks only on cash basis. The entire sale consideration should be received upfront and the asset can be taken out of the books of the selling bank only on receipt of the entire sale consideration.

x) A non-performing financial asset should be held by the purchasing bank in its books at least for a period of 15 months before it is sold to other banks. Banks should not sell such assets back to the bank, which had sold the NPFA.

(xi) Banks are also permitted to sell/buy homogeneous pool within retail non-performing financial assets, on a portfolio basis provided each of the non-performing financial assets of the pool has remained as non-performing financial asset for at least 2 years in the books of the selling bank. The pool of assets would be treated as a single asset in the books of the purchasing bank.

xii) The selling bank shall pursue the staff accountability aspects as per the existing instructions in respect of the non-performing assets sold to other banks.

6. Prudential norms for banks for the purchase/ sale transactions

(A) Asset classification norms

(i) The non-performing financial asset *purchased*, may be classified as 'standard' in the books of the purchasing bank for a period of 90 days from the date of purchase. Thereafter, the asset classification status of the *financial asset purchased,* shall be determined by the record of recovery in the books of the purchasing bank with reference to cash flows estimated while purchasing the asset which should be in compliance with requirements in Para 5 (iii).

(ii) The asset classification status of an existing exposure *(other than purchased financial asset)* to the same obligor in the books of the purchasing bank will continue to be governed by the record of recovery of that exposure and hence may be different.

(iii) Where the purchase/sale does not satisfy any of the prudential requirements prescribed in these guidelines the asset classification status of the financial asset in the books of the purchasing bank at the time of purchase shall be the same as in the books of the selling bank. Thereafter, the asset classification status will continue to be determined with reference to the date of NPA in the selling bank.

(iv) Any restructure/reschedule/rephrase of the repayment schedule or the estimated cash flow of the non-performing financial asset *by the purchasing bank* shall render the account as a non-performing asset.

(B) Provisioning norms

Books of selling bank

i) When a bank sells its non-performing financial assets to other banks, the same will be removed from its books on transfer.

ii) If the sale is at a price below the net book value (NBV) (i.e., book value less provisions held), the shortfall should be debited to the profit and loss account of that year.

iii) If the sale is for a value higher than the NBV, the excess provision shall not be reversed but will be utilised to meet the shortfall/ loss on account of sale of other non performing financial assets.

Books of purchasing bank

The asset shall attract provisioning requirement appropriate to its asset classification status in the books of the purchasing bank.

(C) Accounting of recoveries

Any recovery in respect of a non-performing asset purchased from other banks should first be adjusted against its acquisition cost. Recoveries in excess of the acquisition cost can be recognised as profit.

(D) Capital Adequacy

For the purpose of capital adequacy, banks should assign 100% risk weights to the non-performing financial assets purchased from other banks. In case the non-performing asset purchased is an investment, then it would attract capital charge for market risks also. For NBFCs the relevant instructions on capital adequacy would be applicable.

(E) Exposure Norms

The purchasing bank will reckon *exposure* on the obligor of the specific financial asset. Hence these banks should ensure compliance with the prudential credit exposure ceilings (both single and group) after reckoning the exposures to the obligors arising on account of the purchase. For NBFCs the relevant instructions on exposure norms would be applicable.

7. Disclosure Requirements

Banks which purchase non-performing financial assets from other banks shall be required to make the following disclosures in the Notes on Accounts to their Balance sheets:

A. <u>Details of non-performing financial assets purchased:</u>

(Amounts in Rupees crore)

1. (a) No. of accounts purchased during the year

   (b) Aggregate outstanding

2. (a) Of these, number of accounts restructured during the year

   (b) Aggregate outstanding

B. <u>Details of non-performing financial assets sold:</u>

(Amounts in Rupees crore)

1. No. of accounts sold
2. Aggregate outstanding
3. Aggregate consideration received

C. The purchasing bank shall furnish all relevant reports to RBI, CIBIL etc. in respect of the non-performing financial assets purchased by it.