

RBI/2005-06/421

DBOD.NO.BP. BC. 89 / 21.04.048/ 2005-06

June 22, 2006

All Scheduled Commercial Banks
(Excluding RRBs)

Dear Sir,

Prudential norms on creation and utilisation of floating provisions

In terms of Para (3) of circular DBOD.No.BC.8/21.04.043/94 dated February 4, 1994 on 'Income Recognition, Provisioning and Other Related Matters', banks have been permitted to set-off the floating provisions, wherever available, against provisions required to be made as per extant prudential guidelines on provisioning. Further, in terms of Para 5.6 of our Master Circular DBOD No.BP.BC.11/21.04.048/2005-06 dated July 1, 2005 on 'Prudential norms on Income recognition, Asset Classification and Provisioning pertaining to Advances' banks have been advised to voluntarily set apart provisions much above the minimum prescribed level as a desirable practice due to the fact that higher loan loss provisioning adds to the overall financial strength of the banks and the stability of the financial sector.

2. The use of floating provisions to set-off against provisions required to be made as per extant prudential guidelines appear to have been used in smoothening of profits in some cases. Hence, the extant guidelines have been reviewed and it has been decided to issue revised instructions on, utilisation, creation, accounting and disclosures of floating provisions, i.e., provisions which are not made in respect of specific non-performing assets or are made in excess of regulatory requirement for provisions for standard assets.

(i) Principle for utilisation of floating provisions by banks

The floating provisions should not be used for making specific provisions as per the extant prudential guidelines in respect of non-performing assets or for making regulatory provisions for standard assets. The floating provisions can be used only for contingencies under extraordinary circumstances for making specific provisions in impaired accounts after obtaining board's approval and with prior permission of RBI. The boards of the banks should lay down an approved policy as to what circumstances would be considered extraordinary.

(ii) Principle for creation of floating provisions by banks

The bank's board of directors should lay down approved policy regarding the level to which the floating provisions can be created. The bank should hold floating provisions for 'advances' and 'investments' separately and the guidelines prescribed will be applicable to floating provisions held for both 'advances' & 'investment' portfolios.

(iii) Accounting

Floating provisions cannot be reversed by credit to the profit and loss account. They can only be utilised for making specific provisions in extra-ordinary circumstances as mentioned above. Until such utilisation, these provisions can be netted off from gross NPAs to arrive at disclosure of net NPAs. Alternatively, they can be treated as part of Tier II capital within the over-all ceiling of 1.25 % of total risk-weighted assets.

(iv) Disclosures

Banks should make comprehensive disclosures on floating provisions in the "notes on accounts" to the balance sheet on (a) opening balance in the floating provisions account, (b) the quantum of floating provisions made in the accounting year, (c) purpose and amount of draw down made during the accounting year, and (d) closing balance in the floating provisions account.

(v) Provisions for advances at higher than prescribed rates

A bank may voluntarily make specific provisions for advances at rates which are higher than the rates prescribed under existing regulations provided such higher rates are approved by the Board of Directors and consistently adopted from year to year. Such additional provisions are not to be considered as floating provisions.

3. Please acknowledge receipt.

Yours faithfully,
(Prashant Saran)
Chief General Manager-in-Charge