

September 13, 2007.

The Chief Executive Officer of all  
Primary (Urban) Co-operative Banks

Dear Sir,

**Monitoring of Advances-Safeguards to be observed-UCBs**

Please refer to our instructions on the above subject issued from time to time as consolidated in Para 4 of the Master Circular UBD.BPD (PCB) MC. No.9 /13.05.000/2007-08 dated July 4, 2007 on Management of Loans and Advances.

2. While various safeguards have been prescribed therein pertaining to the post sanction monitoring of advances, such as regular inspection of borrowers' assets charged to the banks, periodical visits to the assisted units, stock audits, etc, instances of diversion of funds and non – credit of sale proceeds to borrowal accounts continue to come to light, and are observed to be an important factor contributing to the perpetration of frauds/ the account turning NPAs.

3. It has been observed that at times credit facilities extended have been utilized for purposes other than those for which they were sanctioned and payments have been made from borrowal accounts to parties unconnected with the business of the borrower. Such diversion of funds also results in depletion of working capital leading to the account turning into NPA. Banks are advised to ensure that loan facilities are utilized by borrowers for the purpose sanctioned. Banks should therefore have a mechanism for proper monitoring of the end use of funds. Wherever diversion is observed, they should take appropriate action against the borrowers concerned and the steps needed to protect the bank's interest.

4. It is therefore advised that the banks may put in place more stringent safeguards, especially where accounts shows sign of turning into NPAs. In such cases banks may strengthen their monitoring system by resorting to more frequent inspections of borrowers' godowns, ensuring that sale proceeds are routed through the borrower's accounts maintained with the bank and insisting on pledge of the stock in place of hypothecation.

5. It is further, advised that whenever stocks under hypothecation to cash credit and other loan accounts are found to have been sold but the proceeds thereof not credited to the loan account, such action should normally be treated as a fraud. In such cases, banks may take immediate

steps to secure the remaining stock so as to prevent further erosion in the value of the available security as also other action as warranted.

Yours faithfully,

(N.S.Vishwanathan)  
Chief General Manager-in-Charge