Case Studies on IRACP Norms

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Applicable RBI Circulars on IRACP

Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances dated October 1, 2021

Circular DBR.No.BP.BC.45/21.04.048/2018-19 dated June 7, 2019 on Prudential Framework for Resolution of Stressed Assets

Circular no. DBOD.No.BP.BC.27/21.04.048/2014-15 dated July 22, 2014 on Loans against Gold Ornaments and Jewellery for Non-Agricultural End-uses

Circular no. DOR.STR.REC.68/21.04.048/2021-22 dated November 12, 2021 on Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances – Clarification

Case Studies #1

Borrower has CC facility of 1 Crore and outstanding on 1st July was Rs. 78 lacs. No stock statements submitted from November 2021 month onwards till March 2022.

The Borrower needs to be classified as ‘out of order’ in January 2022. In April 2022, the borrower will be classified as NPA.

Case Studies #2

Total of Interest debited during the 90 days period is less than total credits in account during the 90 days period ended March 31. There are no other transactions in the account. However, in previous quarter, as on December 31, the account was out of order for more than 100 days due to insufficient credits in the account.

The account can be treated as standard provided entire overdue in account including interest debited in previous quarter including other charges are recovered. Also, there should not be any overdue in any other credit facilities of the same borrower.

Case Studies #3

CC Account was out of order till March 10, 2022 by 100 days but was brought within limit on 11th March and is within limit as on March 31, 2022.

The account is not required to be classified as NPA.

Case Studies #4

Account due for renewal in June 2021. The same was subjected to short review for 3 months and subsequently again subjected to short review of 3 months in September 2021.

The account will be classified as NPA in December 2022. Complete review is required to be done within 6 months.

Case Studies #5

Borrower Term Loan Account instalment was due on December 31. The payment by the borrower could not be done for this instalment. There was no repayment from the borrower till March 29. However, borrower repaid the instalments debited as on December 31 and January 31 on March 30. On 31st March, only February instalment remained unpaid. Would the situation change if the above repayment was done on 31st March?

The borrower will not be classified as NPA when he makes the repayment on 30th March 2022. In the other situation when the repayment is made on 31st March the account will be classified as NPA as the instalment for February month is still due.

Case Studies #6

Interest was debited in loan account on September 30 was paid on December 30th. October interest was paid on December 31st.

Account will be sub standard on December 28th. Unless entire overdues are cleared by the borrower, the account would be NPA.

Case Studies #7

Borrower had two facilities, Term loan and CC. due to CC account being overdrawn for continuous period of more than 90 days, both facilities were classified as NPA by the Bank even though only 1 instalment was overdue in case of TL on March 1. Subsequently, borrower regularised the CC account on March 15th and Bank upgraded the borrower accounts as Standard.

The Bank's action of upgrading CC account is incorrect as 1 instalment of TL overdue & unpaid. Account can be upgraded only when entire overdues are recovered from the borrower.

Case Studies #8

One borrower has taken housing loan in Individual name and same borrower has taken loan in Proprietorship XYZ Corporation under CC facility of the Bank. The CC loan was restructured and Bank classified the CC facility of the borrower as NPA. Housing loan was continued as Standard as it was in Individual name and was regular and there was no default or overdue.

The Bank is incorrect in classifying the account as standard. It should be classified as NPA. As NPA classification is borrower wise and not facility wise.

Case Studies #9

Borrower given moratorium of interest on a project loan for a period of 2 years. 2 years period getting completed on September 30, 2021. The Bank has realised interest on accrual basis under moratorium period for Rs. 50 lacs. From October onwards, the borrower couldn't pay interest till January 31st and account became NPA. The amount of interest for October, November and December was Rs. 1.25 lacs each. Bank reversed amount of Rs. 3.75 pertaining to the past 3 months while classifying borrower account as NPA. The interest income has been considered as income till September by the Bank.

The Bank is correct in reversing the interest for a period of 3 months. The interest capitalised for moratorium period need not be reversed.

Case Studies #10

Short term loan given to borrower was maturing after 6 months. The bank rolled over the loan falling due on September 30 for a period of 6 months and again on March 31.

In case of roll over of short term loans, unless the repayment has come from the borrower before roll over, it would be implied that repayment is by fresh sanction by the Bank and hence the account would be classified as Sub standard.

Case Studies #11

Borrower has CC account along with Non fund based facilities in form of LC. The CC account of the borrower was out of order by 40 days as on 1st December. While the out of order status continued, LC devolved on December 25th and Bank had to make payment to Foreign bank of supplier on the same day. Borrower promised to pay the Bank for the LC devolvement amount and Bank Created a separate account for the borrower for the funded exposure in form of LC devolvement. Borrower could not arrange for funds for LC devolvement but regularised the CC account before 90 days period got over.

The operative account of borrower (CC account) should have been debited by the Bank for the amount paid towards LC devolvement. If considering above debit, the account becomes out of order for more than 90 days, the facilities of the borrower would become NPA.

Case Studies #12

Bank sanctioned a loan of Rs. 1 Crore which was unsecured ab initio. The account became sub standard due to Fraud on July 31st . What will be provision requirement?

In case of fraud, Banks are required to make 100% provision. However, they can spread the provision impact in maximum 4 quarter.

Case Studies #13

Bank sanctioned a secured loan of Rs. 1 Crore. The account became sub standard due to Fraud on March 15th. What will be provision requirement? Can Branch make provision of 25% per quarter?

Bank has option to create 100% provision in 4 quarters. However, when the provision is spread over 2 financial years, the Bank need to create provision from “other reserves” for the amount which would be provided in next FY. At the time of actual provision through P&L, this entry can be reversed.

Case Studies #14

Bank sanctioned a infra loan of 50 Crores with moratorium of principle for 2 years ending June 2019. In June 2019, the moratorium was further extended for 2 years till June 2021. The borrower made request to extend the moratorium period by further 6 months due to reasons beyond their control due to some government permission issues. The interest payments have been regular throughout the period till June 2021.

Extension of moratorium for a total period of 3 years due to reasons beyond promotors controls is not permitted even if the borrower is regular in repayment of interest dues. 4 years permitted in cases where court cases are involved. In this case, the account would be standard as its below 3 years. However, it will attract additional standard asset provisioning of 5%.

Case Studies #15

A loan was sanctioned as Secured loan in February 2022 for 3 Crores. The security creation could not be completed before March 31, 2022. What will be loan classification? The documentation could not be completed at the time of signing the branch financials.

The account would be considered as unsecured loan and if it becomes NPA, would attract higher provisioning.

Case Studies #16

A loan was sanctioned as Secured loan in February 2021 for 3 Crores. The security creation could not be completed before March 31, 2021 and hence the account was treated as unsecured. Subsequently, the account became sub standard in June 2021. What will be provision requirement?

Since the account was treated as substandard ab initio, the provision in account would be 10% higher than standard account provisioning. However, if security documentation is created in favour of the lender, the same can be considered while making provision under Doubtful category.

Case Studies #17

In previous case, if the account was treated as secured in previous year in March 2021 and it became sub standard in December 2021 and provision of 15% on outstanding was created. If value of security was eroded by more than 50% as on March 31, 2022. Would it impact the provisioning?

In case of more than 50% erosion in value of security from what was envisaged at the time of original sanction, the account need not go through various categories of NPA and will be straightaway classified as doubtful requiring higher provisioning.

Case Studies #18

A loan was sanctioned on 10th April 2021 against the pledge of gold ornaments and jewellery for non-agricultural purposes. The margin (LTV) prescribed in the sanction terms is 75%. During the tenor of the loan , due to gold price fluctuations and the accrual of interest, prescribed margin was not maintained in the loan account.

Note: For the purpose of valuation of gold, banks may use the historical spot gold price data publicly disseminated by a commodity exchange regulated by the Forward Markets Commission on a consistent manner as per their Board approved policy, in addition to the prices disseminated by the India Bullion and Jewellers Association Ltd.

This account would be treated as Sub standard as the LTV ratio is below permissible limit of 75%.

Case Studies #19

Accounts of the same borrower got restructured under Covid 19 Relief Package 1 (in October 2020) and Covid 19 Relief Package - 2 (in June 2021)

This would be treated as re restructuring. Restructuring of account which is already done under other scheme would not be permitted. This account would be treated as NPA

Case Studies #20

Accounts of the borrower was overdue in March 21 and became NPA in May 2021. Bank reversed the amount of interest and other charges debited in account from April 2021.

Bank need to reverse entire amount of interest plus any fees/charges which are unpaid by borrower upon classification of account even if it pertains to previous year. Here any unrecovered interest prior to March 21 will also need to be reversed.

Case Studies #21

Bank sanctioned bill discounting to one borrower against LC of other Bank along with Term loan facility. Term loan account became NPA in the Branch. Branch did not classify the BD account of borrower as NPA.

The bank is right in continuing classification of BD facilities of the borrower under standard as its against LC of the other Bank. However, if the payment from the other Bank against bill is not made on due date, this facility will immediately be classified as sub standard.

Case Studies #22

A Bank has one borrower facility which is under consortium and leader of consortium is B Bank. Due to financial difficulties being faced by borrower, repayments are not being made regularly. B Bank has been receiving funds from borrower but is not parting with funds and adjusting recoveries against its own dues and has classified the account as Standard. Bank A has not been receiving funds but since the account is classified as Standard by Bank B, the same classification has continued.

Irrespective of the account classification by the consortium leader, unless the repayments are done for Bank's own lending facilities, the account classification would be on the basis of record of recovery.

Case Studies #23

Agricultural loan given to farmers by a Branch could not be repaid on due date after the end of crop season and was overdue due to natural calamities. Bank has rescheduled the loan by one more crop season and granted fresh loan. The fresh loan along with existing re scheduled loan was treated as standard by the Bank.

Bank can continue the existing and additional facilities under standard category as the same was granted and rescheduled due to natural calamities upto 1 or 2 crop seasons depending on if the finance was for short or long duration crop.

Case Studies #24

Government guaranteed advance borrower company did not pay the instalment due for more than 90 days. Bank did not reverse interest income and continued the asset classification as Standard since the same was Guaranteed by Government.

Interest reversal not done is incorrect as its mandatory to reverse interest irrespective of government guarantee. For classification, it depends if guaranteed by Central Govt. or State Govt. In case of Central Govt, account not NPA unless Central Govt repudiates guarantee when invoked. In case of State Govt, irrespective of Guarantee invocation, account classification would be on basis of record of recovery.

Case Studies #25

One Infra project loan having moratorium for 2 years was rescheduled by the Bank for a further period of 2 years. Since it was a project involving court case, the account was permitted to continue under standard category as the revised DCCO was not beyond 2 years. Bank continued recognising interest income on the same as the account was standard. The interest was under moratorium.

Bank can not recognise interest beyond 2 years of original DCCO date in case of moratorium due to high risk involved in Project loans though the account is retained in standard category.

Case Studies #26

Bank gave export finance facility to one exporter in India. The importer is based out of Russia. The importer made full payment for the goods imported to its Bank in Russia but due to restrictions by other countries, the importer's Bank which is headquartered in USA is not allowing to remit money to India to the exporter.

Bank in India in such situation which is beyond control of both importer and exporter due to political reasons and where importer has made payment for the invoice, if able to establish through documentary evidence that importer has cleared his dues, can do classification after 1 year from the date importer has deposited money to his Banker.

Case Studies #27

One MSME borrower facilities were restructured by the Bank and account was classified as sub standard upon restructuring. Bank gave moratorium of 2 years for term loan and 1 year for FITL created from out of order status of CC account of borrower. The period of 1 year of FITL got over in February 2021. Based on the satisfactory repayment of FITL and other facilities for 1 year, Bank upgraded the account as Standard.

Condition for upgrade is 1 year of satisfactory performance during specified period. Specified period commences from the repayment date of facility with longest moratorium period starts. There should not be any overdue at end of the specified period and during the period, overdue should not be more than 30 days Hence Bank can’t upgrade account unless satisfactory performance till February 2023.

Case Studies #28

A large Corporate borrower account having total exposure of 150 Crores was restructured by the Bank and account was classified as sub standard upon restructuring. Bank gave moratorium of 18 months for term loan and 1 year for WCDL created from out of order status of CC account of borrower. The period of 18 months term loan got over in January 2021. Based on the satisfactory repayment of WCDL and other loan facilities for 1 year, Bank upgraded the account as Standard.

Apart from condition of Satisfactory performance, additional conditions in case of other than MSME is 10% of the total outstanding principal and interest capitalisation should be paid. Also, in case of accounts where aggregate exposure of above 100 Crores, need to be rated as investment grade (BBB- or better) [for exposure above 500 Cr, minimum 2 ratings required].

Case Studies #29

Taking forward above example, the borrower has defaulted in other Bank dues in month of February 2022.

A fresh RP to be implemented with account to be retained under Standard category but an additional provision of 15% will be required to be made by all the lenders.

Case Studies #30

A Limited account was classified as Substandard in June 2021. Subsequently, one of the Company's Directors name appeared in the wilful defaulter list twice before December 2021. Bank made a provision of 25% as the account was unsecured.

In case where Company has director whose name appear twice in list of wilful defaulters, additional provision need to be created as per Part C of Master circular. In this case, 40% since period under substandard category between 6 months to 1 year.

Brief of November 12 clarifications on IRAC issued by RBI

The exact due dates for repayment of a loan, frequency of repayment, breakup between principal and interest, examples of SMA/NPA classification dates, etc. shall be clearly specified in the loan agreement and the borrower shall be apprised of the same at the time of loan sanction and also at the time of subsequent changes, if any, to the sanction terms/loan agreement till full repayment of the loan.

Borrower accounts shall be flagged as overdue by the lending institutions as part of their day-end processes for the due date, irrespective of the time of running such processes. Similarly, classification of borrower accounts as SMA as well as NPA shall be done as part of day-end process for the relevant date and the SMA or NPA classification date shall be the calendar date for which the day end process is run

Brief of November 12 clarifications on IRAC issued by RBI

The extant instructions, stipulate that the account should be treated as ‘out of order’ if there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period. Instead, determination of ‘out of order’ status of CC/OD accounts would be done on a continuous basis considering 90 days.

In case of interest payments, an account is classified as NPA only if the interest due and charged during any quarter is not serviced fully within 90 days from the end of the quarter. In order to fully align with the 90 days delinquency norm as well as the requirement to apply interest at monthly rests, the above instructions are modified as an account will be classified as NPA if the interest applied at specified rests remains overdue for more than 90 days

Brief of November 12 clarifications on IRAC issued by RBI

Accounts classified as NPAs may be upgraded as ‘standard’ asset only if entire arrears of interest and principal are paid by the borrower.

If loans with moratorium on payment of interest (permitted at the time of sanction of the loan) become NPA after the moratorium period is over, the capitalized interest corresponding to the interest accrued during such moratorium period need not be reversed.

Consumer Education: It shall be ensured that their front-line officers educate borrowers about all these concepts, with respect to loans availed by them, at the time of sanction/disbursal/renewal of loans. These instructions shall be complied with at the earliest, but not later than March 31, 2022.

Thank You

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