RECENT RBI CICULARS & IMPLICATIONS OF COVID RESTRICTIONS IN BANK AUDIT

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Circulars issued by RBI

- COVID-19 – Regulatory Package (March 27, 2020)
- COVID19 Regulatory Package - Asset Classification and Provisioning (April 17, 2020)
- COVID19 Regulatory Package – Review of Resolution Timelines under the Prudential Framework on Resolution of Stressed Assets (April 17, 2020)
- MSME – Restructuring of Advances (February 11, 2020)
- MSME – Restructuring of Advances (August 6, 2020)
- Resolution framework for COVID-19 related stress (August 6, 2020)
- Resolution framework for COVID-19 related stress (August 6, 2020)
- Resolution framework for COVID-19 related stress – financial parameter (September 7, 2020)

Rescheduling of Payments – Term Loans and Working Capital Facilities (March 27, 2020)

- In respect of **all term loans** (including agricultural term loans, retail and crop loans),
  - all commercial banks (including regional rural banks, small finance banks and local area banks), co-operative banks, all-India Financial Institutions, and NBFCs (including housing finance companies) (“**lending institutions**”) are permitted to grant a **moratorium** of three months on payment of all instalments1 falling **due** between **March 1, 2020 and May 31, 2020.(extended to August 31,2020 subsequently)**
  - The repayment schedule for such loans as also the residual tenor, will be shifted across the board by three months after the moratorium period.
  - Interest shall continue to accrue on the outstanding portion of the term loans during the moratorium period.
  - **Instalments** will include the following payments falling due from March 1, 2020 to May 31, 2020 **.(extended to August 31,2020 subsequently)** : (i) principal and/or interest components; (ii) bullet repayments; (iii) Equated Monthly instalments; (iv) credit card dues.

Clarification on April 17, 2020

- In line with the clarification provided by the Basel Committee on Banking Supervision, in respect of **all accounts classified as standard as on February 29, 2020**, even if **overdue**, the moratorium period, wherever granted, shall be excluded by the lending institutions from the number of days past-due for the purpose of asset classification under the IRAC norms.
- This arrangement is **not** considered as **Restructure** for the purpose of Asset classification; hence no down gradation of the account need to be done as per appendix II of Master circular

Working Capital finance – CC/OD (March 27, 2020)

- In respect of working capital facilities sanctioned in the form of cash credit/overdraft ("CC/OD"), lending institutions are permitted to defer the recovery of interest applied in respect of all such facilities during the period from March 1, 2020 up to May 31, 2020 .**(extended to August 31,2020 subsequently)** ("deferment").
- The accumulated accrued interest shall be recovered immediately after the completion of this period
- In respect of borrowers facing stress on account of the economic fallout of the pandemic, lending institutions may recalculate the 'drawing power' by reducing the margins and/or by reassessing the working capital cycle
- This relief shall be available in respect of all such changes effected up to May 31, 2020 .**(extended to August 31,2020 subsequently)**
- such a measure, by itself, shall not result in asset classification downgrade.
- This will not qualify as a default for the purposes of supervisory reporting and reporting to Credit Information Companies(CICs) by the lending institutions. CICs shall ensure that the actions taken by lending institutions pursuant to the above announcements do not adversely impact the credit history of the beneficiaries.

Clarification on April 17, 2020

- In respect of working capital facilities sanctioned in the form of cash credit/overdraft ("CC/OD"), the Regulatory Package permitted the recovery of interest applied during the period from March 1, 2020 up to May 31, 2020 .**(extended to August 31,2020 subsequently)** to be deferred ('deferment period').
- Such deferment period, wherever granted in respect of all facilities classified as standard, including SMA, as on February 29, 2020, shall be excluded for the determination of out of order status.
- The days past due and SMA status, where applicable, as on March 1, 2020 will remain unchanged till May 31, 2020 .**(extended to August 31,2020 subsequently)**.
- NBFCs which are required to comply with Indian Accounting Standards (IndAS) shall, as hitherto, continue to be guided by the guidelines duly approved by their Boards and as per ICAI Advisories for recognition of the impairments.-ECL

Provisioning

- In respect of accounts in default but standard where provisions of circular dt April 17,2020 are applicable, and asset classification benefit is extended, lending institutions shall make general provisions of not less than 10 per cent of the total outstanding **of such accounts**, to be phased over two quarters as under:
  - (i) Quarter ended March 31, 2020 – not less than 5 per cent
  - (ii) Quarter ending June 30, 2020 – not less than 5 per cent
- The above provisions may be adjusted against the actual provisioning requirements for slippages from the accounts reckoned for such provisions.
- The above provisions shall **not** be reckoned for arriving at **net NPAs** till they are adjusted against the actual provisioning requirements as above
- Till such adjustments, these provisions shall **not** be netted from **gross advances** but shown separately in the balance sheet as appropriate
- All other provisions required to be maintained by lending institutions, including the provisions for accounts already classified as NPA as on February 29, 2020 as well as subsequent ageing in these accounts, shall continue to be made in the usual manner.

Disclosures (April 17, 2020)

- The lending institutions shall suitably disclose the following in the 'Notes to Accounts' while preparing their financial statements for the half year ending September 30, 2020 as well as the financial years 2019-20 and 2020-2021:
  - (i) Respective amounts in SMA/overdue categories, where the moratorium/deferment was extended, in terms of paragraph 2 and 3 of the circular;
  - (ii) Respective amount where asset classification benefits is extended.
  - (iii) Provisions made during the Q4FY2020 and Q1FY2021 in terms of paragraph 5 of the circular;
  - (iv) Provisions adjusted during the respective accounting periods against slippages and the residual provisions in terms of paragraph 6 of the circular.

Review of Resolution Timelines under the Prudential Framework on Resolution of Stressed Assets (April 17, 2020)

- **Prudential Framework on Resolution of Stressed Assets (circular dated June 7,2019)**
- In terms of paragraph 11 of the Prudential Framework, lenders are required to implement a resolution plan in respect of entities in default within 180 days from the end of Review Period of 30 days
- In respect of accounts which were within the Review Period as on March 1, 2020, the period from March 1, 2020 to May 31, 2020 .**(extended to August 31,2020 subsequently)** shall be excluded from the calculation of the 30-day timeline for the Review Period. In respect of all such accounts, the residual Review Period shall resume from June 1, 2020,(**subsequently from Sept. 1, 2020)** upon expiry of which the lenders shall have the usual 180 days for resolution
- In respect of accounts where the Review Period was over, but the 180-day resolution period had not expired as on March 1, 2020, the timeline for resolution shall get extended by 90/**180** days from the date on which the 180-day period was originally set to expire.

Prudential Framework on Resolution of Stressed Assets –contd…

- Consequently, the requirement of making additional provisions specified in paragraph 17 (an additional provision of 20 per cent if a resolution plan has not been implemented within 180 days) of the Prudential Framework shall be triggered as and when the extended resolution period, as stated above, expires.
- The lending institutions shall make relevant disclosures in respect of accounts where the resolution period was extended in the 'Notes to Accounts' while preparing their financial statements for the half year ending September 30, 2020 as well as the financial years FY2020 and FY2021.

Other conditions/measures

- Lending institutions shall frame Board approved polices for providing the reliefs to all eligible borrowers, inter alia, including the objective criteria for considering reliefs under paragraph 4 of the circular and disclosed in public domain.
- Wherever the exposure of a lending institution to a borrower is Rs. 5 crore or above as on March 1, 2020, the bank shall develop an MIS on the reliefs provided to its borrowers which shall inter alia include borrower-wise and credit-facility wise information regarding the nature and amount of relief granted.
- **Distribution of Dividend -** in view of the COVID-19-related economic shock, scheduled commercial banks and cooperative banks shall not make any **further** dividend payouts from profits pertaining to the financial year ended March 31, 2020 until further instructions. This restriction shall be reviewed on the basis of the financial position of banks for the quarter ending September 30, 2020.

NBFC Loans to Commercial Real EstateProjects

- In terms of the extant guidelines for banks, the date for commencement for commercial operations (DCCO) in respect of loans to commercial real estate projects delayed for reasons beyond the control of promoters can be extended by an additional one year, over and above the one-year extension permitted in normal course, without treating the same as restructuring.
- It has now been decided to extend a similar treatment to loans given by NBFCs to commercial real estate.
- This will provide relief to NBFCs as well as the real estate sector

SUPREME COURT DECISION

- In the case of GAJENDRA SHARMA VS. UNION OF INDIA & ANR. Hon Supreme Court decided on September 3, 2020 that

  "….. The accounts which were not declared NPA till 31.08.2020 shall not be declared NPA till further order."

- In the light of this the banks are not classifying accounts as NPA even if there are overdues for more than 90 days
- Issues are- The accounts which would have turned out to be NPA in normal situation, in such case
  - Is the relaxation is applicable only to classification of the account?
  - Whether interest income to be recognize as income or reversal of interest is to be done?
  - What about the provision on such accounts?

RESOLUTION FRAMEWORK FOR COVID - 19

- The Resolution framework is given to the following categories of assets
- The restructuring of accounts is allowed without the account being downgraded in the following three categories subject to certain conditions
  - MSME loans
  - Personal loans
  - Other exposures

MSME DEFINITION

- Earlier MSME was decided on the basis of investment in plant and machinery. With effect from July 1, 2020 the definition has changed

Particulars	Investment in Plant and machinery	And turnover
micro	Does not exceed Rs. 1 crore	Does not exceed Rs. 5 crore
small	Does not exceed Rs. 10 crore	Does not exceed Rs. 50 crore
medium	Does not exceed Rs. 50 crore	Does not exceed Rs. 250 crore

Restructuring of loans-MSME

- As per Income Recognition and Asset Classification circular, if the account is restructured, then the same shall be classified as non performing, however RBI has allowed to retain the account as standard by issuing following circulars.
  - RBI/2018-19/100 DBR.No.BP.BC.18/21.04.048/2018-19 dated January 1, 2019 Micro, Small and Medium Enterprises (MSME) sector – Restructuring of Advances and RBI/2019-20/160 DOR.No.BP.BC.34/21.04.048/2019-20 dated February 11, 2020 Micro, Small and Medium Enterprises (MSME) sector – Restructuring of Advances [Hereinafter referred as "MSME Restructuring Circulars]
  - RBI/2020-21/16 DOR.No.BP.BC/3/21.04.048/2020-21 dated August 6, 2020 Resolution Framework for COVID-19-related Stress and RBI/2020-21/34 DOR.No.BP.BC/ 13 /21.04.048/2020-21 dated September 7, 2020 Resolution Framework for COVID-19-related Stress – Financial Parameters [Hereinafter referred as "Covid Relief Circulars"]

Restructuring of loans

- **Restructuring Under MSME Restructuring circulars**
- **Eligible Borrowers** -Borrowers falling under category MSME borrowers. MSME is defined in the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006
- **Pre-Conditions** –
- The aggregate exposure, including non-fund based facilities, of banks and NBFCs to the borrower does not exceed ₹25 crore as on March 1, 2020.
- The borrower's account was a 'standard asset' as on March 1, 2020.
- The restructuring of the borrower account is implemented by March 31, 2021.
- The borrowing entity is GST-registered on the date of implementation of the restructuring. However, this condition will not apply to MSMEs that are exempt from GST-registration. This shall be determined on the basis of exemption limit obtaining as on March 1, 2020.

Restructuring of loans-MSME

- Asset classification of borrowers classified as standard may be retained as such, The accounts which may have slipped into NPA category between March 2, 2020 and date of implementation may be upgraded as ‘standard asset’, as on the date of implementation of the restructuring plan. The asset classification benefit will be available only if the restructuring is done as per provisions of this circular.
- As hitherto, for accounts restructured under these guidelines, banks shall maintain additional provision of 5% over and above the provision already held by them.
- Account should not have been already restructured in terms of the circular dated January 1, 2019.

Details of restructured accounts should be disclosed in notes to accounts in format specified in circular.

Restructuring of loans-other than MSME

- **Eligible Borrowers are borrowers other than**

a. MSME borrowers whose aggregate exposure to lending institutions collectively, is Rs.25 crore or less as on March 1, 2020.

b. Farm credit as listed in Paragraph 6.1 of Master Direction FIDD.CO.Plan.1/04.09.01/2016-17 dated July 7, 2016 (as updated) or other relevant instructions as applicable to specific category of lending institutions.

c. Loans to Primary Agricultural Credit Societies (PACS), Farmers' Service Societies (FSS) and Large-sized Adivasi Multi- Purpose Societies (LAMPS) for on-lending to agriculture

d. Exposures of lending institutions to financial service providers.

e. Exposures of lending institutions to Central and State Governments; Local Government bodies (eg. Municipal Corporations); and, body corporates established by an Act of Parliament or State Legislature.

f. Exposures of housing finance companies where the account has been rescheduled in terms of para 2(1)(zc)(ii) of the Master Circular

Restructuring of loans-other than MSME

Personal Loans - Personal Loan refers to loans given to individuals and consist of (a) consumer credit, (b) education loan, (c) loans given for creation/ enhancement of immovable assets (e.g., housing, etc.), and (d) loans given for investment in financial assets (shares, debentures, etc.).

Conditions

- Standard, but not in default for more than 30 days with the lending institution as on March 1, 2020.
- Resolution framework must be implemented within 90 days from the date of invocation.
- Resolution under this framework may be invoked not later than December 31, 2020
- The concessions / moratorium under resolution plans shall be subject to a maximum of two years

- **Criteria for Implementation of Resolution Plan**

- Execution of Documentation
- Changes are updated in system/ books
- Borrower is not in default with the lending institution as per the revised terms.

Restructuring of loans-other than MSME

Asset Classification & Provisioning

- Lending institutions shall keep provisions from the date of implementation, which are higher of the provisions held as per the extant IRAC norms immediately before implementation, or 10 percent of the renegotiated debt exposure of the lending institution post implementation.

- **Reversal of provision**

- Half of the above provisions may be written back upon the borrower paying at least 20 per cent of the residual debt without slipping into NPA post implementation of the plan, and the remaining half may be written back upon the borrower paying another 10 per cent of the residual debt without slipping into NPA subsequently.

Restructuring of loans-other than MSME

- **Other Loans than Personal Loans referred in above**
- **Conditions**
- Standard, but not in default for more than 30 days with the lending institution as on March 1, 2020.
- **In case of multiple lending institution Resolution framework is approved by lenders having 75% of total outstanding (FB + NFB) and 60% of lending institution in numbers**
- **Resolution framework** must be implemented within 180 days from the date of invocation.
- Resolution under this framework may be invoked not later than December 31, 2020
- The concessions / moratorium under resolution plans shall be subject to a maximum of two years
- **The Reserve Bank shall constitute a committee to decide financial parameters** which, in their opinion would be required to be factored into the assumptions that go into each resolution plan, and the sector specific benchmark ranges for such parameters. **(Expert Committee).** The financial parameters are prescribed in RBI/2020-21/34 DOR.No.BP.BC/ 13 /21.04.048/2020-21 dated September 7, 2020

Restructuring of loans-other than MSME

- Expert Committee shall also have the responsibility of vetting the resolution plans in respect of all accounts where the aggregate exposure of the lending institutions at the time of invocation of the resolution process is Rs.1500 crore and above.
- The concessions / moratorium under resolution plans shall be subject to a maximum of two years
- The Resolution Plan may involve any action / plan / reorganization including, but not limited to, regularisation of the account by payment of all over dues by the borrower entity, sale of the exposures to other entities / investors, change in ownership and restructuring except compromise settlement.
- The securities, if any received by Lending Institution by conversion of Debt into security shall be governed by extant instructions on investments.

Criteria for Implementation of Resolution Plan -

Execution of ICA within 30 days by lenders having 75% of total outstanding (FB + NFB) and 60% of lending institution in numbers

- Changes are updated in system/ books
- Borrower is not in default with the lending institution as per the revised terms.

Restructuring of loans-other than MSME

Asset Classification & Provisioning

- Additional Finance will be standard till implementation of resolution plan. If not implemented within 180 days then classification based on extant guidelines for additional finance or based on original facility whichever is worse.
- In case where Resolution plan is implemented
  - For lending institutions which signed ICA within 30 days : higher of the provisions held as per the extant IRAC norms immediately before implementation, or 10 percent of the total debt, including the debt securities issued in terms of clause 30, held by the ICA signatories post-implementation of the plan (residual debt).
- Lending institutions which did not sign the ICA within 30 days of invocation shall, immediately upon the expiry of 30 days, keep provisions of 20 per cent of the debt on their books as on this date (carrying debt), or the provisions required as per extant IRAC norms, whichever is higher. Even in cases where the invocation lapses on account of the thresholds for ICA signing not being met, in terms of clause 18 of RBI circular, such lending institutions which had earlier agreed for invocation but did not sign the ICA shall also be required to hold 20 percent provisions on their carrying debt.

Audit checks and challenges

- Understanding and interpreting the circulars in totality and prepare the audit checks
- Existence of Board approved policy
- Accounting policies need to be reviewed and revised in the line of the guidelines
- The directions given by the circulars should be studied and ensured for implemented.
- The branch auditors have to be informed about the exact strategy adopted for this
- The details of the account having the benefit under prudential framework for stressed assets should be take and the accounts have to be analyzed as the additional provision has to be made manually. The system may not be geared up to identify them through software and make additional provision
- Agricultural loans.. Application of regulatory measures
- Working of additional provision, its adjustment for future slippages
- Disclosure requirement – appropriate disclosure, validity of the data

Audit checks and challenges

- Accounts which are not classified by the Hon Supreme Court decision. Implications on income and additional provision
- Individual credit exposure limit and group credit exposure limits need to be reviewed.
- Restructured assets need to be looked into thoroughly. If need be the additional provision should be made.
- Guidelines given for reporting on Internal Financial Controls on Financial Reporting to be looked into.

Audit Report (RBI Letter to Bank dt March 17, 2020)

- In this regard, the bank is requested to advise the SCAs of the bank to also report on following items in the 'Independent Auditors' Report' submitted by them for FY 2019-20 and onwards:
- i) Whether the financial statements comply with the applicable accounting standards.
- ii) The observations or comments on financial transactions or matters which have any adverse effect on the functioning of the bank.
- iii) Whether any director is disqualified from being a director of the bank under sub-section (2) of section 164 of the Companies Act, 2013
- iv) Any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith.
- v) Whether the bank has adequate internal financial controls system in place and the operating effectiveness of such controls.

THANK YOU

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