

Typical reasons for the divergence observed in asset classification (large accounts) by banks vis-à-vis supervisory assessment made by RBI during Supervisory Cycle 2018-19 (FY 2017-18) were the following:

A. Divergence in Classification of Standard Accounts

1. **In instances of failure of multiple restructurings, the banks had failed to back date the NPA:** Despite approval of multiple restructuring schemes, some accounts were not successful in turning around and were eventually classified as NPAs. In such cases, the date of approval of the latest scheme was considered for downgrading the account, ignoring the unsuccessful restructuring packages approved under previous schemes.

As per para 17.2.4 of MC on IRAC 2015, *"In case, however, satisfactory performance after the specified period is not evidenced, the asset classification of the restructured account would be governed as per the applicable prudential norms with reference to the pre-restructuring payment schedule."*

In the instant cases of introduction of multiple restructuring schemes, as none of the restructuring schemes were implemented successfully, specified period is deemed not to have started. Effectively, the accounts had not performed satisfactorily during the specified period in respect of the various schemes approved in the account. Hence, the repayment schedule prevailing prior to the date of the first restructuring needs to be considered for classification of the account.

To illustrate, in one account S4A was approved despite unsuccessful implementation of SDR. S4A implementation too was unsuccessful. Hence, the account should have been downgraded from the date of SDR and not from the date of approval of S4A.

2. **In some cases, upgradation was observed even in absence of satisfactory performance during the specified period.**

As per para 17.2.3 of IRAC 2015 *"Standard accounts classified as NPA and NPA accounts retained in the same category on restructuring by the bank should be upgraded only when all the outstanding loan / facilities in the account perform*



satisfactorily during the 'specified period', i.e. principal and interest on all facilities in the account are serviced as per terms of payment during that period.

Further as per para 17.2.4 of IRAC 2015, "In case, however, satisfactory performance after the specified period is not evidenced, the asset classification of the restructured account would be governed as per the applicable prudential norms with reference to the pre-restructuring payment schedule"

As per para (vii) of Annex v to IRAC 2015 "Specified Period means a period of one year from the commencement of the first payment of interest or principal, whichever is later, on the credit facility with longest period of moratorium under the terms of restructuring package"

It was observed that in some instances, the banks had either upgraded the account without considering satisfactory performance during the specified period or the specified period was incorrectly reckoned or interpreted for upgradation of the account.

3. **Accounts were not downgraded when conditions for eligibility of restructuring benefit** such as conversion of debt into equity within stipulated time frame under SDR, conversion of unsustainable portion into equity/ redeemable cumulative optionally convertible preference shares within stipulated time under S4A scheme, completion of security documentation under CDR, infusion of promoter equity etc **were not met.**
4. **Accounts were upgraded despite partial recovery of overdues:** As per para 4.2.5 of IRAC 2015 *"If arrears of interest and principal are paid by the borrower in the case of loan accounts classified as NPAs, the account should no longer be treated as non-performing and may be classified as 'standard' accounts."* In some instances, banks had upgraded the account despite partial recovery (of principal or interest) contrary to extant instructions.
5. **The latest position of Drawing Power (DP) as intimated by the lead bank was not updated in the system, resulting in non-recognition of the down gradation:** In case of consortium lending for working capital, monthly stock statements were generally submitted by the borrower to the lead bank. The lead bank, based on the stock statements, computed the share of the DP for member

banks in the consortium. The assigned DP limit was to be used by individual banks for calculation of Days Past Dues (DPD)/overdrawal status of the account/ NPA identification by system. However, in some instances it was observed that the latest DP limit assigned by the lead bank was not updated in the system leading to erroneous classification.

6. **In few Instances evergreening of accounts by sanction of additional loans were observed:** In some instances, it was observed that, evergreening was resorted to by way of sanction of additional facilities (which were not assessed earlier or not approved earlier) to avoid classification of the account as NPA based on record of recovery. In some cases, this was done through sanction of additional loans/facilities to group entities and the amount was round tripped through other banks or through internal/office accounts of the bank though there was no economic rationale for the transfer of funds among the group entities which was utilised for repayment of instalment/interest dues.

B. Divergence in classification of NPAs

Latest valuation of security was not obtained or erosion in the value of security was not recognised:

As per para 5.3.ii of IRAC 2015 "With a view to bringing down divergence arising out of difference in assessment of the value of security, in cases of NPAs with balance of Rs.5 crore and above stock audit at annual intervals by external agencies appointed as per the guidelines approved by the Board would be mandatory in order to enhance the reliability on stock valuation. Collaterals such as immovable properties charged in favour of the bank should be got valued once in three years by valuers appointed as per the guidelines approved by the Board of Directors"

Further, as per para 4.2.9.i.a and b of IRAC 2015

- a. *"Erosion in the value of security can be reckoned as significant when the realisable value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be. Such NPAs may be straightaway classified under doubtful category."* and



b. *"If the realisable value of the security, as assessed by the bank / approved valuers / RBI is less than 10 per cent of the outstanding in the borrowal accounts, the existence of security should be ignored, and the asset should be straightaway classified as loss asset".*

It was observed that in some instances, banks had either not undertaken valuation/stock audit as per the periodicity prescribed by the MC on IRAC norms or had not considered the latest available valuation report/stock audit report for calculating the realisable value of security/stock and calculating erosion in security value/ consequent provisioning.

C. Divergence in Investment and Provisioning

In some cases, shortfall in provisioning was observed as the valuation of investment exposure was not in line with extant guidelines:

"In respect of an account that is classified as a non-performing asset as on the reference date, the Part B instruments shall continue to be classified as non-performing investment and provided for as a non-performing asset as per extant prudential norms, as long as such instruments remain in Part B. The sustainable portion (Part A) may optionally be treated as 'Standard' upon implementation of the resolution plan by all banks, subject to provisions made upfront by the lenders being at least the higher of 50 percent of the amount held in part B or 25 percent of the aggregate outstanding (sum of Part A and part B). For this purpose, the provisions already held in the account can be reckoned."

As per para (iv) of the circular DBR.No.BP.BC.33/21.04.132/2016-17 dated November 10, 2016 *"In all cases, lenders may upgrade Part B to standard category and reverse the associated enhanced provisions after one year of satisfactory performance of Part A loans. In case of any pre-existing moratorium in the account, this upgrade will be permitted one year after completion of the longest such moratorium, subject to satisfactory performance of Part A debt during this period. However, in all cases, the required MTM provisions on Part B instruments must be maintained at all times"*

It was observed that in few cases, banks were not holding the provision as per above extant instructions.

