Webinar for Bank Branch Statutory Auditors

IRAC Norms – NPA Case Studies

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Coverage

- Objective
- Overview of IRAC Norms
- Relief to MSME borrowers
- Covid 19 Regulatory Package (RBI Circular dated 27.Mar.2020)
- Prudential Framework for Resolution of Stressed Assets (RBI Circular dated 07.Jun.2019)
- NPA Case Studies

RBI Circulars Reference

- Master Circular dated July 01, 2015 on IRAC Norms
- Master Direction – RBI (Relief Measures by Banks in Areas affected by natural calamities) Directions, 2018 dated October 17, 2018
- Prudential Framework for Resolution of Stressed Asset –Circular dated June 07, 2019
- Relief for MSME Borrowers : 07.Feb.2018, 08.Jun.2018, 01.Jan.2019 & 11.Feb.2020
- Covid-19 – Regulatory Package
- Early Warning Signals Circular

Overview of IRAC Norms

- **Term Loans** (Interest and/or installment remains overdue for a period of more than 90 days in respect of a term loan, except for para 2.1.3)
- **Agricultural Loans** (Interest or installment remains overdue for two crop seasons for short duration crop, one crop season for long duration crop)
- **Cash Credit Accounts** (‘out of order’)
- **Definition of Overdue** (If an amount due to bank under any credit facility is not paid on the due date fixed by the bank) {Example of installment due on 1st of January}
- **Accounts with temporary deficiency** (Non-renewal / non-regularisation of ToDs, non-submission of stock statements)

Overview of IRAC Norms

- **Term Loans** (Interest and/or installment remains overdue for a period of more than 90 days in respect of a term loan, except for para 2.1.3)
- **Exceptions / Clarifications** (Advance against FDR/KVP/LIP/NSCs, Central Government guaranteed accounts)
- **Qua borrower classification**
- **Straight away classification norms** (Erosion in Value, Realisable Value vis-à-vis ledger balance of Secured Loans, Fraud Cases, wherein 100% provision is required)
- Solitary or few credit entries recorded before Balance Sheet to regularise the account and accounts having inherent weakness

Overview of IRAC Norms

- Mandatory Valuation of Securities
- Projects under implementation (Relevance of DCCO and extension of DCCO)
- Income Recognition and Provisioning
- Restructuring of Advances (Definition, provision requirement, calculation of sacrifice, satisfactory performance)

{Annex 5 : A restructured account is one where the bank, for economic or legal reasons relating to the borrower's financial difficulty, grants to the borrower concessions that the bank would not otherwise consider.}

- Prudential Framework for Resolution of Stressed Assets (RBI Circular dated 07.Jun.2019)

Overview of IRAC Norms

- Concept of auto-marking of NPAs on continuous (daily) basis

- Para 4.2.2 : Banks should establish appropriate internal systems (including technology enabled processes) for proper and timely identification of NPAs, especially in respect of high value accounts.
- Para 4.2.5 : 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

Relief for MSME Borrowers

Circular dated February 11, 2020
MSME Sector restructuring of advances (in continuation of 01.Jan.19 circular)
One time relaxation given for restructuring of MSME standard accounts without downgrade subject to conditions

Relief for MSME Borrowers

Circular dated February 11, 2020
MSME Sector restructuring of advances (in continuation of 01.Jan.19 circular)
1. Aggregate exposures (FB/NFB) of banks and NBFCs should not exceed Rs. 25 crores as on 01.Jan.19
Exposure need not be balance outstanding

Relief for MSME Borrowers

Circular dated February 11, 2020
MSME Sector restructuring of advances (in continuation of 01.Jan.19 circular)
2. Borrower account should be ‘Standard Asset’ as on 01.Jan.20 and till date of implementation of restructuring
• *An account not marked as NPA but fulfilling NPA criteria to become ineligible* • *An account which is NPA as on 01.Jan.20 but upgraded subsequently ineligible*

Relief for MSME Borrowers

Circular dated February 11, 2020
MSME Sector restructuring of advances (in continuation of 01.Jan.19 circular)
3. Borrower entity should be registered on the date of implementation of restructuring (except for MSMEs exempt from GST Registration)
A borrower entity can opt for GST registration during the phase of implementation

Relief for MSME Borrowers

Circular dated February 11, 2020
MSME Sector restructuring of advances (in continuation of 01.Jan.19 circular)
4. Restructuring of borrower accounts to be implemented on or before December 31, 2020 subject to fulfilment of specified conditions
No apparent eligibility criteria defined for which accounts can be restructured besides no criteria defined as regards no. of years criteria for restructuring / reschedulement

Relief for MSME Borrowers

Circular dated February 11, 2020
MSME Sector restructuring of advances (in continuation of 01.Jan.19 circular)
5. Account restructured earlier under 01.Jan.19 is ineligible.
5. Additional provision of 5% to be made and retained till end of specified period or account demonstrating satisfactory performance *(no payment should be overdue for more than 30 days during the period of one year from the date when first interest / installment is due)*
6. Post restructuring usual NPA norms to apply

Relief for MSME Borrowers

Circular dated February 11, 2020
MSME Sector restructuring of advances (in continuation of 01.Jan.19 circular)
7. Disclosure in Notes on accounts required for MSME restructured accounts specifying no. of accounts and Amount
8. If restructured accounts is downgraded as NPA as per IRAC norms, the same would be eligible for upgradation only if it demonstrates satisfactory performance during the specified period

COVID-19 – Regulatory Package

Circular dated March 27, 2020
Purpose To mitigate the burden of debt servicing brought about by disruptions on account of COVID-19 pandemic and to ensure the continuity of viable businesses.
Relief: i) Rescheduling of Payments – Term Loans and Working Capital Facilities ii) Easing of working capital financing iii) Relaxation from Classification as Special Mention Account (SMA) and Non-Performing Asset (NPA)

COVID-19 – Regulatory Package

Rescheduling of Payments – Term Loans and Working Capital Facilities

Term Loan (Includes EMIs, Interest / Principal, Bullet Payment, Credit Card dues)

Relief:

i) permitted to grant a moratorium period of three months on payment of all instalments to all types of term loans which are falling due between March 01, 2020 and May 31, 2020

ii) accordingly the residual tenor of the account would be extended to the extent of such moratorium period granted

COVID-19 – Regulatory Package

Rescheduling of Payments – Term Loans and Working Capital Facilities

Working Capital Facilities (Not to include LCBD)

Relief:

i) permitted to defer the recovery of interest applied on working capital finance facilities during the period March 01, 2020 upto May 31, 2020, which would thus be considered as ‘accrued but not due’

Application of ‘out of order’ status to get impacted

COVID-19 – Regulatory Package

Easing of Working Capital Financing
Relaxation in margins, etc.
Relief: i) The circular grants discretion to the lending institutions regarding reduction in margin and reassessment of working capital cycle, during the period upto May 31, 2020. ii) The said relief will have limited impact to the extent of change in method of calculation of drawing power to the extent of reduction in margin and relaxation in consideration of working capital cycle

COVID-19 – Regulatory Package

Classification as Special Mention Account (SMA) and Non-Performing Asset (NPA)
The relief granted by banks to the borrower as specified and permitted under the said circular, will not be considered as concession or change in terms and conditions of loan agreements. Thus, no downgrading is required.
Anything beyond the relief specified in the circular will result in restructuring and thus would be required to be downgraded There is no relaxation on NPA norms specified in the circualr

COVID-19 – Regulatory Package

Questions unanswered
Whether the circular is applicable only to borrowers which are affected by COVID 19?
Whether the circular will be applicable to all borrowers or only to borrowers who opt for availing this benefit? If it is selectively applied, whether the same requires any documentation to ensure legal compliance?

COVID-19 – Regulatory Package

Questions unanswered
Due to extension of repayment schedule, the EMI will undergo a change due to interest charged for the moratorium period of 3 months which will practically affect ECS, SIs besides requirements to update documentation
No specifications given as regards relaxation of working capital drawing power calculation e.g.: book debts to be considered upto 120 days / 180 days / 365 days, etc.?

COVID-19 – Regulatory Package

Communication of RBI to IBA dated March 31, 2020

In this context, we advise that the intention of the reliefs provided under the circular dated March 27, 2020 is to mitigate the burden of debt servicing brought about by disruptions on account of Covid-19 on borrowers who otherwise have been servicing their accounts regularly, but would have defaulted on account of the temporary stress due to Covid-19.

If a borrower has been in default even before March 01, 2020, such a default cannot be said to be as a result of the economic fallout of the pandemic. The benefit of moratorium can be extended to such borrowers in respect of payments falling due during the period March 01 to May 31, 2020. However, the payments overdue on or before February 29, 2020 will attract current IRAC norms.

NPA Case Studies

Case Study # 01
In case of Term Loan account, a borrower has prepaid 12 months' EMIs in the month of April and subsequently has not paid any amount to the credit of TL, would that account be required to be classified as NPA due to non-servicing of interest?
In case of Term Loan, an account is classified as NPA only if the interest / instalment remains overdue for a period of more than 90 days. In the instant case, since there is a prepayment of EMIs, there is no amount overdue and hence the account would be classified as PA. It would be pertinent to note that the concept of servicing of interest does not apply to Term Loan accounts

NPA Case Studies

Case Study # 02
In case of CC/OD facility, an account is operated within the limit but there are no credits in the said account since 1st January, would such account be required to be classified as NPA even though its not overdrawn for a single day?
Yes the account would be required to be classified as NPA as the account is ‘out of order’ since there are no credits in the said account for 90 days as on balance sheet date. As there are no credits for period from 1st January to 31st March, the criteria of no credits in the account for 90 days is fulfilled.

NPA Case Studies

Case Study # 03
In case of CC/OD facility, an account is operated within the limit but the summation credits in the account in the last quarter of Jan-Mar'20 are less than the interest debited during the said quarter. What would be the classification of such account especially in the background of Covid-19 circular?
Yes the account would be required to be classified as NPA as the account is 'out of order' since the account does not have credits sufficient to cover the interest debited during the same period. The interest for Jan'20 and Feb'20 to be considered for comparison with credits for Mar'20 quarter.

NPA Case Studies

Case Study # 04
In case of CC/OD facility, an account has credit balance for a period of first 10 days during the last quarter but does not have any credits during the said quarter, would the account be classified as NPA if the account is in debit as at March-end?
Yes the account would still be required to be classified as NPA as the account is ‘out of order’ since there are no credits in the said account for 90 days as on balance sheet date. As there are no credits for period from 1st January to 31st March, the criteria of no credits in the account for 90 days is fulfilled.

NPA Case Studies

Case Study # 05
In case of a CC facility, if the last stock statement submitted is of Oct’19, would the said account be classified as NPA, due to non-submission of stock statement as at Mar’20?
As per para 4.2.4 of Master Circular, the classification of advances should be based on record of recovery and any deficiencies which are temporary in nature like non-submission of stock statement need not construed to classify the account as NPA. Never the less, considering the difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than three months. The outstanding in the account based on drawing power calculated from stock statements older than three months, would be deemed as irregular.

NPA Case Studies

Case Study # 06
In case of a CC facility is short reviewed twice for a period of 90 days each, i.e., firstly from Jul'19 to Sep'19 and the from Oct'19 to Dec'19. Would the said account be classified as PA or NPA as at Mar'20-end, if the same is not renewed till that time?
Yes, the account would be required to be classified as NPA since the same is not regularly renewed within 180 days from the original due date for renewal.

NPA Case Studies

Case Study # 07
In case of a SSA account wherein one of the underlying security is in the form of FDR to the extent of 50% of the ledger balance, what would be the BDDR requirement?
As the account is a secured SSA loan, the provision for BDDR would be required be made @ 15% on the balance outstanding on the entire ledger balance.

NPA Case Studies

Case Study # 08
A Term Loan account has 4 EMIs overdues as on Nov’19 and subsequently there is a partial recovery in the account, however, two instalments have always remained overdue for rest of the period till Mar’20. Would this account be required to be classified as NPA as at Mar’20-end?
As the account was having 4 EMIs overdue as at Nov’19, the account was required to be classified as NPA in Nov’19 itself. Further, as there is a partial recovery in the account, the said account cannot be upgraded and thus, would be required to be classified as NPA with date of NPA as Nov’19 and will continue to be a NPA as at Mar’20.

NPA Case Studies

Case Study # 09
A Term Loan account has 4 EMIs overdues as on 31.Mar.2020 and subsequently, the entire overdues are recovered on 08.Apr.2020, i.e., before signing of the balance sheet by the statutory auditors. Would this account be required to be classified as NPA as at Mar'20-end?
As the account was having 4 EMIs overdue as at 31.Mar.2020, the account is required to be classified as NPA as at 31.Mar.2020. Subsequent recoveries in the said account would not make the account upgraded in the month of Apr'20 and would not have any impact on the asset classification for FY: 2019-20. The subsequent recoveries made in an account cannot be construed to be events occurring after the date of balance sheet.

NPA Case Studies

Case Study # 10
A Term Loan account has 4 EMIs overdues as on 31.Mar.2020 and subsequently, the account is closed on 08.Apr.2020, i.e., before signing of the balance sheet by the statutory auditors. Would this account be required to be classified as NPA as at Mar’20-end?
As the account was having 4 EMIs overdue as at 31.Mar.2020, the account is required to be classified as NPA as at 31.Mar.2020. Subsequent recoveries in the said account would make the account upgraded in the month of Apr’20 and would not have any impact on the asset classification for FY: 2019-20. The subsequent recoveries made in an account cannot be construed to be events occurring after the date of balance sheet.

NPA Case Studies

Case Study # 11
A Term Loan account had 4 EMIs overdues as on 31.Dec.2019 and was accordingly marked as NPA. Subsequently, the entire overdues were recovered on 28.Feb.2020, and there are no overdues in the account as on the said date. Would this account be eligible for upgrade to PA or should it remain under NPA category for a further period of one year?
The said account should be upgrade to Standard Asset as the anomaly related with the overdue portion of Term Loan has been nullified by way of complete recovery of overdue amount and thus, there is no requirement to wait for a period of one year for upgradation but the account would be upgraded with immediate effect in Feb'20 itself.

NPA Case Studies

Case Study # 12
A GST registered MSME account was classified as NPA and the same has repaid the overdue portion in entirety in Feb’20 and accordingly was classified as PA. Can the said account be restructured in Mar’19 without downgrading as per RBI circular dated 11.Feb.2020?
Though the said account can be restructured, the same would be required to be downgraded to SSA as the benefit of retention of class of asset as SA is available only if the account was standard as on 01.Jan.2020.

NPA Case Studies

Case Study # 13
In case of a CC facility, the bank has not charged penal interest and processing fees, applicable as per the terms of sanction. If the said penal interest is charged on the respective dates, the account would be continuously overdrawn for a period of more than 90 days considering value-dating effect of such penal interest. Would such account be classified as NPA with value dating effects of such revenue leakages?
Though, technically the value dating of such revenue leakages should be considered for the purpose of review of the account and consideration of the 'continuously overdrawn' status, classification of an account should be on the basis of 'record of recovery', unless the revenue leakage or postponement of charges being debited to the account appears to be an intentional one

NPA Case Studies

Case Study # 14
In case of working capital finance facilities if the trade creditors are more than book debts and stock, (but are below the level of trade creditors as specified in CMA data) would there be drawing power available for the said borrower?
Though the banks are having varied practices of calculation of drawing power, it would be pertinent to note that the auditor needs to review the terms of the sanction of working capital finance wherein the drawing power calculation method would be prescribed. However, prima facie, if there is a negative working capital, question of availability of drawing power would not arise

NPA Case Studies

Case Study # 15
A borrower had availed OD against property to the tune of Rs. 5 crores against primary security of immovable property of Rs. 20 crores. Subsequently, the said property was subjected to valuation and the present value of the said property is Rs. 8 crores. Would this account be required to be classified as DA even though the outstanding balance is Rs. 2 crores.
Yes, the said account would be required to be classified as DA though the said account is within limit, as the realisable value of the security has eroded beyond 50% of the value assessed earlier as per ‘Straightway Classification norms’ specified in para 4.2.9

NPA Case Studies

Case Study # 16
Post-Covid-19 circular, the bank has granted relaxation for payment of Mar'20 installment to borrower and has deferred it by 3 monhts. However, the borrower is having EMI of TL which was due on 1st January and 1st February, 2020 unpaid as at March 31, 2020. What would be the classification of the TL?
The Covid-19 circular, provides relaxation to a limited extent in terms of deferment of installments falling due between 1st March to 31st May. The circular per se does not grant any concession to installments which were due earlier and also does not grant any relief regarding IRAC norms. Thus, the account will be classified as NPA as at March 31, 2020 as EMI due on 1st January is overdue for more than 90 days as at March 31, 2020.

NPA Case Studies

Case Study # 17
ABC Enterprises is a Partnership firm with A, B and C as its partners. The TL account of ABC Enterprises is marked as NPA by the bank but bank does not mark the housing loans availed by partner A as the same is regular in terms of repayment and is not overdue beyond 90 days. Does the bank is required to also mark the housing loan account of the partner A as NPA? Will situation change if the property given as security for housing loan is taken as collateral for loan extended to partnership firm.
As ABC Enterprises and Partner A in his individual capacity are two different persons, the borrower-wise classification norms will not apply and thus, bank is correct in classification of advances. There would not be any change in asset classification though security for both exposures is same.

NPA Case Studies

Case Study # 18
A large variance in case of DP of CC account observed in DP calculation as per March stock statement and as per audited Financials, what auditor should do in this scenario?
The auditor needs to seek clarification regarding large variance and based on clarification received and overall conduct of account, should take a call as regards the classification of such CC account.

NPA Case Studies

Case Study # 19
A bank is having a housing loan product which is in the form of drop-line OD, whereby the drawing power of the said loan product is reduced over the tenor of the housing loan. The borrower is given a cheque book facility under the product and the product otherwise operates like OD product. The bank wishes to apply the norms of TL for classification of advance whereas the auditor is of the opinion that norms related to OD should be applied. Which view is correct?
The auditor is absolutely right in adopting the NPA norms related to OD, i.e., ‘out of order’ norms as the product is an Overdraft product with cheque book facility issued.

Points to Ponder

Divergences in NPA observed by RBI AFI
Verification Parameters in CBS vis-à-vis RBI Circular
Purity of Master Data in CBS
Reversal of un-serviced Interest of NPA
Availability of valuation of security for advances below 5 crores
Authenticity and regularity of stock statements
Date of NPA – current and prior year of newly identified NPAs
Unique Customer-id of borrower accounts
Accounts upgraded during the year
Regularisation of account subsequent to balance sheet date

Points to Ponder

Accounts other than Advances accounts including Sundries / Suspense Accounts
Accounts transferred to other branches – control over identification / classification of accounts
Income leakages identified and resulting in overdrawing of accounts
Recalculation of Drawing Power
Early Mortality Cases
Ever-greening of accounts
MOCs vis-à-vis Main Audit Report vis-à-vis LFAR

Thank you!

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