

IMPORTANT GUIDELINES ON MANAGEMENT OF ADVANCES – UCBs*

1. WORKING CAPITAL ASSESSMENT

- Primary (Urban) Cooperative Banks (UCBs) are expected to put in place with the approval of their Boards, transparent policies and guidelines for credit dispensation in respect of each broad category of economic activity keeping in view of the credit exposure norms and various other guidelines issued by RBI from time to time.
- The working capital (WC) fund based requirement of borrowers, other than SSI units, upto Rs. 1.00 crore and SSI units upto Rs. 5.00 crore from the banking system can be made on the basis of projected turnover. The WC is computed at 25% of the projected gross annual turnover (incl. excise duty) of which at least 4/5th (i.e. 20%) can be made by bank as WC finance and the balance 1/5th (i.e. 5%) is to be contributed by the borrower as Net Working Capital (margin) towards WC.
- Banks may compute the WC requirement on turnover basis or traditional method and if the assessment based on the latter method is higher than the former, the same can be made available as borrower must be financed upto to the minimum 20% of the projected annual turnover.
- Actual drawals may be allowed on the basis of drawing power to be determined by UCBs after excluding unpaid stocks. The WC assessment for both the categories of borrowers can be made either on the turnover method or cash budgeting method or any other method as considered necessary. UCBs to ensure that the book debts finance does not exceed 75% of the limits sanctioned for inland credit sales and remaining 25% may be through bills financing.

1.1 Loan System for Delivery of Bank Credit

- Under the system, the borrowers enjoying working capital credit limits of Rs.10 crore and above from the banking system, the loan component should normally be 80% and the remaining Cash Credit component with flexibility to vary the loan component by UCBs. Pricing may also be fixed factoring the impact on their cash and liquidity management.
- UCBs may persuade the borrowers with working capital (fund based) credit limit of less than Rs.10 crore, to go in for the Loan System by offering an incentive in the form of lower rate of interest on the 'loan component' as compared to the 'cash credit component'

- The release of ad hoc / additional credit for meeting temporary requirements may be considered by the financing bank only after the borrower has fully utilised / exhausted the existing limit.
- The minimum period of the loan for working capital purposes may be fixed by banks in consultation with borrowers. Banks may split the loan component according to the need of the borrower with different maturity bases for each segment and allow roll over.
- The export credit limit may be netted for working out the bifurcation of WC limit into loan and cash credit components. Bills limit and cheque purchase of third party (outstation) is to be fully carved out of loan component.

1.2 Credit Administration

a) Rate of Interest

- A transparent rate of interest structure for all categories of borrowers may be fixed, taking into account their cost of funds, transaction costs etc with the approval of their Board. Banks are also required to publish the minimum and maximum interest rates charged on advances and display the information in every branch. Suitable principles and procedures may also be put in place in respect of small value loans particularly personal loans, and such other loans of similar nature and the same should be justifiable.
- No penal interest would be charged for loans up to Rs.25,000/- in respect of priority sector advances. Banks are required to ensure that the total interest debited to an account should not exceed the principal amount in respect of short term advances granted to small and marginal farmers with land holding of 5 acres and less. Appropriate ceiling may also be fixed for interest including processing and other charges.
- UCBs are not supposed to finance a borrower already availing credit facility from another bank without obtaining a 'No Objection Certificate' from the existing financing bank.

b) Obtaining of Financial statements

- Banks may insist for audited financial statements from borrowers enjoying large credit limits.
- Banks are supposed to ensure that borrowers pay the statutory dues viz. Provident Fund and other similar dues promptly and in case of any default, banks may stipulate suitable restrictions on the outflow of funds. In case audited accounts do

not indicate the position clearly, a certificate may be obtained from the Chartered Accountant for this purpose.

c) Sanction of Advances

- Banks are required to take suitable precautions to avoid irregular practices such as sanctioning advances beyond discretionary powers and/or without proper appraisal in order to minimize chances of fraud.
- Higher authorities at various levels should desist from the unhealthy practice of conveying sanction of advances orally or on telephone. Such instructions in exigencies, may be suitably recorded and confirmation be obtained by the disbursing authority/official within a week/fortnight.
- Sanctions within discretionary powers should also be reported to Head Office within a stipulated time and Head Office should meticulously follow up receipt of such returns.

d) Monitoring Operations in Loan Accounts

- Banks should ensure proper end use of funds drawn by way of cash credit and overdraft facilities for the purpose for which the limits are sanctioned.
- Effective post sanction follow up of loans and advances should be put in place to ensure that the security obtained from borrowers against the limits sanctioned are not tampered with in any manner and are adequate.
- Stringent safeguards are to be taken when any sign of sickness/turning into NPA, etc. is observed in any accounts. Monitoring system should be strengthened by resorting to frequent inspections of borrower's godowns so as to ensure that the sale proceeds are routed through the accounts.
- UCBs are required to take appropriate steps to review and tighten their internal administration and control measures so as to eliminate the scope for misuse / diversion of funds and malpractices.
- Periodical review of accounts on regular basis should be put in place for effective monitoring of the advance, etc.
- UCBs are required to put in place a system / procedure for realistic valuation of fixed assets and also for empanelment of valuers in view of the implication for correct measurement of capital adequacy position of the banks.
- Wherever diversion of funds/siphoning of funds is observed, they should take appropriate action including recalling the loans, reduction of sanctioned limits, charging penal interest etc. to protect the bank's interest.

- In case of project financing, CA certificate may be obtained to ensure the proper end use of funds. For short term corporate/clean loans proper due diligence be carried out and such loans be granted only to those borrowers whose integrity and reliability were above board.
 - Banks should build up database for effective exchange of credit information and exchange the information under Consortium Arrangement/Multiple Banking Arrangement
 - UCBs are required to submit to RBI as at the end of September and March every year, the details of the borrowal accounts which have been classified as doubtful, loss or suit filed with outstanding (both funded and non-funded limits) aggregating Rs.1 crore and above
 - UCBs are required to report on a quarterly basis, all cases of wilful defaults. All NPA accounts with outstanding (funded facilities and such non-funded facilities which are converted into funded facilities) aggregating to Rs.25.00 lakh and above are to be reported.
- e) Penal provision on wilful defaulters
- Any wilful defaulter with an outstanding balance of Rs. 25 Lakh or more would attract the penal measures which include:-
- i) To prevent access to the capital markets by the wilful defaulters, a copy of the list of wilful default is forwarded to SEBI by RBI.
 - ii) No additional facilities are to be granted to wilful defaulters. They should be debarred from institutional finance for floating new ventures for a period of 5 years from the date the name of the wilful defaulter is published in the list of wilful defaulters by the RBI.
 - iii) The legal process, where warranted, against the borrowers / guarantors and foreclosure of loans should be initiated expeditiously. The lenders may also initiate criminal proceedings against wilful defaulters, wherever necessary.
 - iv) Banks may consider change in Management of the willfully defaulting borrower unit. Banks may put in place a transparent mechanism for the entire process so that the penal provisions are not misused.
 - v) In case of dishonor of LoC/Guarantee given by any company in the group on behalf of the willfully defaulting units, such group companies are also to be reckoned as wilful defaulters.
 - vi) In case any falsification of accounts on the part of the borrowers is observed by banks, they should lodge a formal complaint against the

auditors of the borrowers with ICAI if it is observed that the auditors were negligent or deficient in conducting the audit to enable the ICAI to examine and fix accountability of the auditors.

- vii) UCBs are required to examine all cases of wilful defaults of Rs.1.00 crore and above and file suits either civil or criminal against those borrowers. In other cases involving amounts below Rs.1.00 crore, banks should take appropriate action, including legal action, against the defaulting borrowers.

2. **Prudential Guidelines on Restructuring of Advances**

- A restructured account is one where the bank grants concessions, which would not otherwise consider, taking into account the borrower's financial difficulty. Restructuring involves modification of terms of advance/securities, which would generally include, among others, alteration of repayment period / repayable amount/ the amount of instalments / rate of interest, etc.
- Specified Period means a period of one year from the date when the first payment of interest or instalment of principal falls due under the terms of restructuring package.

Eligibility

- Accounts classified under 'Standard', 'Substandard' and 'doubtful' categories.
- Banks cannot reschedule / restructure / renegotiate borrowal accounts with retrospective effect. While a restructuring proposal is under consideration, the usual asset classification norms would continue to apply.
- No account is taken up for restructuring by the banks unless the financial viability is established and there is a reasonable certainty of repayment from the borrower, as per the terms of restructuring package.
- Borrowers indulged in frauds and malfeasance is ineligible for restructuring.
- BIFR cases are not eligible for restructuring without their express approval. The lead bank in the case of SME Debt Restructuring Mechanism and the individual banks in other cases, may consider the proposals for restructuring in such cases, after ensuring that all the formalities in seeking the approval from BIFR are completed before implementing the package.

Asset classification norms

Restructuring of advances could take place in the following stages:

- (a) Before commencement of commercial production / operation;
- (b) After commencement of commercial production / operation but before the asset has been classified as 'sub-standard';

- (c) After commencement of commercial production / operation and the asset has been classified as 'sub-standard' or 'doubtful'.

Upon restructuring:-

- 'Standard assets' should be reclassified as 'sub-standard assets'
- NPAs would continue asset classification as prior to restructuring and may slip into further lower asset classification categories with reference to the pre-restructuring repayment schedule.
- All NPA accounts would be eligible for being reclassified as 'standard' category after observation of satisfactory performance during the 'specified' period. Thereafter, the account would be governed as per the existing prudential norms with reference to repayment schedule.
- Additional finance considered may be treated as 'standard asset' during the 'specified period.' Any Interest income should be recognized only on cash basis in respect of accounts classified as 'substandard' or 'doubtful' at pre-restructuring stage.
- A restructured standard asset is subjected to restructuring on a subsequent occasion; it should be classified as substandard. Similarly, a sub-standard or a doubtful restructured asset which is subjected to restructuring on a subsequent occasion, its asset classification will be reckoned from the date when it became NPA on the first occasion.
- Interest income in respect of restructured standard asset can be recognized on accrual basis
- In case part of the outstanding principal amount is converted into debt or equity instruments as per the restructuring package, the asset so created will be classified in the same asset classification category in which the restructured advance has been classified.
- The FITL / debt or equity instrument created by conversion of unpaid interest will be classified in the same asset classification category in which the restructured advance has been classified.

Banks will hold provision in respect of restructured assets as per existing provisioning norms.

Asset classification benefits are available to banks subject to:-

- The dues of the banks are fully secured except SSI borrowers where the outstanding is upto Rs.25 Lakh
- Infrastructure projects provided the cash flows generated from these projects are adequate for repayment of the advance, escrow mechanism for the cash flows available, and banks have a clear and legal first claim on these cash flows.
- The unit becomes viable in 10 years, if it is engaged in infrastructure activities, and in 7 years in the case of other units.
- The repayment period of the restructured advance including the moratorium, if any, does not exceed 15 years in the case of infrastructure advances and 10 years in the case of other advances other than restructured home loans.

- Promoters' sacrifice (contribution) and additional funds brought by them should be a minimum of 15% of banks' sacrifice upfront. However, if the banks are convinced that the promoters face genuine difficulty in bringing the share of sacrifice immediately, the promoters could be allowed to bring in 50% of their sacrifice i.e. 50% of 15% upfront and the balance within a period of one year.

Objective

It may be observed that the basic objective of restructuring is to preserve economic value of units and not ever greening of problem accounts. This can be achieved by banks and the borrowers only by careful assessment of the viability, quick detection of weaknesses in accounts and a time-bound implementation of restructuring packages.

3. Micro, Small and Medium Enterprises

Micro, Small & Medium Enterprises Development (MSMED) Act, 2006 enacted in June 2006 classifies units as under:-

Category	Manufacture, processing or preservation of goods	Providing/rendering services **
Micro Enterprises	Investment in Plant & Machinery (original cost excl. land & building) not to exceed Rs. 25 Lakh.	Investments in equipments not to exceed Rs. 10 Lakh
Small Enterprises	Investment in Plant & Machinery (original cost excl. land & building) above Rs. 25 Lakh but not to exceed Rs. 5 crore.	Investments in equipments above Rs. 10 Lakh but does not exceed Rs. 2 crore.
Medium Enterprise	Investment in Plant & Machinery (original cost excl. land & building) above Rs.5 crore but not to exceed Rs.10 crore.	Investments in equipments above Rs 2 crore but not to exceed Rs. 5 crore.

** These include:-

Activity	Investment/borrowing limits
Road & Water Transport Operators (owing fleet of vehicles not exceeding ten vehicles)	Borrowing limits not exceeding Rs. 10
Small Business	Original cost price of equipment not exceeding Rs. 20 Lakh
Professional & Self Employed	Borrowing limits not to exceed Rs. 10 Lakh of which Working capital limit not to exceed Rs. 2 Lakh)

Professionally qualified medical practitioners for setting up of practice in semi urban and rural areas	Borrowing limit not to exceed Rs. 15 Lakh with a sub-ceiling of Rs. 3 Lakh for working capital.
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4. **Specific Lending Activities**

a) **Bridge Loans/Interim Finance**

- No UCBs are permitted to grant any bridge loan/interim finance including in respect of Euro issues to any company (including finance companies).
- In case any bank has sanctioned and disbursed any bridge loan, the matter should be reported to UBD of RBI with full particulars with certification that the loans are utilized strictly for the purpose and the bank is required to ensure timely repayment and no extension of repayment period be considered.

b) **Advances to Real Estate and Commercial Real Estate Sector**

- UCBs are required to frame their comprehensive policy duly approved by their Boards relating to prudential norms, exposure ceiling for single/group, margins, security, repayment schedule, etc. in conformity with RBI guidelines. Similarly, suitable policy should be in place in respect of finance to builders and contractors for commercial real estates.

c) **Financing of Leasing & Hire Purchasing companies/Asset Finance Companies**

- UCBs are normally not expected to enroll non-banking financial institutions like investment and financial companies as their members nor permitted to finance non-banking financial companies (NBFCs), other than those engaged in hire purchase / leasing. NBFCs engaged in hire purchase / leasing are reclassified as Asset Finance Companies (AFCs).
- UCBs with working capital funds of Rs. 25 crore and above and under consortium arrangement with other scheduled commercial banks are only permitted to finance Asset Finance Companies.
- The level of finance linked with Net Owned Funds (NOF) of AFCs subject to the overall ceiling of borrowings upto 10 times of their Net Owned Funds as under:-
 - i) At least 75% of assets are in equipment leasing/hire purchase and 75% of their gross income is derived from these two types of activities as per their last audited balance sheet – Level of Finance within the ceiling of 3 times NOF within the overall ceiling of 10 times of NOF.

- ii) Assets in equipment leasing/hire purchase are less than 75% and gross income derived from these two activities is also less than 75% - Level of Finance within 2 times of NOF within the overall ceiling.

d) Working capital finance to Information Technology and Software Industry

- As this being a new area of credit deployment, UCBs may frame their own policies based on RBI guidelines circulated along with circular DS.SUB.No.4/13.05.00/98-99 dated 5 October 1998, addressed to schedule UCBs.

e) Advances against Pledge of gold & Silver Ornaments

- Detailed guidelines are given in RBI Master Circular by way of Annexure for compliance by UCBs.

f) Loans for Acquisition of /Investing in Small Savings Instruments including Kisan Vikas Patras (KVP)

- UCBs are not permitted to grant loans for acquisition of /investing in small savings instruments including KVPs.

g) Discounting/Rediscounting of Bills

- UCBs are required to put in place suitable policy in consistent with their policy of sanctioning of working capital limits duly approved by their boards for undertaking the business
- UCBs can establish Letter of Credit (LC) and purchase / discount / negotiate bills under LCs only in respect of genuine commercial and trade transactions of their borrower constituents who have been sanctioned regular credit facilities by the banks.
- Banks are not permitted to open LCs and purchase/discount/negotiate bills bearing the 'without recourse' clause.
- Banks are required to avoid purchase/discount/negotiate accommodation bills and they are supposed to be circumspect while discounting bills drawn by front companies set up by large industrial groups on other group companies.
- Bills rediscounts should be restricted to usance bills held by other banks. Banks are not permitted to rediscount bills earlier discounted by NBFCs except in respect of bills arising from sale of light commercial vehicles and two / three wheelers.

- Finance against discounting of services sector bills is treated as unsecured advance and it should be within the limits prescribed by Urban Banks Department for sanction of unsecured advances, etc.

h) Loans to Self Help Groups (SHGs) / Joint Liability Groups (JLGs)

- Lending to SHGs / JLGs would be considered as normal business activity of the bank. UCBs will be required to frame, with the approval of their Board, a comprehensive policy on lending to SHGs / JLGs. The maximum amount of loan to SHGs should not exceed four times of the savings of the group. The limit may be exceeded in case of well managed SHGs subject to a ceiling of ten times of savings of the group.
- UCBs may follow the method of lending directly to SHGs / JLGs. Lending through intermediaries will not be permitted.
- The UCBs are required to adhere to the KYC guidelines in respect of each member of the SHG/ JLG before opening savings bank account / grant of loans.

i) Guidelines on Relief Measures to be extended by banks in areas affected by natural calamities

- Detailed guidelines on relief measures to be extended by UCBs in areas affected by natural calamities activity wise with quantum of finance, margin, repayment, rate of interest, etc. are given in the RBI Master Circular by way of an annexure.

(*SOURCE: RBI MASTER CIRCULAR)