POLICY FOR PRUDENTIAL NORMS ON INCOME RECOGNITION, ASSET CLASSIFICATION AND PROVISIONING PERTAINING TO ADVANCES OF AKARA CAPITAL ADVISORS PRIVATE LIMITED ("AKARA" or "Company")

INTRODUCTION

The Reserve Bank of India has introduced, in a phased manner, prudential norms for income recognition, asset classification and provisioning for the advances portfolio of the NBFC so as to move towards greater consistency and transparency in the published account.

The policy of income recognition should be objective and based on record of recovery rather than on any subjective considerations. Likewise, the classification of assets of has to be done on the basis of objective criteria which would ensure a uniform and consistent application of the norms. Also, the provisioning should be made on the basis of the classification of assets based on the period for which the asset has remained non-performing and the availability of security and the realisable value thereof.

Akara is ensuring that while granting loans and advances, realistic repayment schedules may be fixed on the basis of cash flows with borrowers. This would go a long way to facilitate prompt repayment by the borrowers and thus improve the record of recovery in advances.

INCOME RECOGNITION

Income Recognition Policy

1. The policy of income recognition has to be objective and based on the record of recovery. Therefore, the banks should not charge and take to income account interest on any NPA. This will apply to Government guaranteed accounts also.
2. However, interest on advances against Term Deposits, National Savings Certificates (NSCs), Indira Vikas Patras (IVPs), Kisan Vikas Patras (KVPs) and Life policies may be taken to income account on the due date, provided adequate margin is available in the accounts.
3. Fees and commissions earned by the banks as a result of renegotiations or rescheduling of outstanding debts should be recognised on an accrual basis over the period of time covered by the renegotiated or rescheduled extension of credit.
4. Reversal of income

a) If any advance, including bills purchased and discounted, becomes NPA, the entire interest accrued and credited to income account in the past periods, should be reversed if the same is not realised. This will apply to Government guaranteed accounts also.
b) In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed with respect to past periods, if uncollected.

c) Leased Assets - The finance charge component of finance income [as defined in 'AS 19 Leases')] on the leased asset which has accrued and was credited to income account before the asset became non performing, and remaining unrealised, should be reversed or provided for in the current accounting period.

5. Appropriation of recovery in NPAs
   a) Interest realised on NPAs may be taken to income account provided the credits in the accounts towards interest are not out of fresh/ additional credit facilities sanctioned to the borrower concerned.
   b) In the absence of a clear agreement between the bank and the borrower for the purpose of appropriation of recoveries in NPAs (i.e. towards principal or interest due), banks should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner.
6. Interest Application
   On an account turning NPA, banks should reverse the interest already charged and not collected by debiting Profit and Loss account and stop further application of interest. However, banks may continue to record such accrued interest in a Memorandum account in their books. For the purpose of computing Gross Advances, interest recorded in the Memorandum account should not be taken into account.

7. Computation of NPA levels
   Banks are advised to compute their Gross Advances, Net Advances, Gross NPAs and Net NPAs, as per the format in Annex -1.

ASSET CLASSIFICATION

Categories of NPAs

Banks are required to classify non-performing assets further into the following three categories based on the period for which the asset has remained non performing and the realisability of the dues:

(i) Substandard Assets

(ii) Doubtful Assets

(iii) Loss Assets

<u>Substandard Assets</u>

A substandard asset would be one, which has remained NPA for a period less than or equal to 12 months. Such an asset will have well defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.

<u>Doubtful Assets</u>

An asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, – on the basis of currently known facts, conditions and values – highly questionable and improbable.

Loss Assets

A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

Guidelines for classification of assets

General

Broadly speaking, classification of assets into above categories should be done taking into account the degree of well-defined credit weaknesses.

1. Appropriate internal systems for proper and timely identification of NPAs

Banks should establish appropriate internal systems (including technology enabled processes) for proper and timely identification of NPAs, including putting in the necessary infrastructure to comply with the requirements of the circular DoS.CO.PPG./SEC.03/11.01.005/2020-21 dated September 14, 2020 on Automation of Income Recognition, Asset Classification and Provisioning processes in banks (as updated).

2. Availability of security / net worth of borrower/ guarantor

The availability of security or net worth of borrower/ guarantor should not be taken into account for the purpose of treating an advance as NPA or otherwise, except to the extent provided herein.

3. Accounts with temporary deficiencies

The classification of an asset as NPA should be based on the record of recovery. Bank should not classify an advance account as NPA merely due to the existence of some deficiencies which are temporary in nature such as non-availability of adequate drawing power based on the latest available stock statement, balance outstanding exceeding the limit temporarily, non-submission of stock statements and non-renewal of the limits on the due date, etc. In the matter of classification of accounts with such deficiencies banks may follow the following guidelines:

a) Banks should ensure that drawings in the working capital accounts are covered by the adequacy of current assets, since current assets are first appropriated in times of distress. Drawing power is required to be arrived at based on the stock statement which is current. However, 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.

b) A working capital borrowal account will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days even though the unit may be working or the borrower's financial position is satisfactory.

c) Regular and ad hoc credit limits need to be reviewed/ regularised not later than three months from the due date/date of ad hoc sanction. In case of constraints such as non-availability of financial statements and other data from the borrowers, the branch should furnish evidence to show that renewal/ review of credit limits is already on and would be completed soon. In any case, delay beyond six months is not considered desirable as a general discipline. Hence, an account where the regular/ ad hoc credit limits have not been reviewed/ renewed within 180 days from the due date/ date of ad hoc sanction will be treated as NPA.

4. Upgradation of loan accounts classified as NPAs

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 nonperforming and may be classified as 'standard' accounts. With regard to upgradation of accounts classified as NPA due to restructuring, non-achievement of DCCO, etc., the instructions as specified for such cases shall be applicable.

5. Accounts regularised near about the balance sheet date

The asset classification of borrowal accounts where a solitary or a few credits are recorded before the balance sheet date should be handled with care and without scope for subjectivity. Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as a NPA. In other genuine cases, the banks must furnish satisfactory evidence to the Statutory Auditors/Inspecting Officers about the manner of regularisation of the account to eliminate doubts on their performing status.

6. Asset Classification to be borrower-wise and not facility-wise

a) It is difficult to envisage a situation when only one facility to a borrower/one investment in any of the securities issued by the borrower becomes a problem credit/investment and not others. Therefore, all the facilities granted by a bank to a borrower and investment in all the securities issued by the borrower will have to be treated as NPA/NPI and not the particular facility/investment or part thereof which has become irregular.

b) If the debits arising out of devolvement of letters of credit or invoked guarantees are parked in a separate account, the balance outstanding in that account also should be treated as a part of the borrower's principal operating account for the purpose of application of prudential norms on income recognition, asset classification and provisioning.

c) The bills discounted under LC favouring a borrower may not be classified as a Non-performing assets (NPA), when any other facility granted to the borrower is classified as NPA. However, in case documents under LC are not accepted on presentation or the payment under the LC is not made on the due date by the LC issuing bank for any reason and the borrower does not immediately make good the amount disbursed as a result of discounting of concerned bills, the outstanding bills discounted will immediately be classified as NPA with effect from the date when the other facilities had been classified as NPA.

d) Derivative Contracts: The overdue receivables representing positive mark-to-market value of a derivative contract will be treated as a non-performing asset, if these remain unpaid for 90 days or more. In case the overdues arising from forward contracts and plain vanilla swaps and options become NPAs, all other funded facilities granted to the client shall also be classified as nonperforming asset following the principle of borrower-wise classification as per the existing asset classification norms.

e) If the client concerned is also a borrower of the bank enjoying a Cash Credit or Overdraft facility from the bank, the receivables mentioned at sub-paragraph (a) above may be debited to that account on due date and the impact of its non-payment would be reflected in the cash credit / overdraft facility account. The principle of borrower-wise asset classification would be applicable here also, as per extant norms.

f) In cases where the contract provides for settlement of the current mark-to-market value of a derivative contract before its maturity, only the current credit exposure (not the potential future exposure) will be classified as a non-performing asset after an overdue period of 90 days.

g) As the overdue receivables mentioned above would represent unrealised income already booked by the bank on accrual basis, after 90 days of overdue period, the amount already taken to 'Profit and Loss a/c' should be reversed and held in a ‘Suspense Account-Crystalised Receivables’ in the same manner as done in the case of overdue advances.

h) Further, in cases where the derivative contracts provides for more settlements in future, the MTM value will comprise of (a) crystallised receivables and (b) positive or negative MTM in respect of future receivables. If the derivative contract is not terminated on the overdue receivable remaining unpaid for 90 days, in addition to reversing the crystallised receivable from Profit and Loss Account as stipulated in sub-paragraph (d) above, the positive MTM pertaining to future receivables may also be reversed from Profit and Loss Account to another account styled as ‘Suspense Account – Positive MTM’. The subsequent positive changes in the MTM value may be credited to the ‘Suspense Account – Positive MTM’, not to P&L Account. The subsequent decline in MTM value may be adjusted against the balance in ‘Suspense Account – Positive MTM’. If the balance in this account is not sufficient, the remaining amount may be debited to the P&L Account. On payment of the overdues in cash, the balance in the ‘Suspense Account-Crystalised Receivables’ may be transferred to the ‘Profit and Loss Account’, to the extent payment is received.

i) If the bank has other derivative exposures on the borrower, it follows that the MTMs of other derivative exposures should also be dealt with / accounted for in the manner as described in sub-paragraph (e) above, subsequent to the crystalised/settlement amount in respect of a particular derivative transaction being treated as NPA.

j) Similarly, in case a fund-based credit facility extended to a borrower is classified as NPA, the MTMs of all the derivative exposures should be treated in the manner discussed above.

Provisioning norms in respect of all cases of fraud:

a) Banks should normally provide for the entire amount due to the bank or for which the bank is liable (including in case of deposit accounts), immediately upon a fraud being detected. While computing the provisioning requirement, banks may adjust financial collateral eligible under Basel III Capital Regulations - Capital Charge for Credit Risk (Standardised Approach), if any, available with them with regard to the accounts declared as fraud account;

b) However, to smoothen the effect of such provisioning on quarterly profit and loss, banks have the option to make the provisions over a period, not exceeding four quarters, commencing from the quarter in which the fraud has been detected;

c) Where the bank chooses to provide for the fraud over two to four quarters and this results in the full provisioning being made in more than one financial year, banks should debit 'other reserves' [i.e., reserves other than the one created in terms of Section 17(2) of the Banking Regulation Act 1949] by the amount remaining un-provided at the end of the financial year by credit to provisions. However, banks should proportionately reverse the debits to 'other reserves' and complete the provisioning by debiting profit and loss account, in the subsequent quarters of the next financial year;

d) Banks shall make suitable disclosures with regard to number of frauds reported, amount involved in such frauds, quantum of provision made during the year and quantum of unamortised provision debited from 'other reserves' as at the end of the year.

PROVISIONING NORMS

1. General

1. The primary responsibility for making adequate provisions for any diminution in the value of loan assets, investment or other assets is that of the bank managements and the statutory auditors. The assessment made by the inspecting officer of the RBI is furnished to the bank to assist the bank management and the statutory auditors in taking a decision in regard to making adequate and necessary provisions in terms of prudential guidelines.

2. In conformity with the prudential norms, provisions should be made on the non performing assets on the basis of classification of assets into prescribed categories as detailed in paragraph 4 supra. Taking into account the time lag between an account becoming doubtful of recovery, its recognition as such, the realisation of the security and the erosion over time in the value of security charged to the bank, the banks should make provision against substandard assets, doubtful assets and loss assets as below.

2. Loss assets

Loss assets should be written off. If loss assets are permitted to remain in the books for any reason, 100 percent of the outstanding should be provided for.

3. Doubtful assets

a) 100 percent of the extent to which the advance is not covered by the realisable value of the security to which the bank has a valid recourse and the realisable value is estimated on a realistic basis.

b) In regard to the secured portion, provision may be made on the following basis, at the rates ranging from 25 percent to 100 percent of the secured portion depending upon the period for which the asset has remained doubtful:

Period for which the advance has remained in 'doubtful' category	**Provisioning requirement (%)**
Up to one year	25
One to three years	40
More than three years	100

c) 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 ₹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.

4. Substandard assets

a) A general provision of 15 percent on total outstanding should be made without making any allowance for ECGC guarantee cover and securities available.

b) The 'unsecured exposures' which are identified as 'substandard' would attract additional provision of 10 per cent, i.e., a total of 25 per cent on the outstanding balance. However, in view of certain safeguards such as escrow accounts available in respect of infrastructure lending, infrastructure loan accounts which are classified as sub-standard will attract a provisioning of 20 per cent instead of the aforesaid prescription of 25 per cent. To avail of this benefit of lower provisioning, the banks should have in place an appropriate mechanism to escrow the cash flows and also have a clear and legal first claim on these cash flows.

c) The provisioning requirement for unsecured 'doubtful' assets is 100 per cent. Unsecured exposure is defined as an exposure where the realisable value of the security, as assessed by the bank/approved valuers/Reserve Bank's inspecting officers, is not more than 10 percent, ab-initio, of the outstanding exposure. 'Exposure' shall include all funded and non-funded exposures (including underwriting and similar commitments). 'Security' will mean tangible security properly charged to the bank and will not include intangible securities like guarantees (including State government guarantees), comfort letters etc.

d) In order to enhance transparency and ensure correct reflection of the unsecured advances in Schedule 9 of the banks' balance sheet, it is advised that the following would be applicable from the financial year 2009-10 onwards:

e) For determining the amount of unsecured advances for reflecting in schedule 9 of the published balance sheet, the rights, licenses, authorisations, etc., charged to the banks as collateral in respect of projects (including infrastructure projects) financed by them, should not be reckoned as tangible security. Hence such advances shall be reckoned as unsecured.

f) However, banks may treat annuities under build-operate-transfer (BOT) model in respect of road / highway projects and toll collection rights, where there are provisions to compensate the project sponsor if a certain level of traffic is not achieved, as tangible securities subject to the condition that banks' right to receive annuities and toll collection rights is legally enforceable and irrevocable.

g) It is noticed that most of the infrastructure projects, especially road/highway projects are user-charge based, for which the Planning Commission has published Model Concession Agreements (MCAs). These have been adopted by various Ministries and State Governments for their respective public-private partnership (PPP) projects and they provide adequate comfort to the lenders regarding security of their debt. In view of the above features, in case of PPP projects, the debts due to the lenders may be considered as secured to the extent assured by the project authority in terms of the Concession Agreement, subject to the following conditions:

i. User charges / toll / tariff payments are kept in an escrow account where senior lenders have priority over withdrawals by the concessionaire;

ii. There is sufficient risk mitigation, such as pre-determined increase in user charges or increase in concession period, in case project revenues are lower than anticipated;

iii. The lenders have a right of substitution in case of concessionaire default;

iv. The lenders have a right to trigger termination in case of default in debt service; and

v. Upon termination, the Project Authority has an obligation of (i) compulsory buy-out and (ii) repayment of debt due in a pre-determined manner.

vi. In all such cases, banks must satisfy themselves about the legal enforceability of the provisions of the tripartite agreement and factor in their past experience with such contracts.

h) Banks should also disclose the total amount of advances for which intangible securities such as charge over the rights, licenses, authority, etc. has been taken as also the estimated value of such intangible collateral. The disclosure may be made under a separate head in "Notes to Accounts". This would differentiate such loans from other entirely unsecured loans.

Amount of provision accounts in books is computed as follows:

Type of Asset	Days Past Due	Provision
Standard Asset	0-180	0.25%
Sub-standard	181-546	10%
Doubtful Asset 1	546-911	20%
Doubtful Asset 2	911-1276	30%
Doubtful Asset 3	1276-1641	50%

Annex - 1

Details of Gross Advances, Gross NPAs, Net Advances and Net NPAs

Part A

		(Rs. in Crore up to two decimals)	
		Particulars	**Amount**
1.	Standard Advances		
2.	Gross NPAs *		
3.	Gross Advances ** (1+2)		
4.	Gross NPAs as a percentage of Gross Advances (2/3) (in %)		
5.	Deductions		
	(i)	Provisions held in the case of NPA Accounts as per asset classification (including additional Provisions for NPAs at higher than prescribed rates).	
	(ii)	DICGC / ECGC claims received and held pending adjustment	
	(iii)	Part payment received and kept in Suspense Account or any other similar account	
	(iv)	Balance in Sundries Account (Interest Capitalization - Restructured Accounts), in respect of NPA Accounts	
	(v)	Floating Provisions***	
	(vi)	Provisions in lieu of diminution in the fair value of restructured accounts classified as NPAs	
	(vii)	Provisions in lieu of diminution in the fair value of restructured accounts classified as standard assets	
6.	Net Advances (3-5)		
7.	Net NPAs {2-5(i + ii + iii + iv + v + vi)}		
8.	Net NPAs as percentage of Net Advances (7/6) (in %)		
*	Principal dues of NPAs plus Funded Interest Term Loan (FITL) where the corresponding contra credit is parked in Sundries Account (Interest Capitalization - Restructured Accounts), in respect of NPA Accounts.		
**	For the purpose of this Statement, 'Gross Advances' mean all outstanding loans and advances including advances for which refinance has been received but excluding rediscounted bills, and advances written off at Head Office level (Technical write off).		
***	Floating Provisions would be deducted while calculating Net NPAs, to the extent, banks have exercised this option, over utilising it towards Tier II capital.		

Part B

Supplementary Details		
(Rs. in Crore up to two decimals)		
Particulars		**Amount**
1.	Provisions on Standard Assets excluding 5(vi) in Part A above	

2.	Interest recorded as Memorandum Item	
3.	Amount of cumulative Technical Write - Off in respect of NPA accounts reported in Part A above	