

# CLARIFICATION BY RBI ON IRACP NORMS - A MUCH NEEDED RELIEF

Recently, through its notification, (RBI/2021-2022/125 DOR.STR.REC.68/21.04.048/2021-22 dated November 12, 2021) RBI has issued clarifications on Prudential norms for Income Recognition, Asset Classification and Provisioning pertaining to Advances. There was certainly a need to ensure uniformity in the implementation of IRACP norms across all lending institutions and especially NBFCs. Let us have a quick look at the clarifications in this article.

## **DUE DATE**

Presently, due dates for repayments are sometimes not specifically mentioned in the loan agreements, and instead a description of due dates is mentioned. Such situation would have scope of different interpretations for SMA /NPA accounts classification.

It has been clarified that exact due dates for repayment of a loan (in case of moratorium, the exact date of commencement of repayment), frequency of repayment, breakup between principal and interest, examples of SMA/NPA classification dates, etc. shall be clearly specified in the loan agreement at the time of loan sanction and at the time of subsequent changes, if any, till full repayment of the loan. For existing loan this will be applicable from next due date for renewal and for fresh loan this will be applicable at the earliest, but not later than December 31, 2021.

## **SMA AND NPA**

The circular DBR.No.BP.BC.45/21.04.048/2018-19 dated June 07, 2019 on 'Prudential Framework for Resolution of Stressed Assets' requires the lenders to recognize incipient stress in borrower accounts, immediately on default, by classifying them as SMA. Multiple views were taken by lenders on account of classification of advances as SMA and NPA.

While clarifying, it is mentioned that the intervals for the above classification are intended to be continuous and borrower accounts shall be flagged as overdue and classification of borrower accounts as SMA / NPA shall be done as part of their day-end processes. Further, the SMA or NPA classification date shall be the calendar date for which the day end process is run.

For example, If due date of a loan account is March 31, 2021, and full dues are not received before the NBFC runs the day-end process, the date of overdue shall be March 31, 2021. If it continues to remain overdue, then this account shall get tagged as SMA-1 upon running day-end process on April 30, 2021 i.e. upon completion of 30 days of being continuously overdue. Accordingly, the date of SMA-1 classification for that account shall be April 30, 2021.

Similarly, if the account continues to remain overdue, it shall get tagged as SMA-2 upon running day-end process on May 30, 2021 and if continues to remain overdue further, it shall get classified as NPA upon running day-end process on June 29, 2021. These instructions on SMA classification of borrower accounts are applicable to all loans, including retail loans, irrespective of size of exposure of the lending institution.

## **DEFINITION OF 'OUT OF ORDER'**

As per present norms, an account should be treated as 'out of order' if there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period. Ambiguity remains regarding determination of 'out of order' status of CC/OD accounts on a continuous basis.

As per clarification, an account shall be treated as 'out of order' if:

- Outstanding balance in the CC/OD account remains continuously in excess of the sanctioned limit/drawing power for 90 days or
- The outstanding balance in the CC/OD account is less than the sanctioned limit/drawing power but, no credits continuously for 90 days or credits are not enough to cover the interest debited during the previous 90 days period.

### **NPA CLASSIFICATION IN CASE OF INTEREST PAYMENTS**

Presently, an account is classified as NPA only if the interest due and charged during any quarter is not serviced fully within 90 days from the end of the quarter. Now, in case of interest due and charged at monthly rests, the period of 90 days for NPA classification will be considered from the end of quarter. There is a requirement to apply interest at monthly rests.

It has been clarified that an account will be classified as NPA if the interest applied at specified rests remains overdue for more than 90 days. This will be applicable from March 31, 2022

### **UPGRADATION OF ACCOUNTS CLASSIFIED AS NPAS**

It was observed that some lending institutions used to upgrade accounts classified as NPAs to 'standard' asset category upon payment of only interest overdues, partial overdues, etc. This was a significant matter and debated a lot.

It is now clarified that upgradation of NPA accounts to standard accounts to be made only on account of payment of entire arrears and not partial payments. In case of upgradation due to restructuring, non-achievement of date of commencement of commercial operations (DCCO), etc., the instructions as specified for such cases shall continue to be applicable.

### **INCOME RECOGNITION POLICY FOR LOANS WITH MORATORIUM ON PAYMENT OF INTEREST**

The instructions in paragraph 3.2 of the Master Circular on IRACP norms dated October 1, 2021 require that once an account is classified as NPA, the entire interest accrued and credited to income account in the past periods, must be reversed to the extent it remains

unrealised. There was ambiguity in lenders regarding recognition of income on loans where moratorium has been granted.

Following have been clarified

- If loans with moratorium on payment of interest (permitted at the time of sanction of the loan) become NPA after the moratorium period is over, the capitalized interest corresponding to the interest accrued during such moratorium period need not be reversed.
- For loans where moratorium has been granted for repayment of interest, the lending institutions may recognize interest income on accrual basis for accounts which continue to be classified as 'standard'.
- Income recognition norms for loans towards projects under implementation involving deferment of DCCO and gold loans for non-agricultural purposes shall continue to be governed as per the existing instructions.

### **CONSUMER EDUCATION**

There was lack of awareness among the borrowers. To create awareness among the borrowers, lending institutions shall place consumer education literature on their websites explaining the concepts of date of overdue, SMA, NPA classification, up gradation and shall instruct its front line officers to educate the borrowers about such concepts at the time of sanction/renewal of the loans. This shall be applicable at the earliest, but not later than March 31, 2022.

NBFCs have to apply IND-AS and most important aspect under this framework is present value concept and substance based accounting. ECL models will play an important role in loan loss provisioning and securitisation besides classification of investment into debt or equity. Management estimates and judgement related to effective interest rate and fair valuation remain other significant challenges. And account wise understanding will make task complicated for the executives. Frankly, we are in transition from rule based approach. Having said that, instructions from RBI (rules) vs Substance based accounting will remain a challenge till the time our environment gradually matures to adopt these new reporting pattern.

Recent clarifications were much needed for NBFCs as different interpretations of existing instructions were resulting in inconsistencies and non-compliances in certain areas. Debates between management and auditors should also be made to rest. A Much needed relief, but more required.

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