Important Circulars by Reserve Bank of India

Two important Master Circulars from the Reserve Bank of India have come into effect from April 1, 2025. One deals with Prudential Norms on Income Recognition, Asset Classification, and Provisioning (IRACP) pertaining to Advances and the other pertains to Guarantees and Co-acceptances.

These circulars are part of RBI's annual exercise to consolidate and update all earlier instructions issued up to March 31, 2025, and to provide a clear, consistent framework to be followed by banks and financial institutions.

The first circular lays down the ground rules for issuing guarantees, letters of credit, and co-acceptances what's allowed, what's restricted, how banks should manage risks, and how to deal with invoked guarantees, among other things.

The second circular deals with asset classification norms—when a loan becomes an NPA, how to treat overdue accounts, what's considered a default, and how provisioning should be done. It also clarifies rules around restructuring, change in ownership, and additional finance, especially in the context of stressed accounts.

Key points and summarised them briefly below. These are just high-level highlights—so for anything more specific or detailed, it's best to refer to the actual circulars.

Summary of the RBI Master Circular[1] – Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances, effective from April 1, 2025, highlighting only the key changes and expectations. Readers are encouraged to refer to the detailed RBI circular for in-depth provisions.

Non-Performing Assets (NPAs): Updated Definitions

- A loan is classified as **NPA** if interest or principal is overdue for more than **90 days**.
- In case of **OD/CC accounts**, "out of order" status applies if:
  - Balance exceeds limit for 90 days, or
  - There are no credits for 90 days, or
  - Credits don't cover interest for 90 days.
- **Crop loans**: NPA if overdue for **two crop seasons** (short) or **one crop season** (long).
- NPAs also include **overdue bills**, **derivative receivables**, and certain **securitised assets**.

Overdue Classification and Drawing Power

- Amount becomes **'overdue'** if not paid on the **due date**, flagged at **day-end**.
- For **working capital accounts**, drawing power based on stock statements older than 3 months renders exposure irregular.
- Account becomes NPA if such irregularity persists for **90 continuous days**.
- Non-renewal of credit limits beyond **180 days** from due date will also lead to NPA classification.

Upgradation Norms for NPAs

- A loan account classified as NPA can be upgraded to **standard** only if **all overdue principal and interest** across all facilities are fully repaid.

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[1] RBI/2025-2026/13 DOR.STR.REC.9/21.04.048/2025-26

- Special norms continue to apply to **restructured accounts**, **DCCO extensions**, etc.

Asset Classification Shall Be Borrower-Wise

- If **any facility or security** issued by a borrower becomes NPA/NPI, **all facilities** are to be treated likewise.
- LC devolved and invoked guarantees parked separately are to be treated as part of principal account for NPA classification.

Consortium Lending – Classification Based on Individual Recovery

- Under consortium arrangements, asset classification will depend on **actual recovery** by each bank.
- If recovery isn't shared by the lead bank, the account will be treated as **not serviced** in other member banks' books and marked as NPA.

Severe Deterioration/Fraud – Immediate Downgrade

- Accounts with **severe erosion in security value** or **fraud** can be **directly classified as doubtful/loss**:
  - If realisable value of security < **50%**, classify as **doubtful**.
  - If < **10%**, classify as **loss asset**.
- In fraud cases:
  - **Entire amount to be provided for** immediately (adjusting eligible financial collateral if available).
  - **Staggered provisioning** over up to **4 quarters** allowed.
  - Unprovided portion at year-end to be debited from **'Other Reserves'** and disclosed.

Early Identification of Stress (SMA Classification)

- Accounts to be classified as **SMA-0 / SMA-1 / SMA-2** based on overdue period (up to 90 days).
- For **cash credit/overdraft**, classification is based on the extent and duration of excess over sanctioned limits.
- Classification is **borrower-wise**, not facility-wise, and should reflect at day-end system level.

Resolution Plan (RP) Initiation

- Banks must initiate review within 30 days of default ("Review Period").
- During the Review Period, lenders decide resolution strategy, including legal action if needed.

Inter-Creditor Agreement (ICA)

- For multiple-lender accounts, ICA must be signed within Review Period.
- Decisions approved by 75% in value and 60% in number of lenders are binding.
- Dissenting lenders must be paid not less than liquidation value.

RP Timelines

- For exposures ≥ ₹2,000 crore (from June 7, 2019) or ≥ ₹1,500 crore (from Jan 1, 2020), RP must be implemented within 180 days of Review Period.
- Timelines for exposure < ₹1,500 crore to be notified separately.

Conditions for RP Implementation

- For accounts with exposure ≥ ₹100 crore, Independent Credit Evaluation (ICE) is mandatory.
- RP deemed implemented only when:
  - All documentation is completed.
  - Borrower is not in default on any facility.
  - Changes are reflected in lender and borrower accounts.
- RPs involving assignment or recovery are implemented only when exposure is extinguished.

Delays in Implementation: Delay in RP beyond permitted timeline attracts additional provisioning by all lenders.

Exemptions

- MSME accounts are governed by separate restructuring guidelines.

- Covid-19 related restructuring governed by specific RBI circulars dated Aug 2020 and May/June 2021.

Restructuring – Definition and Scope (Para 16)

- Restructuring refers to changes in loan terms due to borrower's financial difficulty.
- It includes changes like rescheduling, rate reductions, new funding, rollover, or compromise settlements where payment exceeds 3 months.
- Banks must define financial difficulty using both quantitative and qualitative parameters.
- Signs of financial difficulty include recurring defaults, delisting risks, poor cash flows, and internal downgrades—even before an actual default.

Asset Classification (Para 17.1)

- All restructured standard accounts are downgraded to NPA upon restructuring.
- NPAs will retain their classification and follow aging norms unless upgraded under specific criteria.

Upgradation Post-Restructuring (Para 17.2)

- MSME accounts (< ₹25 crore exposure): Eligible for upgrade after 1 year of satisfactory performance, i.e., no overdues >30 days.
- Other accounts: Upgrade allowed after:
  - 10% of principal and capitalised interest repaid during monitoring period, and
  - Minimum 1-year performance from date of first repayment.
- For exposure ≥ ₹100 crore: Credit rating of investment grade (BBB-) is also required.
- Failure to perform requires fresh RP and 15% additional provision.

Provisioning Norms (Para 18)

- Provisioning continues based on classification (standard/sub-standard).
- No special concessions on provisioning unless account qualifies under separate norms (e.g., MSME or COVID-related restructuring).
- Restructured accounts will attract provisioning as per their asset classification.
- If a resolution plan (RP) is submitted to the Adjudicating Authority under IBC, existing provisions can be frozen for 6 months or until 90 days post-approval, whichever is earlier.
- No reversal of excess provisions during the freeze. Additional provisioning must be made if existing provisions fall short.
- MSME restructuring to follow earlier RBI circulars (2019 & 2020).

Additional & Interim Finance (Para 19)

- Additional finance under RP can be treated as 'standard asset' during monitoring, subject to satisfactory performance.
- Interim finance during IBC also gets 'standard' status during CIRP. Post-approval, it follows the same norms as additional finance.

Income Recognition (Para 20)

- Standard assets: Interest can be accrued.
- NPAs: Interest on cash basis only.
- For restructured NPAs with additional finance: income is recognised on cash basis, unless ownership changes.

Conversion to FITL / Equity / Debt (Para 21)

- Converted securities (e.g. FITL, equity, bonds) carry provisioning based on:
  - Their asset classification; or
  - Fair valuation — whichever is higher.
- Valuation of instruments follows conservative principles:
  - ZCBs/LCBs with no terminal value or no sinking fund: valued at Rs.1.
  - Unquoted equity without recent audit: Rs.1.

- Preference shares discounted further if dividends are in arrears.

- Unrealised income must be separately tracked and only recognised upon realisation or as per permitted norms

Change in Ownership (Para 22)

- Upon change in ownership (via IBC or otherwise), accounts may be upgraded to standard if:
  - Acquirer is not disqualified (Sec. 29A IBC).
  - Acquirer is not linked to previous promoters.
  - Acquirer holds ≥26% equity and controls the borrower.
  - RP is properly implemented and monitoring period performance is satisfactory.
- Provision reversal only after the monitoring period ends with satisfactory performance.

RBI Master Circular on Guarantees and Co-acceptances[2] – Key Highlights

Scope:

Applies to all Scheduled Commercial Banks (excluding Payments Banks and RRBs).

General Principles:

- Prefer short-term financial guarantees over long-term or performance guarantees.
- Maturity of guarantees should not exceed 10 years, except with Board-approved policy.
- Guarantees to non-constituents allowed under strict policy guidelines.

Internal Controls:

- Guarantees over ₹50,000 should be signed jointly by two officers.
- Use serially numbered security forms to prevent fraud.

Guarantees on Behalf of Directors:

- Permissible only with arrangements ensuring no devolvement on bank.
- Any payment under such guarantee violating Section 20 of BR Act is impermissible.

Stock/Commodity Brokers:

Minimum 50% margin required for guarantees; at least 25% in cash.

Export Guarantees:

- Flexible norms for bid/performance guarantees to promote exports.
- Banks must ensure proper due diligence and FEMA compliance.

Personal Guarantees:

To be taken selectively, based on control, ownership, financial strength, and management quality.

Prohibited Transactions:

- Banks cannot issue guarantees to facilitate fund placement with NBFCs or other non-bank entities.
- No guarantees for bond/debt instrument issuance, except as per PCE guidelines.

Payment of Invoked Guarantees:

- Must be honoured promptly, without delay or demur.
- CEOs are personally accountable for delays, especially in cases involving government beneficiaries.

Co-Acceptance of Bills:

- Strict safeguards mandated to avoid fraud and misuse.
- Only genuine trade bills should be co-accepted.

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[2] RBI/2025-2026/12 DOR.STR.REC.06/13.07.010/2025-26

Letters of Credit (LCs):

- Exercise care in issuance and honouring.
- Ensure documentation strictly complies with LC terms.

FEMA and Prudential Norms:

Banks must adhere to FEMA 2000 regulations and all applicable RBI prudential norms.

We trust you will find this an interesting read. For any queries or comments on this update, please feel free to contact us at insights@elp-in.com or write to our authors:

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