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Banking Regulation & Policy Department

27 November 2024

BRPD Circular No. 15
12 Agrahayan 1431
Managing Director/Chief Executives
All Scheduled Banks in Bangladesh

Date: -----

Dear Sir,

Master Circular: Loan Classification and Provisioning

Please refer to the BRPD Circular No. 14 of 23 September 2012, BRPD Circular No. 05 of 29 May 2013, BRPD Circular No. 03 of 21 April 2019, BRPD Circular No. 16 of 21 July 2020 and the subsequent circulars or circular letters on the captioned subject.

2. Given the changes in the economic cycle, global dynamics, borrowers' risk profile over time, and international best practices, it is crucial for supervisors to regularly review and update regulations on Non-Performing Loans (NPL) and provisioning policies to ensure more effective risk management. It is ultimately the responsibility of bank management to make accurate classifications and ensure adequate provisions, in line with supervisory guidance, established global standards, and the relevant accounting framework. Basel III standard also requires supervisors to closely monitor whether banks have robust policies and processes in place for managing credit risk.

3. As part of its continuous efforts to enhance risk management capabilities of banks and strengthen the transparency of the financial reporting, Bangladesh Bank plans to implement Expected Credit Loss (ECL) methodology -based provisioning system for banks in accordance with International Financial Reporting Standard (IFRS 9) by 2027. The ECL Model under IFRS 9 enables banks to manage credit risk more effectively by considering past events, current conditions, and future forecast.

4. Against this backdrop, to make advancement of the implementation of IFRS 9 standards and align with international best practices for loan classification and provisioning requirements, the following instructions are provided:

5. Categories of Loans and Advances:

All loans and advances will be grouped into four categories for the purpose of classification, namely- (a) Continuous Loan (b) Demand Loan (c) Fixed Term Loan and (d) Short-term Agricultural Credit.

a) Continuous Loan: The loan accounts in which transactions may be made within certain limit and have an expiry date for full adjustment will be treated as Continuous Loan. Examples are: Cash Credit, Overdraft, etc.

b) Demand Loan: The loans that become repayable on demand by the bank will be treated as Demand Loan. Such as: Post Import Financing, Payment against Document,

Foreign Bill Purchased, and Inland Bill Purchased, etc. However, if any contingent or any other liabilities are turned to forced loan (i.e. without any prior approval as regular

loan) those too will be treated as Demand Loan.

c) Fixed Term Loan: The loans which are repayable within a specific time period under a specific repayment schedule will be treated as Fixed Term Loan.

d) Short-term Agricultural Credit: Short-term Agricultural Credit will include the short-term credits as listed under the Agricultural and Rural Credit Policy and Program issued by the Agricultural Credit Department (ACD) of Bangladesh Bank. Credits in the agricultural sector repayable within 12 (twelve) months will also be included herein.

6. Basis for Loan Classification (CL):

(a) Objective Criteria:

(1) Past Due/Over Due: All the loans will be treated as past due/overdue from the following day of the expiry date or from the creation of the forced loan or from the due date if not repaid/renewed depending on different categories of loans and advances defined in para 5. However, in case of any installment(s) or part of installment(s) of a Fixed Term Loan is not repaid within the fixed expiry /due date, the amount of unpaid installment(s) will be treated as past due/overdue from the following day of the expiry/due date.

(2) Categories of CL: All the loans will be classified into following categories:

(i) Standard-0 (STD-0)

(ii) Standard-1 (STD-1)

(iii) Standard-2 (STD-2)

(iv) Special Mention Account (SMA)

(v) Sub-Standard (SS)

(vi) Doubtful (DF)

(vii) Bad/Loss (B/L)

(3) Objective Criteria for CL:

For all categories of loans, the entire loan will be classified depending on the period of past due or overdue as stipulated below:

CL Categories Period of past due or overdue

Unclassified

STD-0 No past due or overdue

STD-1 ≥ 1 day but < 1 month

STD-2 ≥ 1 month but < 2 months

SMA ≥ 2 months but < 3 months

Classified

SS ≥ 3 months but < 6 months

DF ≥ 6 months but < 12 months

B/L ≥ 12 months

(b) Qualitative Judgment:

Under qualitative judgment, any loan can be classified based on the perceived risk and/or if full repayment is unlikely even if it has no past due or overdue on the basis of objective criteria.

Such classification should reflect the degree of deterioration in the borrower's creditworthiness and the anticipated impact on repayment. For incorporating qualitative judgment, banks must use their own judgment based on the following indicative assessment factors:

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(1) Special Mention Account (SMA)

(i) Loans must be classified no higher than SMA if any of the following deficiencies of the obligor is present: occasional overdrawn within the past year, below -average or declining profitability; barely acceptable liquidity; or problems in strategic planning.

(ii) Loans must be classified no higher than SMA if any of the following deficiencies of the bank management is present: the loan was not made in compliance with the bank's internal policies; failure to maintain adequate and enforceable documentation; minor operational or governance weaknesses; or poor control over collateral.

(2) Sub-Standard (SS)

(i) Loans must be classified no higher than SS if any of the following deficiencies of the obligor is present: recurrent overdrawn, low account turnover, competitive difficulties, location in a volatile industry with an acute drop in demand; very low profitability that is also declining; inadequate liquidity; cash flow less than repayment of principal and interest; weak management; doubts about integrity of management; conflict in corporate governance; unjustifiable lack of external audit; or pending litigation of a significant nature.

(ii) Loans must be classified no higher than SS if any of the following deficiencies of the bank management is present: the banking organization has acquired the asset without the types of adequate documentation of the obligor's net worth, profitability, liquidity, and cash flow that are required in the banking organization's lending policy, or there are doubts about the validity of that documentation.

(3) Doubtful (DF)

Loans must be classified no higher than DF if any of the following deficiencies of the obligor is present: permanent overdrawn; location in an industry with poor aggregate earnings or loss of markets; serious competitive problems; failure of key products; operational losses; illiquidity, including the necessity to sell assets to meet operating expenses; cash flow less than required interest payments; very poor management; non-cooperative or hostile management; serious doubts of the integrity of management; doubts about true ownership; or complete absence of faith in financial statements.

(4) Bad/Loss (B/L)

Loans must be classified no higher than B/L if any of the following deficiencies of the obligor are present: the obligor seeks new loans to finance operational losses; location in an industry that is disappearing; location in the bottom quartile of its industry in terms of profitability; technological obsolescence; very high losses; asset sales at a loss to meet operational expenses; cash flow less than production costs; no repayment source except liquidation; presence of money laundering, fraud, embezzlement, or other criminal activity; or no further support by owners.

(c) Finalization of CL:

(i) Preliminarily banks are required to assess and classify loans on the basis of both objective criteria and qualitative judgment. Final classification will be the worse one.

(ii) Classified Loans and Advances i.e. SS, DF and B/L (on the basis of both objective criteria and qualitative judgment) will be treated as Non-Performing Loans (NPL). of 7

However, loan shall be treated as defaulted loan for the purpose of section 27KaKa(3) as per section 5(GaGa) of the Bank Company Act, 1991 and to be reported accordingly.

(d) Improvement in CL:

(i) If a loan is classified, either by bank or Bangladesh bank, on the basis of objective criteria, it can be moved to a more favorable classification category depending on payment of its past due/overdue amount as per agreement.

(ii) If a loan is classified on the basis of Qualitative Judgment by the bank, from time to time, in the judgment of the bank, it may be moved to a more favorable classification category. The decision must be accompanied by analysis showing that there has been improvement in the payment performance of the loan and/or in the financial condition of the borrower. The decision to move a loan gradually from B/L to DF, or from DF to SS, may, with appropriate justification, be taken by Managing Director/CEO. The decision to move a loan from SS to SMA/STD must be taken by the Board of Directors, with appropriate justification presented by the branch that originated the loan in question and the Managing Director/CEO.

(iii) If a loan is classified during Bangladesh Bank's inspection on the basis of qualitative judgment, it cannot be declassified without the consent of the concerned Department of Banking Inspection of Bangladesh Bank.

(iv) A bank may request the concerned Department of Banking Inspection of Bangladesh Bank to review the classification of any loan for which there is a disagreement on classification that is not resolved during the on-site inspection. However, in any case where there is a lingering disagreement between the classification determined by bank management and the classification determined by the concerned Department of Banking Inspection, the judgment of the later one will prevail.

7. Accounting of the Interest of Classified Loans:

- (a) If any loan or advance is classified as SS and DF, interest accrued on such loan will be credited to Interest Suspense Account instead of crediting the same to Income Account.
- (b) As soon as any loan or advance is classified as B/L, charging of interest in the same account will cease. If any interest is charged on any B/L account for any other special reason, the same will be preserved in the Interest Suspense account.
- (c) In case of rescheduled loans, the unrealized interest, if any, will be credited to Interest Suspense Account, instead of crediting the same to Income Account.
- (d) In case of filing a law-suit for recovery of such loan, interest for the period till filing of the suit can be charged in the loan account in order to file the same for the amount of principal plus interest. But interest thus charged in the loan account has to be preserved in the Interest Suspense account.
- (e) If classified loan or part of it is recovered i.e., real deposit is effected in the loan account, first the interest (charged and not charged) is to be recovered from the said deposit and the principal to be adjusted afterwards.

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8. Maintenance of Provision:

Banks will maintain provision at the following rates for all categories of loans:

Particulars Rate of provision

General Provision STD-0, STD-1, STD-2 1% of loan outstanding

SMA 5% of loan outstanding

Specific Provision

SS 20% of base for provision

DF 50% of base for provision

B/L 100% of base for provision

The rates of provisions stated above are absolute minimums, and banks are encouraged to assess the adequacy of provisions on a continuous basis to ensure that the provisions set aside are reflective of their potential losses.

9. Base for Provision:

For eligible collaterals of the following types, specific provision will be maintained at the stated rates in Para 8 on the outstanding balance of the classified loans less the amount of Interest Suspense and the value of eligible collateral:

- a. Deposit with the same bank under lien against the loan;
- b. Government bond/savings certificate under lien; and
- c. Guarantee given by Government or Bangladesh Bank and AAA rated Multilateral Development Banks (MDBs).

For all other eligible collaterals, specific provision will be maintained at the stated rates in Para 8 on the balance calculated as the greater of the following two amounts:

- i. outstanding balance of the classified loan less the amount of Interest Suspense and the value of eligible collateral; and
- ii. 15% of the outstanding balance of the loan.

10. Eligible Collateral:

(a) Types of Eligible Collateral:

In the definition of Eligible Collateral as mentioned in the above paragraph the following collateral will be included as eligible collateral in determining base for provision:

- (i) 100% of deposit under lien against the loan;
- (ii) 100% of the value of government bond/savings certificate under lien;

- (iii) 100% of the value of guarantee given by Government or Bangladesh Bank or AAA rated MDBs;
- (iv) 100% of the market value of gold or gold ornaments pledged with the bank;
- (v) 50% of the market value of easily marketable commodities kept under control of the bank;
- (vi) Maximum 50% of the market value of land and building mortgaged with the bank;
- (vii) 50% of the average market value for last 06 months or 50 % of the face value or 50 % of the last closing price, whichever is less, of the shares traded in stock exchange.
- (b) Determination of Market Value of Eligible Collateral:
 - (i) Easily marketable goods will mean pledged and easily en-cashable/saleable goods that remain under full control of the bank. However, while the concerned bank branch official will conduct periodic inspection to verify as to whether requirements have been met such as the suitability of goods for use, expiry period, appropriateness of documentary evidences, and up to date insurance cover, the same will have to be assessed by the professional assessor from time to time. of 7

(ii) For land and building, banks will have to ensure whether title documents are in order and concerned land and building will have to be mandatorily valued by the collateral valuation firm enlisted by Bangladesh Bank along with completion of proper documentation in favor of the bank. In cases, where the valuation by the collateral valuation firm is not mandatory, bank will do it by themselves. Nevertheless, temporary establishments shall not be shown as building.

(iii) In order to facilitate the on-site inspection by concerned Department of Banking Inspection of Bangladesh Bank, banks are also advised to maintain a complete statement of eligible collateral on a separate sheet in the concerned loan file. Information such as a description of eligible collateral, their assessment by a recognized firm, marketability of the commodity, control of the bank, and reasons for considering eligible collateral etc. will have to be included in that sheet.

11. General Instructions & Reporting:

- (a) In terms of the above policies, the banks will conduct their classification activities on quarterly basis.
- (b) Periodic revaluations of collateral should be done. For movable collateral, it should not be revalued at least one year before the last valuation. On the other hand, for immovable, it should not be revalued at least three years before the last valuation. However, when objective evidences such as an economic downturn or decrease in collateral value require revaluation, it might be done before the mentioned time considering the bank's risk perspective. In that case, minimum value of the last two assessments should be considered as actual valuation.
- (c) The classification of each individual loan must be justified in writing and the documentation must contain the signatures of both the persons assigning the classification and the person reviewing it. These written justifications must be maintained in the loan files and be available for viewing by the Bangladesh Bank inspection teams. Banks should continue to use the existing forms for loan classification, provisioning and interest suspense i.e. CL-1 to CL-5 as follows until further modification:

- (i) CL-1 is the compilation/summary of 4 other forms. This form is for showing summary of classification status for different loan categories mentioned earlier along with staff loan;
- (ii) CL-2 is for reporting loan classification of Continuous Loan;
- (iii) CL-3 is for reporting loan classification of Demand Loan;
- (iv) CL-4 is for reporting loan classification of Fixed Term Loan; and
- (v) CL-5 is for reporting loan classification of Short-term Agricultural Credit.

(d) Bank branches shall send the completed forms (CL -1 to CL -5) to their Head Office. The Head Offices of banks should make arrangements for scrutiny of all the forms prepared by

the branches. Where necessary, they should carry out corrections and ensure maintenance of the corrected forms in the records of the branch. After scrutiny of all forms (CL-1, CL-2, CL-3, CL - 4 and CL-5) prepared by branches and being satisfied with the results, they should prepare a consolidated position of classification, provisions and interest suspense using form CL-1. Banks are also advised to preserve the CL statements in both their Head Offices and branches for inspection by the Bangladesh Bank inspection team. of 7

(e) Bank should upload the CL-1 (Both Domestic Banking Unit and Offshore Banking Unit) statement in Enterprise Data Warehouse (EDW) of Bangladesh Bank according to the template (T_PS_Q_LN_PROV) for loan classification and provisioning.

(f) Banks are advised to submit detailed statements through CL -1 in respect of classification, provision and interest suspense accounts within the 15th of next month after the quarter-end.

(g) Banks are advised to ensure correct and timely submission of CL -1; failing to which penalty may be imposed on the concerned non compliant bank.

(h) The classification status of each individual loan will have to be reported to the Credit Information Bureau (CIB) according to the instructions given by CIB of Bangladesh Bank.

12. Instructions given in BRPD Circular No. 14/2012 and its subsequent modifications through any circulars or circular letters will be superseded by this circular. However, for provisioning of Off-Balance Sheet exposures, the BRPD circular No. 06/2023 and any subsequent instructions related to this will have to be followed.

13. Islamic banks must adhere to this loan classification and provisioning policy for their investments.

14. This directive has been issued by Bangladesh Bank in exercise of its power conferred on it under section 49(1)(Cha) of the Bank Company Act, 1991.

15. This circular will come into force from 01 April 2025.

Yours faithfully,

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