Credit Audit & Monitoring Policy : 2018-19]

Version 2.0

DOCUMENT VERSION CONTROL

Document Title	Credit Audit and Monitoring Policy & Procedures - 2018-19
Prepared By	Senior Manager, Credit Audit & Monitoring Department
Verified By & Recommended By	Deputy General Manager, Credit Audit & Monitoring Department
Approved By	Board
Board Approval Date	
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Document History

Version No.	**Date of Approval**	**Brief Description of Changes**
1.0	**2017-2018**	**Newly Developed** As per the guidelines of RBI letter Ref. Circular /Letter No.DBS.CO.PP.D.B.C.10/ 11.01.005/16-17 dt.19.04.17
2.0	18.08.2017 Board	The Board has made the following observations: a. Page No. 3 - Sl. No 1.1, organizational setup: 2nd row should be modified as 'Deputy General Manager / Assistant General Manager'. b. Page No. 5 – Sl. No. 2.2, credit monitoring: The following observation should be added in the last line. **'Early warning signals of a serious nature should be reported to the Audit Committee of the Board'.** c. Page No. 6 – Sl. No 3.3, Post Credit Supervision: **For credit limits of Rs. 3.00 crore and above, it should be ensured that all pre-disbursement conditions were complied with.** **The Board has reviewed and approved the policy for the year 2017-18 subject to the above observations.** **The appropriate changes have been incorporated in the policy.**

Next Review Date: 31.03.2019. The document should be reviewed every year.

TABLE OF CONTENTS

TAMILNAD MERCANTILE BANK LTD., HEAD OFFICE, THOOTHUKUDI

CREDIT AUDIT & MONITORING DEPARTMENT

CREDIT AUDIT & MONITORING POLICY: 2018-19

1. Preamble:

Our Bank has in place a loan policy covering the credit appraisal standards, exposure level, credit risk assessment, loan pricing etc. In continuation to the loan policy, the Bank has the following policies for effective management.

1. Stock Audit Policy
2. **Credit Audit Policy**
3. Potential NPA Policy

In accordance with the observations made by Reserve Bank of India vide their letter DBS.CO.PP.D.B.C.10/11.01.005/16-17 dated 19.04.2017, the Credit Monitoring Policy is framed in our Bank. A department exclusively for Credit Audit & Monitoring, which is functioning from 07th November 2005, looks after the following areas of Credit as a measure of having a Systematic / Committed approach in Credit Administration in Post sanction level. At, present, our CAM Department is functioning under the control of Deputy General Manager (CAM) and assisted by supporting team.

1.1. Organizational Set up:

DEPUTY GENERAL MANAGER	
SENIOR MANAGER	MANAGER
OFFICER	OFFICER
CLERK	CLERK

1.2. Need For the Policy Revamp:

It has been observed in some instances that the borrowers had diverted funds by creating fictitious suppliers, debtors etc. with consequential misrepresentation of stock position/book debts. Such practices were not detected due to,

1. the deficient monitoring of stock statements
2. absence of periodic field visits and
3. inadequacy of other processes for ensuring availability / adequacy of the stocks.

Hence Reserve Bank of India advised all banks to revise / formulate Credit Monitoring Policy incorporating few additional measures with the approval of the Board. Effective implementation of the policy should be overseen by the Board / Board level Committees and specifically examined and commented upon by internal auditors.

…2

The following practices are already in use to monitor end use of funds and are detailed in Credit Policy:

a. The sanctioning Authorities stipulating conditions in their sanction letters to get the opinion report on suppliers of machinery / equipment and verification of their existence done by the branches before disbursal in case of Term loans and direct disbursement are made to the suppliers followed by immediate verification of assets by the branch officials. This existing activity undergone by the sanctioning Authorities are to be continued as per the guidelines of RBI.

b. The field level checking authorities like Regional Office to verify the stage wise disbursement of branches for the housing loans by spot visits, stage wise photographs taken and based on the stage completion certificates of the panel engineers and to verify the disbursement on a random visits to check the deployment.

c. Since the Chartered Accounts do not possess the required technical expertise to certify the end uses, certificates from technical experts such as machinery valuers are made mandatory for the term loans involving high value capital assets and this has to be incorporated in the sanction conditions by the Regional Offices and Credit Department.

d. In case of non co-operating customers with Inspectors / stock auditors / concurrent auditors, stringent application of financial disincentives such as pricing adjustment as penalty and non-financial disincentives like freezing / non renewal of limits are suggested and to be used case to case basis by the sanctioning authorities.

e. For meaningful control of the large advances, the funds are to be deployed through the branch nearby the concerned business place or with a nearby big branch in necessary cases. The Regional Offices has to decide the branch while accepting the proposal itself.

f. In respect of consortium /multiple banking advances, the check points are to be aggregated at the industry level and should be compared with the borrower's financial statements and meaningful conclusions are to be arrived by the Credit Department.

g. Bills purchased and discounted, returned unpaid on the same day are being followed by the Regions through statements received from the branches and also through direct options available in the system. Subsequent followup and escalations are made by the CAM Department.

1.3. This Document:

This document, termed as **“Credit Audit and Monitoring Policy”**, places the Bank’s policy and operational processes. This policy is placed in addition to the existing policies such as **1.Stock Audit Policy and 2.Potential NPA Policy** under purview of the Department. This has incorporated with all amendments, clarifications and new interventions that have been received in the interregnum.

…3

1.4. Authority for issuance of Policy:

The Credit Audit & Monitoring Department is responsible for drafting of Credit Audit & Monitoring policy, its procedures and also for periodical review of the relative policy and processes.

2. Objectives of the Policy:

The key objective of the Policy describes the two major types of functions like **1.Credit Audit** and **2.Credit Monitoring.**

2.1 Credit Audit:

Credit Audit examines compliance with extant sanction and post-sanction processes / procedures laid down by the bank from time to time.

a. Objectives of Credit Audit:

i. Improvement in the quality of credit portfolio.
ii. Review sanction process and compliance status of large loans.
iii. Feedback on regulatory compliance.
iv. Pick-up early warning signals and suggests remedial measures.

b. Functions of Credit Audit Department:

i. To process Credit Audit Reports.
ii. To analyze Credit Audit findings and advise the department / functionaries concerned
iii. To follow up with controlling authorities.
iv. To apprise the Top Management.

c. Scope and Coverage:

The focus of credit audit needs to be broadened from the account level to look at the overall portfolio and the credit process being followed. The important areas are:

c.1 Portfolio Review:

Examine the quality of Credit & Investment (Quasi Credit) Portfolio and suggest measures for improvement, including reduction of concentrations in certain sectors to levels indicated in the Loan Policy and Prudential Limits suggested by RBI.

c.2 Loan Review:

GRID Committee of Executives formed at Head Office level for the Fresh Credit Proposals (restricted to large accounts). Review of the sanction process and status of post sanction processes / procedures.

c.3 **Action Points for Review:**

i. Verify compliance of bank's laid down policies and regulatory compliance with regard to sanction.
ii. Examine adequacy of documentation.
iii. Conduct the credit risk assessment.
iv. Examine conduct of account and follow up looked at by line functionaries.
v. Oversee action taken by line functionaries in respect of serious irregularities.
vi. Detect early warning signals and suggest remedial measures thereof.

2.2 Credit Monitoring:

Credit monitoring activities are to monitor the borrowal accounts on off-site basis to ensure that the asset quality of each borrowal account and that of the Credit Portfolio as a whole is kept under “Standard” category at all points of time. Credit Audit and Monitoring activity commences immediately after the disbursement of advances of fresh, renewal, additional and enhancement of the limits. Symptoms of sickness, weakness and deterioration of asset quality are recognized in advance and acted upon promptly through effective monitoring to capture the Early Warning Signal which would minimize the influx of NPAs. **Early Warning Signals of a serious nature should be reported to the Audit Committee of Board.**

a. Strategies:

The Bank will endeavor to meet all the anticipated risk arise due to the deviations/ violations of the operating personnel and mitigate the possible loss to the Bank.

b. Coverage Of The Policy:

i. Scrutiny of Conditions Compliance Report.
ii. Scrutiny of Disbursement Report.
iii. Follow up of the operations in the credit limits of Rs.3 crore & above
iv. Scrutiny of E-Audit report
v. Scrutiny of Stock Audit Report
vi. SMA Followup of Rs.25.00 lakhs and above
vii. Off-site surveillance on random basis of exposure Rs.1.00 crore and above.
viii. Monitoring of non-renewal of Working Capital Limits.
ix. **Follow up of EWS and report to CMG/MD&CEO/ Audit Committee of Board as the case may be depending upon the severity of the scenario/s for the borrowal account of aggregate credit exposure of Rs.25.00 crore and above.**

3. Functions of CAM Department:

3.1 Scrutinizing Of Loan Disbursal Report (LDR) & Conditions Compliance Report (CCR):

As per our Loan Policy and Head Office Circular No.HO.DGM.CRAM.GEN.0023/2017-18 dt.07.03.2018, the branches has to submit the Loan Disbursement Report (LDR) and Conditions Compliance Report (CCR) to CAM Department **for the credit limits of `1.00crore and above sanctioned.** Such received Reports are to be scrutinized by CAM Department and non compliance of sanction conditions if any, are to be taken up with the branches for compliance with a copy to their respective Regional Office.

3.2 Monthly Monitoring Of Borrowal Accounts With Credit Limit Of `3 Crores and Above:

The branches has to submit the monthly monitoring reports for the borrowal accounts having credit limit of `3 Crores and above, excluding NPA & Suit Filed accounts, in a structured format as on the last Friday of every month to the CAM department and scrutinizing to be done for any deviation.

a. Areas of Scrutiny:

i. Renewal of working capital limits and execution of documentation.
ii. Insurance made for primary/collateral securities.
iii. Submission of Stock / Book Debts statements
iv. Verification of Stock / Book Debts by Branch Officials every month.
v. Timely recovery of interest and / or installment.
vi. Turnover made in working capital accounts and Current / AWB Account of the borrower in tune with limit size.
vii. Cheques / Bills purchased to the borrower and returned.
viii. Return of cheques issued by the borrower.
ix. Operations in export credit limits & overdue export Bill if any.
x. Meeting of commitments under BG / LC/ DPG.
xi. Progress in rectification of supervisory reports such as Stock Audit Report, Concurrent Audit Report, E-Audit Report, Legal Audit Report and Statutory Audit Report etc.

3.3 E-Audit :

Inspection Division of the Bank is conducting E-Audit for the eligible borrowal accounts (both fund based and non fund based, excluding NPA accounts) having credit limit of Rs.3 Crore and above once in a year by identifying the eligible accounts as on 31st March of previous year. **For credit limits of Rs.3.00 crore and above, it should be ensured that all pre-disbursement conditions were complied with.**

A separate Policy was framed by the Inspection Department of our Bank for the E-Audit.

a. **Scrutiny of E-Audit Reports :**

The reports are generated through e-Audit – Credit Audit Module (eTHIC Software). The rectification of features pointed out in the Credit Audit report is followed up by the respective Regions.

The Credit Audit & Monitoring Department is scrutinizing the reports and features are taken up with the respective branches with a copy to their Region. The findings of the report are followed by Regional Office and Head Office till rectification of the commented features. The submissions of Final Certificate for the E-Audit Reports are also taken care by the Credit Audit & Monitoring Department.

3.4 Stock Audit :

The Stock Audit system was first introduced in the Bank in October 2002 to monitor the available Drawing power in relation to the balance outstanding of borrowal accounts enjoying working capital limits of Rs.3.00 Crore & above (Both Fund and Non-fund based).

Our present Bank's Loan policy stipulates as hereunder:

"Stock Audit should be conducted by appointing Chartered Accountants, who are in our panel as Stock Auditors, for Working Capital Limits of ` 3.00 Crore & above (both Fund based and Non Fund based Limits) where the primary security is hypothecation of Stock and/or Book Debts once in a year".

In order to have uniform procedure and practice and to regulate the system of stock audit process, a Policy document on Stock Audit was considered necessary and first such Policy was drafted and adopted in our Bank in the year 2007. **The detailed procedures are available in the Stock Audit Policy.**

As per the guidelines given by Reserve Bank of India the CAM Department identify the eligible borrowal accounts having Working Capital exposure of both Fund based and Non Fund based credit facilities of Rs.3 crores and above by engaging the services of External Stock Auditors to conduct the stock Audit every year.

The External Stock Auditors are instructed to institute receivables audit for large borrowal accounts to check the position of book debts with the invoices, bills raised, book debt and age of book debts in relation to normal credit period. Book debts under dispute, periodic confirmations from debtors, credit reports of high value outstanding buyers of the borrower obtained in the Forensic reports. In case of small borrowers the Internal Inspectors and in case of medium borrowers the external stock auditors and Post Credit Supervisors designated by the Internal Inspection Department are instructed to verify the above and to ensure the drawing power permitted by the branch.

3.5 Monitoring Of Special Mention Accounts :

To improve the credit portfolio not only in speedy recovery of NPAs but also on the prevention of assets from falling into NPA, potential NPA policy was framed and placed in the Bank.

The bases of classification of Special Mention Accounts are given below:

SMA Sub-categories	Basis for classification
SMA-0	Principal or interest payment not overdue for more than 30 days but account showing signs of incipient stress
SMA-1	Principal or interest payment overdue between 31-60 days
SMA-2	Principal or interest payment overdue between 61-90 days

The detailed procedures are available in **POTENTIAL NPAs - POLICY AND PROCEDURES**.

a. Potential NPA Accounts above Rs.1.00 crore:

Branches of the Bank are preparing the potential NPA report through Core Banking system. The CAM department is taking report of SMA1 & SMA2 on fortnightly basis and submitting the same to the Committee of Executives and submitting the report of SMA0, SMA1 & SMA2 to our Board on monthly basis. The CAM department will undertake the following responsibilities:

i. Prepare a statement of such potential NPAs as done by the RMC and also meet, as mentioned for the RMC.
ii. Form a Head Office Monitoring Committee with GM Credit, GM Inspection, GM Recovery & their DGMs/AGMs, with a quorum of three persons.
iii. This Committee will study each unit, suggest remedial measures and prepare resolving/rehabilitating packages for each unit.

The Regional Manager will monitor the progress and report to the CAM. In addition to the exposure of Rs.1.00 crore and above, CAM department is also intimating the overdue amounts of SMA2 accounts having limit of Rs.25.00 lakhs and above to the branches once in a month with instruction to recover the overdue amount with copy to Regional Office.

The stressed accounts are identified and being closely monitored by Credit Audit & Monitoring Department and the accounts which remain continuously under stressed assets are to be placed before the COE of the Bank by the Credit Audit & Monitoring Department.

3.6 Off-Site Surveillance:

CAM Department has to carry out off-site surveillance on an ongoing basis to monitor the operation of large borrowal accounts with the exposure of Rs.1.00 crore and above on random basis to identify the deficiencies, if any, through Core Banking System and communicate the deficiencies to the concerned Branches / Regional Offices / Credit Department to take appropriate / corrective measures in time to avoid the recurrence of such deficiencies and keep the accounts regular and standard always. Special note has to be submitted to the MD & CEO based on the seriousness of the features and on case to case basis.

…8

.**The areas covered under off-site surveillance:**

i. Routing of entire business transactions in the principal borrowal account.
ii. Analysis of account turnover.
iii. Funds transfer, if any, i)to Sister Concern's / Partner's / Director's personal accounts, ii)funds to the borrower's accounts maintained with other Banks through RTGS, NEFT & Clearing and iii) transfer of funds to the beneficiaries who are not related to the business / trade.
iv. Frequent / huge Cash withdrawals in the borrowal account.
v. Passing of cheques favoring other Financial Institutions/ Banks.
vi. Return of cheques issued by the borrower for want of funds in the borrowal account.
vii. Verifying the availability of drawing power for the balance outstanding.
viii. Ensuring the reason for creation of Temporary OD in Finacle system.
ix. Delay, if any, in submission of Stock / Book Debts statements.
x. Wrongly entering the date of receipt of Stock / Book Debts statements in the Finacle system.
xi. Servicing of periodical interest in Working Capital limit accounts and principal with interest in case of Term Loan accounts.
xii. Reviewing / renewing the working capital limits promptly.
xiii. Execution of loan documents for renewal of limits.
xiv. Verifying Unique Customers ID for all the accounts of a single borrower.
xv. Position of realization of Cheque / DD, Inland/Foreign bills drawn under ILC/FLC purchased.
xvi. Ensuring the adequacy of insurance cover for both primary and collateral securities.
xvii. Registration of our bank charges with ROC.
xviii. Verifying the entry of particulars of securities, insurance and inspection in the SRM menu in Finacle system.
xix. Verifying the personal details entered in the ACM menu with CUMM menu.
xx. Advising the branches to instruct the Cash Credit / Overdraft borrowers who are also maintaining separate anywhere current account, to change the Cash Credit / Overdraft account as Anywhere CC/OD account by closing the existing anywhere current account.
xxi. Purification of MIS details.

3.7 Monitoring Of Non Renewal Of Working Capital Limits:

The Department has to submit a Note to Management Committee of Board every month regarding the Non Renewal of Working Capital limits of all our Branches with break-up particulars of non renewal of borrowal accounts having credit limits of `1.00Crore and above.

The Department has to assist the branches in the following ways to reduce the non renewal of working capital limits:-

a. In the beginning of every quarter, the list of Working capital accounts for which the due date is going to expire within 3 months period is to be generated from Finacle and sent to all the branches with a copy to Regional Office with instructions to renew the limits within the due date.

…9

b. Identifying the non renewal of working capital accounts through E-Audit Report, Offsite Surveillance, Monthly Monitoring Reports of `3.00 & above and EAS reports and advising the concerned branches to renew those accounts immediately.

c. Sending letters to Regional Managers every month by comparing the positions of Non renewal accounts with advise to achieve the Bank's Corporate Goal of 'NIL' Timelag accounts position.

d. Sending appreciation letter to Regional Managers who have reduced the non renewal accounts substantially.

3.8 Monitoring Of Large Value Borrowal Accounts :

The Reserve Bank of India has given various guidelines on "Early Recognition of Financial Distress, Prompt Steps for Resolution and Fair Recovery for Lenders: Framework for Revitalizing Distressed Assets in the Economy". These guidelines will also be applicable for lending under Consortium and Multiple Banking Arrangements. The list of the guidelines is appended below for the usage of the Branches in effective monitoring on large borrowal accounts.

a. Reporting information of SMA accounts:

- The Borrowers having aggregate fund-based and non-fund based exposure of Rs 5.00 crore and above with the Bank have come under the purview of monitoring and mandatory reporting to RBI.
- RBI has formed Central Repository of Information on Large Credits (CRILC) to collect, store and disseminate credit data to Banks.

i. All borrowal accounts having aggregate exposure of Rs.5.00 crore and above are to be reported to CRILC on monthly basis by Credit Audit and Monitoring Department with effective from 01.04.2018.

ii. All defaulted borrowers (SMA-0, SMA-1, SMA-2 and NPA) having aggregate exposure of Rs.5.00 crore and above are to be reported to RBI on weekly basis on every Friday with effective from 23.02.2018.

iii. **Borrowers moving out of default are also to be reported to RBI on weekly basis on every Friday with effective from 23.02.2018.**

b. Reporting of Non-Cooperative borrowers to CRILC :

CAM is reporting information of the Non-Cooperative borrowers quarterly within 21 days from the close of the relevant quarter to CRILC after getting permission from Committee of Executives. The detailed procedures are available in **POTENTIAL NPAs - POLICY AND PROCEDURES**.

…10

c. Early Warning Signals (EWS)/ Red Flagged Accounts (RFA):

Early Warning Signals are the indicative of potential problems in the accounts. It enables to identify the borrower accounts which show signs of credit deterioration and needs remedial action. The detailed procedures are available in **POTENTIAL NPAs - POLICY AND PROCEDURES**.

b.1 A Red Flagged Account (RFA):

A Red Flagged Account (RFA) is one where a suspicion of fraudulent activity is thrown up by the presence of one or more Early Warning Signals (EWS). These signals in a loan account should immediately put the bank on alert regarding a weakness or wrong doing which may ultimately turn out to be fraudulent. The bank must use EWS as a trigger to launch a detailed investigation into a RFA.

b.2 Committees for classification of Red Flag Accounts (RFA):

As per the guidance of RBI, the following groups were formed in our Bank for this purpose represented by our top executives of our Bank.

Credit Risk Management Group (CRMG)- Headed by General Manager (CAM) comprising the officials of CAM Department. As the CAM Department is not **headed by General Manager, the CRMG is now headed by DGM (CAM) comprising of Senior Manager CAM Department.**

Credit Monitoring Group (CMG) – Headed by General Manager (Risk Management) comprising of General Manager (Credit), General Manager (Inspection) and DGM (CAM Department). As the Risk Management Department is not **headed by General Manager, the CMG is now headed by General Manager (Inspection) comprising of General Manager (Credit), DGM (Risk Department) and DGM (CAM Department).**

b.3 EWS Statement -Scrutinizing and Reporting:

- On receipt of EWS statement submitted by branches through respective Regional Office, CAM Department will scrutinize the statements and will submit a consolidated report for the cases with the Decision Matrix Score upto 40% and account wise details for the cases with Decision Matrix Score above 40% before the CMG and the directions from CMG will be communicated to branches & Regions and Sanctioning Authority for rectification.
- Fraud cases if any identified by CMG will be forwarded to Vigilance Department for a Special investigation and subsequent action.

b.4 Reporting of Red Flag Accounts (RFA) to CRILC:

If any account is classified as RFA/ Fraud, the status of such RFA/ Fraud account must be reported to CRILC platform, so that other Banks will get alerted. Within 15 days, the bank shall approach the consortium leader under consortium advance or the largest lender under MBA as the case may be for a JLF meeting for a coordinated legal action.

4. Followup of Irregular Advances:

It has been decided to implement the followup system for SMA 0 accounts (Principal/interest payment not overdue for more than 30 days but account showing signs of incipient stress) apart from the regular follow up of SMA1, SMA2 and NPA accounts. Prevention is better than cure. When the demand raised is satisfied within 30 days, the recovery system becomes healthy and stabilized. It also educates the borrowers in the right way ensuing the healthy operations.

Hence, Branches are advised to generate the irregular statement of advances upto 30 days (borrowerwise) as on last friday of every month for all the Term Loans and Working Capital Loan accounts. For convenience of the Branches, a separate option No.70 is available in Followup Menu in Finacle. Branches should submit the completed monthly irregular statement to the respective Regional Office within next 3 working days.

After receipt of the statement of irregular advances, the Regional Office should scrutinize the statement and to give suitable directions to the branches within next 3 days and to follow the recovery process taken by the branches. All the Regions should send a certificate to the CAM department on the first week of the succeeding month confirming the obtention and scrutiny of the Statement of overdue advances.

5. Review:

This policy is placed before the board for review and approval for the year 2018-19. **This policy will be in force upto March 2019** and will be reviewed thereafter, with fresh guidelines of RBI and/or as desired by the Board/Management, being incorporated.