Potential NPAs Policy & Procedures : 2018-19]

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DOCUMENT VERSION CONTROL

Document Title	Review of Potential NPAs- Policy & Procedures 2018-19.
Prepared By	Senior Manager, Credit Audit & Monitoring Department
Verified & Recommended By	Deputy General Manager, Credit Audit & Monitoring Department
Approved By	Board
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Document History

Version No.	Date of Approval	Brief Description of Changes	Reason
1.0	27.12.2013 (Board)	**Newly Developed** The following aspects to be included as early alerts. 1. Dispute among partners of the borrower firm. 2. Abrupt change in product lines. 3. Presence of too much stagnant stocks. 4. Too much of sales returns on account of quality issues. 5. Pollution concerns 6. Disputes with revenue authorities. 7. Change in management 8. Adverse rating migrations.	Rectification of AFI 2013-2014 Observation

2.0	18.09.2015 (Board)	**Additional** Timely submission of credit information to CRILC and accessing information therefrom, prompt formation of Joint Lender's Forums (JLFs), monitoring the progress of JLFs and adoption of Corrective Action Plans (CAPS), etc.	Rectification of AFI 2014-2015 Observation
3	10.05.2016 (Board)	**Modification** Page11 Point b. The decisions agreed upon by a minimum of 75% of creditors by value and 50% of creditors by number in the JLF would be considered as the basis for proceeding with the restructuring of the account and will be binding on all lenders under the terms of the Inter Creditor Agreement(ICA).	RBI cir DBR.BP.BC.NO.82/ 21.04.132/2015-16 dated 25.02.16
		Modification Page 11 Point C.2 If the JLF decides to restructure an account, the JLF should carry out the detailed Techno-Economic Viability (TEV) study, and if found viable, finalize the restructuring package within **30** days from the date of signing of the final CAP. **The Borrower indulging in frauds and malfeasance** will normally not be eligible for restructuring. JLF may decide on restructuring of an account classified as "doubtful" in the books of one or more lenders similar to that of SMA 2 and sub-standard assets, if the account has been assessed as viable under the TEV and the JLF-EG concurs with the assessment and approved the proposal.	RBI cir DBOD.BP.BC.No.97 /21.04.132/2013-14 dated 26.02.2014 RBI cir DBOD.BP.BC.No.39 /21.04.132/2015-16 dated 24.09.2015

		Additional <u>Page 11 Point C.5</u> A Restructured account is one where the bank, for economic or legal reasons relating to the borrower's financial difficulty, grants to the borrower concessions that the bank would not otherwise consider. Restructuring would normally involve modification of terms of the advances/securities, which would generally include, among others, alteration of repayment period/repayable amount/the amount of installments/rate of interest(due to reasons other than competitive reasons) <u>Page 12 (d) a</u> All restructuring packages under CDR/JLF /Consortium/ MBA arrangement should be Implemented within 90 days from the date of approval. Other restructuring packages should be implemented within 120 days from the date of receipt of the application by the bank. The borrowers indulging in frauds and malfeasance are not eligible for restructuring. JLF will have the option to initiate Strategic Debt Restructuring (SDR) to effect change of management the borrower company in cases of failure of rectification or restricting as a CAP as decided by JLF, subject to compliance with the stipulated conditions. When a restructured account classified as NPA and upgraded to standard category will attract 5 % provision in the first year from the date of up gradation.	RBI cir DBR.BP.BC.No.82/21.04.132/2015-16 dated 25.02.16

4	27.03.2017 (Board)	**Additional** **Page No- 2; Point: 3.1** **<u>Policy regarding Potential NPAs</u>** Software "Early Warning Signals" to identify Irregular accounts, Potential NPAs and Fraud Accounts for the aggregate exposure of Rs. 25.00 crore and above. 51 parameters considered as EWS in the EWS software for identifying irregular accounts/ potential NPAs (see Annexure -II).	Based on our Circular No.HO.DGM.CRAM. GEN.18/CirNo.1145/ 2017-18 dated 07.02.2018
		Additional **Page No.3; Point: 4.2** **<u>Followup of Irregular Advance</u>** 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.	Based on our Circular No.HO.GM.CRAM. GEN.0004/2017-18 dated 21.07.2017.

		Additional **Page No.3; Point: 4.3** **<u>Identification of Potential NPAs</u>** To help such identification, the Early Alert System will be used for the aggregate exposure of less than `25.00 crore.  To help such identification, the Early Warning Signals software will be used for the aggregate exposure of `25.00 crore and above.	Based on our Circular No.HO.DGM.CRAM. GEN.18/CirNo.1145/ 2017-18 dated 07.02.2018.
		Additional **Page No.9; Point: 7.1** **<u>Reporting information of SMA accounts</u>** The bank should report Credit Information including classification of an account as SMA to CRILC on all borrower entities having aggregate exposure of Rs. 5.00 crore and above with the bank. The CRILC – Main Report will be required to be submitted on a monthly basis effective from April 1, 2018. In addition, the Bank has to report list of defaulted borrowers (SMA-0, SMA-1, SMA-2 and NPA) to RBI on a weekly basis at the close of business on every Friday. If Friday happens to be a holiday they will report the same on the preceding day of the week. The first of such weekly report should be submitted for the week ending February 23, 2018. The Bank has to report list of borrowers of aggregate exposure of `5.00crores and above (SMA-0, SMA-1, SMA-2 and NPA) moving out of the default to RBI on weekly basis with effect from February 23, 2018.	RBI.Circular.No. DBR.No.BP.BC.101/ 21.04.048/2017-18 dt.12.02.18 RBI.Circular.No. DBR.No.BP.BC.101/ 21.04.048/2017-18 dt.12.02.18 RBI.Circular.No. DBS.OSMOS.No.44 92/33.01.18/2017-18 dt.20.02.18

		Deletion **Page No.9; Point: 7.1** **<u>Reporting information of SMA accounts</u>** The Bank has to submit a quarterly return on large credit borrowers.	RBI.Circular.No. DBS.OSMOS.No.4492/33.01.18/2017-18 dt.20.02.18
		Additional **Page No. 11; Point: 7.4** **<u>Resolution of stressed assets – Revised :</u>** Resolution Plan (RP): The Reserve Bank of India has decided to substitute the existing guidelines with a harmonized and simplified generic framework for resolution of stressed assets called Resolution Plan (RP). A Resolution Plan is one which involves actions/ plans/ reorganization including, but not limited to, regularization of the account by payment of all over dues by the borrower entity, sale of the exposures to other entities / investors, change in ownership, or restructuring and revised framework and withdrawal of existing instructions.	RBI.Circular.No. DBR.No.BP.BC.101/21.04.048/2017-18 dt.12.02.18
		Additional **Page No. 13; Point: 8** **<u>Early Warning Signals (EWS)/ Red Flagged Accounts (RFA):</u>** 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.	RBI.Circular.No. DBS.CO.CFMC.BC.NO.007/23.04.001/2014-15 dt.07.05.15.

		<u>A Red Flagged Account (RFA):</u> 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. Implementation of EWS/RFA framework with an objective of prevention, early detection, prompts reporting to the RBI.	

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

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TAMILNAD MERCANTILE BANK LTD., HEAD OFFICE, THOOTHUKUDI

CREDIT AUDIT & MONITORING DEPARTMENT

POTENTIAL NPAs - POLICY AND PROCEDURES 2018-2019

1. Introduction:

1.1 The health of the Credit portfolio in banks in India has been receiving re-iterated regulatory attention, in view of the increasing incidence of Non-Performing Assets (NPAs).

1.2 Accent is on not only in speedy recovery of NPAs but also on the prevention of assets from falling into the NPA category: i.e., identification of Potential NPAs and resolving the related problems.

1.3 This Memorandum seeks to present:

a. The categorization proposed for Stressed Assets in the pre- substandard category.

b. The Bank's policy regarding the category of potential NPAs.

c. Bank's approach towards Potential NPA accounts i.e. on Special Mention Accounts (SMA).

d. Bank's policy on their large borrowers having aggregate fund-based and non fund-based exposure of Rs 5 crores and above.

1.4 This Memorandum covers Potential NPA of all sectors that is MSME, Agriculture, Retail etc., with more focus on MSME.

2. Potential NPAs: Categorization:

2.1 The present accent being to identify potential NPAs or possible incipient sickness at the earliest opportunity and to help a systematic/prioritized approach, a granular segregation of irregular accounts, well before they reach the Sub-Standard stage is being introduced, based on Health status and the duration of irregularity, as follows:

S.No	Asset Category	Tenure
1.	Standard Assets	All regular accounts.
2.	Irregular Accounts	Irregular upto 30 days
	Irregular (SMA 0)	Principal or interest payment not overdue for more than 30 days but account showing signs of incipient stress (Annexure - I)
	Irregular – Probable Potential NPAs (SMA 1)	Irregular for more than 30 days but within 60 days
3.	Potential NPAs (SMA 2)	Irregular for more than 60 days but below 90 days.
4.	Sub-Standard	Slipped below standard assets by being irregular for 90 days & more

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2.2 **Some key characteristics of Potential NPAs (Special Mention Accounts):**

a. The assets have inherent weakness which requires immediate and close attention.

b. Assets which have deeper malaise, may slip into sickness and become NPAs, with consequent deterioration in client's business well being and repayment capability, with parallel adverse impact on the bank's credit risk and profitability.

c. An asset may be regular in its accounts but may still be sick due to internal causes; thus, parameters other than account position would require analysis to identify potential NPAs.

d. Potential NPAs do not require provisioning as they are not in the NPA stage; this facilitates endeavors like alerting and helping the borrowers on financial parameters etc.

3. Policy Regarding Potential NPAs

3.1 Bank has specific Policy and Processes relating to Potential NPAs, such as:

a. A software "Early Alert System" to identify Irregular Accounts and Potential NPAs for the aggregate exposure of less than Rs. 25.00 crore.

b. A software "Early Warning Signals "to identify Irregular accounts, Potential NPAs and Fraud Accounts for the aggregate exposure of Rs. 25.00 crore and above.

c. **51 parameters considered as EWS in the EWS software for identifying irregular accounts/ potential NPAs (see Annexure -II).**

d. A 'Stressed Assets Management Cell' particularly focusing on Head Office Transferred Accounts.

3.2 Likewise, Bank is having a specific Policy and Processes as related to Potential NPAs/Special Mention Accounts for the critical reasons that:

a. This is the 'incubator' stage for NPAs.

b. Early recognition, followed by quick, adequate and appropriate initiatives to prevent credit risks is necessary to help and sustain the health of the Credit portfolio and importantly, the healthy growth of business of the clients.

c. It is not easy to detect the causative factors for incipient sickness and to resolve them when the account slips into delinquency.

3.3 Policy Statement:

Tamilnad Mercantile Bank is sensitized to the fact that early recognition of Potential NPAs and their resolution through speedy, appropriate and adequate initiatives is critical to support sustained health of both itself and that of its clients and is, therefore, committed to such task.

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4. **Approach:**

Bank approach relating to Potential NPAs and their resolution will include the following:

4.1 Creating a Data Base.

In addition to the use of the software for preparing a list of distressed assets at the Head Office, branches are directed to collate and forward their categorized list, to their Regional Managers: they will peruse them and send them, for a all-bank database, to the Credit Audit & Monitoring Department. Parameter necessary for identification (listed below) will be explained to all branches.

The Database will be updated every month. Database creation and maintenance will be strengthened with support from the IT Department.

4.2 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.

4.3 Identification of Potential NPAs:

a. **To help such identification, the Early Alert System will be used for the aggregate exposure of less than `25.00 crore.**

b. **To help such identification, the Early Warning Signals software will be used for the aggregate exposure of `25.00 crore and above.**

c. In addition, the branches/controllers will also use or apply the five categories of parameters, both Quantitative and Qualitative, listed and placed below.

d. The potential NPAs may not exhibit any specific parameter/parameters. To help identify sickness, a comprehensive matrix of parameters may need to be used.

4.2.1.The Five categories of Parameters:

a) Transaction related Parameters (Quantitative):

These are “visible”, seen in the usual account operations of the client.

- Declining balances/declining operations in the account
- Opening of accounts and routing operations with other banks
- Inordinate delays in payment of bills, short payments.
- Return of outward bills/dishonor of cheques;
- Sales transactions not routed through the account
- Frequent requests for loans, particularly temporary overdrafts, adhoc limits etc.
- Frequent delays in submitting stock statements, incomplete/ false data.
- Delay in QIS : Absence of explanations for deviations.
- Diversion of funds.
- Persistent irregularity in the account (Note:where the irregularity persists more than 30 days the account will get categorized as probable potential NPA).
- Inordinate delays/ Default in repayment obligations.
- Devolvement of LC/Invocation of Guarantees.
- Inordinate delays in the submission of audited financials (say more than 3 months)
- Wide variation between the projected financials submitted earlier and the audited ones submitted later (normally the variation should not be more than 5%).
- Non compliance of the sanctioned terms & conditions.
- Non submission of periodic information, returns, as stipulated.
- Frequent Overdrawing.

b) Financial Parameters – (Quantitative):

These are generally seen in or emanate from the client’s balance sheets and financial statements like cash flows, statement of receivables, income-expenditure statements, quarterly information returns (QIS), Stock audit Reports etc.

Each point would need understanding or analysis.

A comparative analysis with two or three balance sheets would help better evaluation/judgment.

- Declining Sales/ Production.
- Decrease in operating Profit/ Net Profit.
- Increase in Operating losses/net losses.
- Declining profits despite increase in sales.
- Steep fall in Current Ratio / Quick Ratio; in all Management Ratios (relating to stocks, creditors, debtors)
- Negative net working capital (NWC).
- High leverage ratio
- Wide variation in key indices like sales, profits, key financial ratios between those anticipated and the actual.

- Low Debt Service Coverage ratio or actual showing high divergence from those projected.
- High amount of Receivables; increase in debts more than 6 months old.
- High amount outstanding in Sundry Creditors.
- Substantial increase in long-term debts in relation to capital.
- Rising level of bad debts.
- Drop in Risk rating.
- Disproportionate increase in overheads related to sales.
- Increase in loans from outsiders.
- Increase in funds lent / received from sister concerns.
- High level of statutory dues; utility bills.
- Uneven/ Inconsistent cash flow.
- Promoters pledging/selling their shares.

c) Operational Parameters: (as related to the Client's Factory Management): some Qualitative, some Quantitative.

Seen during inspections/ stock audits.
Need smart inspection and understanding by inspection staff.
Need analytical discussions with proprietors, key personnel:

- Low activity level in factory/ business.
- Evidence of aged inventory/High level of inventory.
- Pileup in finished goods, returned stocks.
- Cluttered up look; bad maintenance of factory premises, machinery, spares, tools etc.
- A not-so-peaceful ambience; disgruntled workers, frequent labour problems, frequent exit of workmen/supervisor.
- Machinery imbalance in production process.
- Arrears in wages.
- Arrears in utility bills.
- Low productivity; fall in quality standards and value addition.
- Disorderly production process, frequent changes in plans.
- Loss of critical customers
- Time and cost over-run in projects.
- Low order book.
- Non compliance of regulatory requirements.
- Closure of factory for a long time.

d) Management parameter (Qualitative):

Inadequate finance need not necessarily be the major causative factor leading to sickness.

Management ineffectiveness, inadequate administration/ controls also contribute to business decline. Need inspecting staff attention, open discussions with proprietors, market report.

- Infrequent visits by Promoters/Owners.
- Dissension among Partners/Directors/Promoters.
- Exit of partners, key personnel.

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- Change in management, ownership, key personnel.
- Family disputes.
- Inadequate keeping of books, poor financial control.
- Fudging of financials.
- Poor production control; inadequate marketing efforts.
- Diversion of attention/ funds to other activities.
- Taking of undue risks.
- Unplanned expansion.
- Unplanned change in products.
- Badly designed production lines.
- Non adoption of better technology.
- In-sensitizing to changing environment and increasing competition.
- Inadequate management to meet environmental challenges.
- Poor HR practices, inadequate training of executives, workmen.
- Poor costing and pricing methodology.

e) External Factors(Qualitative):

These affect the clients business, profit and future, generally not controllable by the client.

Need good perception by operating staff/controllers;

Study of the industry sector involved; use of internet.

- Global/national recession.
- Emergence of new competition.
- Emergence of new technology, competing products.
- Changes in Government, in regulatory policy, in economic policy.
- Rising cost of inputs.
- Import of products at cheaper price.
- Natural calamities.

4.3 Approach/Processes planned:

a. Emphasis on prevention of irregularity:

Reiterated instructions to branches to tighten monitoring action like sending reminders to clients, well before due dates of interest/installment payments, conducting close and meaningful inspections.

b. When (initial) irregularity occurs:

Intensified action by branch officials for cash recovery like sending letters, reaching by phone calls and by personal visits.

In parallel, particularly when the irregularity shows signs of continuance, initiation of direct discussions with the promoters.

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c. **Creation of a facilitating ambience for communication:**

- Even at the advent of irregularity, there should be no hardening of approach towards the client, lest communication gets blocked, preventing rational approach by the bank.

- Irregularity in an account could be a symptom of a mere lapse in cash flow-which can be resolved easily. It could also be a signal of a deeper malady requiring closure understanding and analysis.

- In the latter instance, it is critically important that clients feel free to have proactive and open discussions with bank officials; this would help the quick drawing up of comprehensive and strategic rehabilitation programs with full client participation.

4.4 Sensitizing Awareness:

To enthuse, operating officials to take quick action and draw adequate and appropriate plans of resolving the situation/rehabilitate the potential NPA account, in addition to letters, Bank shall hold seminars of officials/ controllers/ inspection department officials to explain the category, the signals to look out for and the approach expected. If necessary, short term training programs will also be organized. Excellent work done in the report will receive appreciation from the management and noting in the performance report.

4.5 Method of Resolution:

These will vary and will be unique to the client involved. Their intensity will relate to the problems identified. For eg. a transient problem caused by inconsistent cash flow or paucity in adequate liquidity (caused by, say, delays in bill payments, unexpected exigencies like payment of additional wages/statutory dues/ spurt in cost of inputs etc.) and which may get evened out over a fairly quick period of time may be met through injections of Adhoc funds, restructuring of the stipulated repayment program in the term loan and changes in the composition, of the working capital loans, reduction in margins etc.

If the cause relates to production process, say, mismatch in machinery, lack of some equipment etc, that may be rectified through designing appropriate term loans.

If an inherent serious sickness is indicated, that would require deeper analysis and planning.

Where Management deficiency is seen, perhaps counseling or the imposition of stiff covenant may be needed.

EXIT from Bank exposure may also become necessary if the problem does not look amenable to resolution in a reasonable period of time. All will, nevertheless, be done at the speediest time possible.

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5. **Formation of Committees:**

To boost up the proactive remedial measures, for early regularization of potential NPAs and for monitoring, two committees will be formed:

5.1 Potential NPA accounts up to Rs 1.00 crores:

a. These will be identified and monitored by the respective Regional Office.
b. The Chief Manager designated for this task at the RO, will collate a list of all potential NPAs in the regions branches applying the parameters listed in the EAS.
c. The collated list will be a tabulated list with all essential data like the particulars of the unit identified, position of accounts, the date from which the account is irregular, the possible reason etc.
d. The Regional Manager will constitute a 'Regional Monitoring Committee' (RMC) comprising the RM, CM, the BH concerned, the Credit Officer and where necessary, the Law Officer.
e. The RMC will meet once in a month, on the 7th, or earlier/more frequency when necessary; its quorum will be three members.
f. The RMC will discuss each unit in detail, involve the client and evolve a plan of resolving the problems/rehabilitation.
g. The RM will submit the financial package so devised before the appropriate sanctioning authority.
h. The branches will operationalize the package quickly. The Branch Head will also initiate discussions with the client.
i. The RM will monitor the progress of each unit closely.
j. The RM will place a monthly report to the Credit Audit & Monitoring Department at the Head Office on the details of the meetings held, the packages evolved for each unit, sickness identified, reasons found and the implementation effected.
k. The Officials from Inspection Department will verify the effective functioning of the Committee and the progress made in each package.

5.2 Potential NPA accounts above Rs 1.00 crore:

The CAM department will undertake the following responsibilities:

a. Identify all potential NPAs with the support of Finacle.
b. Prepare a statement of such potential NPAs as done by the RMC and also meet, as mentioned for the RMC.
c. Form a 'Head Office Monitoring Committee' with GM Credit, GM Inspection, GM Recovery & their DGMs/AGMs, with a quorum of three persons.
d. This Committee will study each unit, suggest remedial measures and prepare a resolving/rehabitation packages for each unit.
e. The discussions will involve the Branch Head and the client where ever necessary.
f. The financial package will be placed by CAM before the appropriate sanctioning authority with necessary details and the package sphere-headed by the RM/ BH.
g. The RM will monitor the progress and report to the CAM.

5.3 The CAM will monitor the working of both the Committees. It will place fortnightly report to the Committee of Executives at the HO, Monthly report to the Board of Directors.

5.4 The Inspection Department will perform its task as mentioned in the case of the Regional Monitoring Committee.

6. Modifying the Committee Approach:

The formation of the Committees has been evolved now, to have close attention of the Management as envisaged by RBI and to have the advantage of collective wisdom of people to find solutions.

All operating units - i.e the RO and the branch together develop adequate sensitivity and skills so that delays do not occur in the identification and implementation processes. The officials with skills so developed will help the preparation of the packages as comprehensive as possible, by themselves.

This will reduce, over a period of time, the entire work being done by the Committee.

7. 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 gists of the guidelines are appended below for the usage of the Branches in effective monitoring on large borrowal accounts.

7.1 Reporting information of SMA accounts:

a. The Borrowers having aggregate fund-based and non-fund based exposure of Rs.5 crores and above with the Bank have come under the purview of monitoring and mandatory reporting to RBI.
b. RBI has formed Central Repository of Information on Large Credits (CRILC) to collect, store and disseminate credit data to Banks.
c. **The bank should report Credit Information including classification of an account as SMA to CRILC on all borrower entities having aggregate exposure of Rs. 5.00 crore and above with the bank. The CRILC – Main Report will be required to be submitted on a monthly basis effective from April 1, 2018.**
d. **In addition, the Bank has to report list of defaulted borrowers (SMA-0, SMA-1, SMA-2 and NPA) to RBI on a weekly basis at the close of business on every Friday. If Friday happens to be a holiday they will report the same on the preceding day of the week. The first of such weekly report should be submitted for the week ending February 23, 2018.**
e. **The Bank has to report list of borrowers of aggregate exposure of `5.00crores and above (SMA-0, SMA-1, SMA-2 and NPA) moving out of the default to RBI on weekly basis with effect from February 23, 2018.**

7.2 Adoption of Guidelines on Revitalizing Distressed Assets by RBI:

Banks exposure to Large Borrowal Accounts is on increasing trend. The quantum of SMA2 accounts in total SMA account is also on higher side. Hence by knowing the importance of managing the distressed assets, as per RBI guidelines, our Bank has implemented "Early Warning Signals" for early detection of fraud and to prevent bad loans arising out of fraudulent activities as detailed separately. The Credit Audit Monitoring Department has to follow the guidelines of RBI related to Large Borrowal Accounts and monitor the accounts effectively so as to keep the quantum of distressed large borrowal accounts at a lower level.

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All the reporting to CRILC will be done by Credit Audit Monitoring Department through the Return Section of the Bank. The Department will coordinate with Credit Department and Recovery Department for the effective implementation of RBI guidelines.

7.3 Non Co-operative Borrowers:

A non co-operative borrower is one who does not engage constructively with his lender by defaulting in timely repayment of dues while having ability to pay, thwarting lenders' efforts for recovery of their dues by not providing necessary information sought, denying access to assets financed/ collateral securities, obstructing sale of securities, etc. In effect, a non- co operative borrower is a defaulter who deliberately stone walls legitimate efforts of the lenders to recover their dues.

a. Cutoff limit for classifying Non Co-operative Borrowers :

The cut off limit for classifying borrowers as non-cooperative would be those borrowers having aggregate fund-based and non-fund based facilities of Rs 5.00 crores from the concerned bank /FI. A non-Cooperative borrower in case of a company will include, besides the company, its promoters and directors (excluding independent directors and directors nominated by the Government and the lending institutions). In case of business enterprises (other than companies), non-cooperative borrowers would include persons who are in-charge and responsible for the management of the affairs of the business enterprise.

b. Committee of Executives for classification of Non-Cooperative Borrowers :

A transparent mechanism for classifying borrowers as non-cooperative is required to be put in place. Accordingly the bank will form a committee of Higher Functionaries with General Managers of Credit Department, Recovery Department and Inspection Department, DGM of Credit Audit Monitoring Department.

c. Show Cause Notice to the Non-Cooperative Borrowers :

If the committee concludes that the borrower is non-cooperative, it shall issue show cause notice to the concerned borrower (and the promoter/whole time directors in case of company) and call for his submission, and after considering his submission, issue an order regarding the borrower to be non-cooperative borrower and the reason for the same. An opportunity is required to be given to the borrower for a personal hearing, if the Committee feels such an opportunity is necessary.

d. Review Committee:

The order of the Executive Committee should be reviewed by another Committee headed by the Managing Director & CEO and consisting of two directors of the Bank and the order shall become final only after it is confirmed by the Review Committee.

e. Reporting of Non-Cooperative borrowers to CRILC :

Banks are required to report information on the Non-Cooperative borrowers quarterly within 21 days from the close of the relevant quarter to CRILC. Declassification considering the merits of the case, on review of the non-cooperative borrowers by the Board, need to be reported separately every half-year to CRILC, with adequate reasoning/rationale for such removal.

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f. **Review of the status of Non-Cooperative borrowers by Board :**

The Board of the Bank should review the status of non-cooperative borrowers for deciding whether their names can be declassified as evidenced by their return to credit discipline and cooperative dealing.

The Credit Audit & Monitoring Department has to collect the details of non co-operative borrower of all the branches through their respective regions. It is the Department's responsibility to conduct the meeting of Committee of Executives for identifying Non-Cooperative Borrowers and issuing show cause notice to them. The decision has to be placed in the Review committee of the Board on Non-Cooperative Borrowers for confirming of the classification. The Credit Audit Monitoring Department has to place Half-Yearly note to the Board for review of the status of Non-Cooperative Borrower. And also the Department has to report on the Non-Cooperative Borrowers on quarterly basis within 21 days from the close of the relevant quarter to CRILC and declassification of the Non-Cooperative Borrowers has to be reported to the CRILC separately with adequate reasoning/rationale for such removal on half yearly basis.

7.4 Resolution of stressed assets – Revised:

7.4.1 Resolution Plan (RP):

The Reserve Bank of India has decided to substitute the existing guidelines with a harmonized and simplified generic framework for resolution of stressed assets called Resolution Plan (RP). A Resolution Plan is one which involves actions/ plans/ reorganization including, but not limited to, regularization of the account by payment of all over dues by the borrower entity, sale of the exposures to other entities / investors, change in ownership, or restructuring.

7.4.2 Implementation of Resolution Plan (RP):

A Resolution Plan can be implemented by banks who continue to have credit exposure in respect of the borrowers if the following conditions are met.

a. the borrower entity is no longer in default with any of the lenders;

b. if the resolution involves restructuring; then

I. all related documentation, including execution of necessary agreements between lenders and borrower / creation of security charge / perfection of securities are to be completed by all banks , if the credit arrangement is made under MBA /Consortium.

II. the new capital structure and/or changes in the terms of conditions of the existing loans get duly reflected in the books of all the banks and the borrower.

Resolution Plan involving restructuring/change in owners in respect borrowal account with aggregate exposure of ₹100.00 crores and above requires independent credit evaluation (ICE) of the residual debt by credit rating agencies (CRAs) specifically authorized by the Reserve Bank of India. Similarly, borrowal account with aggregate exposure of ₹500.00 crores and above requires two such ICEs. Only accounts which receive a credit opinion of upto RP4 or better CRAs shall be considered for implementation.

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The requirement of Independent Credit Evaluation (ICE) will be applicable to restructuring of all eligible large borrowal accounts implemented from 12.02.2018 even if the restructuring is carried out before 01.03.2018.

7.4.3 Timeline for Implementation of Resolution Plan (RP):

For large borrowal accounts with aggregate exposure of ₹2000.00 crore and above on or after 01.03.2018 including borrowal accounts where resolution already have been initiated under any of the existing schemes as well as accounts classified as restructured standard assets which are currently in respective specified periods (as per previous guidelines). RP shall be implemented as per the following timelines:

a. 180 days from the date of default (If in default, as on 01.03.2018).
b. 180 days from the date of such default (If in default is after 01.03.2018).

7.4.4 Filing of Insolvency Application:

If Resolution Plan is not implemented as per the timelines, bank should file Insolvency Application singly or jointly under the Insolvency and Bankruptcy Code 2016 (IBC) within 15 days from the expiry of the said timelines.

Where RP involving restructuring / change in ownership is implemented within 180 days, that account should not be in default at any point of time during the specified period, failing which the banks should file an Insolvency Application, singly or jointly, under the IBC Code 2016 within 15 days from the date of such default.

7.4.5 Specified Period:

Specified period means the period from the date of implementation of RP upto the date by which at least 20 percent of the outstanding principal debt as per the RP and interest capitalization sanctioned as part of the restructuring, if any, is repaid. Provided that the specified period cannot end before one year from the commencement of the first payment of interest or principal whichever is later on the credit facility with longest period of moratorium under the terms of RP.

Any default in payment after the expiry of the specified period shall be reckoned as a fresh for the purpose of this frame work.

For other accounts with aggregate exposure of the banks for the aggregate credit exposure of above Rs.100.00 and below Rs.2000 crore, RBI will announce reference dates for implementing the RP to ensure calibrated, time bound resolution of all such account in default over a two year period.

7.4.6 Withdrawal of extant instructions:

The extant instructions on resolution of stressed assets such as Framework for Revitalizing Distressed Assets , Corporate Debt Restructuring (CDR) , Flexible Structuring of Existing Long Term Project Loans, Strategic Debt Restructuring Scheme(SDR), Change in ownership outside SDR and Scheme for Sustainable Structuring of Stressed Assets (S4A) stand withdrawn with immediate effect.

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As such, the Joint Lenders' Forum (JLF) as an institutional mechanism for resolution of stressed accounts also stands discontinued. All accounts including such accounts where any of the schemes have been invoked but not yet implemented should be governed by the revised framework.

8. 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.

8.1 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.

8.2 Objectives:

The objective of this framework is to direct the focus of banks on the aspects relating to prevention, early detection, prompt reporting to the RBI. Accordingly the concept of Red Flagged Account **(RFA)** and Early Warning Signals **(EWS)** are emerged.

8.3 List of EWS:

The RBI has given an illustrative list of some **Early Warning Signals** for follow up and also advised the banks to choose to adopt or adapt the relevant signals from this list and include other alerts/signals based on their experience, client profile and business models. The EWS so complied by a bank would form the basis for classifying an account as a RFA **(as per Annexure – II).**

8.4 Threshold Limit for identifying Early Warning Signals (EWS):

a) The RBI has suggested threshold for EWS and RFA is an exposure of Rs.50.00 crore or more irrespective of the banking arrangement (sole banking, multiple banking or consortium). All accounts beyond Rs.50.00 crore classified as RFA or 'Frauds' must also be reported on the CRILC data platform together with the dates on which the accounts were classified as such.

b) Further, The RBI has advised the banks to fix the threshold limit below Rs.50.00 crore for monitoring of loan frauds is left to the discretion of the banks. Accordingly our Bank has decided to monitor the loans/advances exposure of Rs.25.00 crore and above.

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8.5 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.

a. **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.**

b. 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).**

8.6 Functions of the Groups:

a. **Credit Risk Management Group (CRMG):**

On receipt of EWS statement submitted by branches through respective Regional Manager, CAM Department will scrutinize the statements and will submit

- A consolidated report for the cases with the Decision Matrix Score upto 40% and for the cases with the Decision Matrix Score of above 40 % , accountwise details 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. **Credit Monitoring Group (CMG):**

- The CMG will take a call on the loan accounts observed in EWS are classified as RFA properly. In case the account is classified as RFA, the CMG will stipulate the nature and level of further investigations or remedial measures wherever necessary to protect the Bank's interest within a stipulated time of not exceeding six months.
- Before taking final decision on RFA, CMG can also seek advice from the external auditors, including forensic experts or an internal team for Investigations if necessary. At the end of this time line, not exceeding six months, banks should either lift the RFA status or classify the account as a fraud.
- The CMG shall classify the account as RFA and the details of RFA accounts shall be put up to MD & CEO on every month. If any Red Flagged account is identified as Fraud account, the same will be reported to our Vigilance Department for their further follow up, reporting and action.
- An action taken report on the RFA accounts shall be put up to the Audit Committee of Board with the Synopsis of the remedial action taken together with their current status.
- 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.

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In order to strengthen the monitoring system with automation, and to cover comprehensive fraud scenarios in accordance with the RBI guidelines, it has been decided at our Top Level Committee on 14.06.2017 and 15.06.2017 about the various parameters/ explanation to the parameters considered for EWS which were duly approved by our Audit Committee of Board on 04.11.2017. Our bank has introduced the new software system on 31.01.2018 by our software vendor **M/s.Ernst & Young LLP**, Mumbai. Our CAM Department conducted a training program for one day on 10.02.2018 at our Staff Training College, Nagercoil for 59 officers of our Bank dealing with Big Ticket Advances of Rs.25.00 crore and above and credit officers of all our 12 Regions with the participation of expert team from E & Y and our team from CAM Department in the live session to discuss the operational issues/guidelines for effective implementation of the new scheme.

8.7 The benefits of the new software:

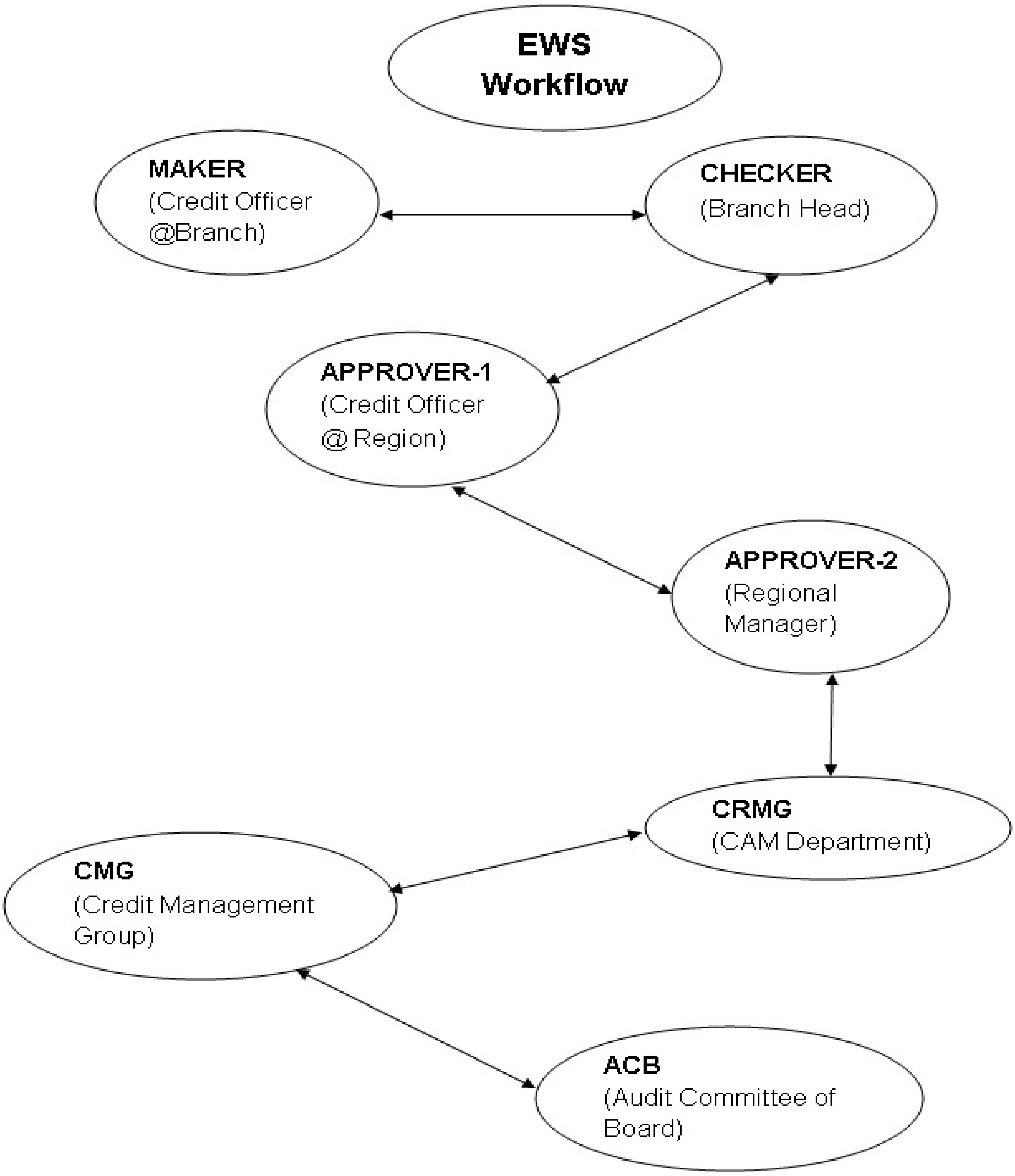
- Assists the bank to determine which accounts should be subjected to Forensic Audit or marked RFA.
- Provides a secured and automated model based platform for decision making.
- Provides comment section for each scenario to enable the bank to document the rationale for marking the respective EWS in a loan account.
- Ensures uniformity within the bank for monitoring and taking decision based on early warning signals.
- Intelligent scoring based model leading to ease in decision making/tracking of the account.
- Helps the user in decision making for future course of action in cases where certain red flags are observed.
- Acts as a backup document for supporting the rationale behind the decision taken.
- Provides complete audit trail of the actions/updates in the system.

At present we are initiating the program with the loans/advances exposure of `25.00 crore and above only. As such, the selective accounts having such exposure only displayed in the new software. The new software shall be access through chrome browser in **"http://10.30.34.11/ews/".**

8.8 Operational Guidelines:

After login, the credit officer at the branches shall able to select the required account and the inputs are to be given with utmost care. The user has to enter the related 'comments' and then only the system able to move into next screen. Branches should extract the required data through Finacle, upload the analysis/comparison of Financial statements with the previous years and information from external sources, if any. Based on the input data, the risk related to a specific account is classified and the decision matrix is formulated, the maker of the data can able to take print out after entering all the required information. The printouts should be maintained for any Inspection purposes. The branches should forward the monthly EWS statement to the respective Regional Office within 7 of the succeeding month.

The completed data should be forwarded by the Credit Officer to the next level as illustrated in the flow chart as follows:



Whenever the maker of the Branch pushed the data to the next level, the Branch Head received a pop up message in his/her official mail it and he/she can approve and forward it to next level, ie., the credit officer of the Region or re-forward to the branch maker for any corrections.

Whenever the Branch Head forwarded the data to the next level, the Region's credit officer will receive the pop up message in his official mail id. The Credit Officer at Regional Office should confirm the facts and figures submitted by the branch comparing the data available with Regional Office. Wherever necessary, clarification from branches can also be sought for. While the Region maker forwards the data to the next level, the Regional Manager receives the pop up message in his official mail id and Regional Manager has to scrutinize the statement and to forward the EWS statement to Credit Audit & Monitoring Department within 2 days from the date of receipt of the statement from branches after modification, if any.

The Regional Managers are empowered to accept the data provided by the branches or can return it for want of additional clarification / substantiation. When the Regional Manager approves the data, the decision matrix shall be formulated with the default decisions incorporated in the system as follows based on the inputs made by the branch.

The final Decision Matrix (scores) as per E & Y software module is as follows:

Decision code	**Score %**	**Explanation**
DM 0	0 -10	Normal Risk Account
DM 1	11-20	Monitor account closely
DM 2	21-40	Discuss with borrower
DM 3	41-60	Perform L1* and L2** background check & surprise visit by RO.
DM 4	61-90	Initiate EWS audit
DM 5	>91	Mark account as RFA and initiate Forensic Audit

*Information from public domain.
** Information from suppliers, customers and employees.

- The DM (Decision Matrix) should be forwarded to the authorized user/s of Credit Department and CAM Department who can view data and Decision Matrix and extract the data from the system. No modification is permitted for CAM Department and only the entered data, audit reports, print outs and decision matrix are able to be taken up.

- On receipt of EWS statement submitted by branches through respective Regional Manager, CAM Department will scrutinize the statements and will submit a consolidated report for the cases with the Decision Matrix Score upto 40% and accountwise 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.

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8.9 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.

8.10 Penal Measures:

a. Borrowers who have defaulted and also committed a fraud from the Banking System or from the Capital Markets by companies etc. would be debarred from availing bank finance from Scheduled Commercial Banks, Development Financial Institutions, Government Owned NBFCS, investment Institutions etc. for a period of five years from the date of full payment of the defrauded amount. After this period, it is a individual institution’s decision to take a call on whether to lend to such a borrower.

b. No restructuring or grant of additional facilities may be made in the case of Red Flagged Account.

c. No compromise settlement is allowed unless the conditions stipulated that the criminal complaint will be continued.

9. Review:

This policy for 2018-19 is placed before the board for review and approval .**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.

Annexure- I

SMA-0 Signs of Stress

Illustrative list of signs of stress for categorizing an account as SMA-0:

1. Delay of 90 days or more in (a) submission of stock statement / other stipulated operating control statements or (b) credit monitoring or financial statements or © non-renewal of facilities based on audited financials.

2. Actual sales / operating profits falling short of projections accepted for loan sanction by 40 % or more: or a single event of non-cooperation/prevention from conduct of stock audits by banks, or reduction of Drawing Power (DP) by 20 % or more after a stock audit, or evidence of diversion of funds for unapproved purpose, or drop in internal risk rating by 2 or more notches in a single review.

3. Return of 3 or more cheques (or electronic debit instructions) issued by borrowers in 30 days on grounds on non-availability of balance/DP in the account or return of 3 or more bills/cheques discounted or sent under collection by the borrower.

4. Devolvement of Deferred Payment Guarantee (DPG) installments or Letters of Credit (LCs) or invocation of Bank Guarantees (BGs) and its non-payment within 30 days.

5. Third request for extension of time either for creation or perfection of securities as against time specified in original sanction terms or for compliance with any other terms and conditions of sanction.

6. Increase in frequency of overdrafts in current accounts.

7. The borrower reporting stress in the business and financials.

8. The promoter(s) pledging/selling their shares in the borrower company due to financial stress.

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<u>**Annexure - I**</u>

EARLY ALERT SYSTEMS-EAS CONDITIONS

1. Overdue in installments and interest for term loans.
2. Credit not covering the interest debited in the OD/CC accounts.
3. Excess drawings over DP other than interest and other charges debited in the OD & CC accounts.
4. Overdue in Agricultural advances.
5. Sight / Usance Bills Purchased / Discounted – Overdue / Return.
6. Cheques including Foreign Cheques purchased – Overdue / Return.
7. Delay in submission of financial data by the client for the Review of Term Loan/ Renewal of the Working Capital limits.
8. Overdue Packing Credit (DL) (except running PCL)
9. Devolvement of Inland LC / Co-acceptance.
10. Invocations of Bank Guarantees/DPG paid by the Bank.
11. Negative Balance in Current / Savings accounts(Temporary Overdraft).
12. Export Bills Negotiated / Purchased /Discounted – Overdue position / Crystallization.
13. Overdue in Advance against Foreign Bills Sent for Collection.
14. Devolvement of LC / Co-acceptance Bills / BG for short term trade credit(import).
15. Overdue in Foreign Currency Loans.
16. Delay/ Non submission of stock statement / Book Debts statement / QIS statements.
17. Collection cheque / Bills Returned/ Dishonored (as % of returned to presented)
18. Cheques issued by borrower returned (as % of returned to presented)
19. Expiry of Documents.
20. Realizable value of Primary Security against Balance outstanding.
21. Scrutiny of large lump sum debits.
22. Recovery of interest.
23. Original BG not received back and not reverted after due date.
24. % of Export Bills overdue / Returned by the importer.
25. Delay in realization of Foreign Bills under collection.
26. Turnover Vs Computed figure (in %).
27. Debit transaction in OD / CC.
28. LOD has fallen due for payment.
29. Overdue in Loan on Produce.
30. Overdue in Non – Agricultural Jewel Loan.
31. Expiry of Insurance policy.
32. Stock / Book Debts inspection.
33. Machinery inspection details.
34. Immovable property (Land & Building etc.,) inspection details (Date).

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Annexure - II

Early Warning Signals approved by our Bank

1. Discounting of cheque / bill to adjust overdue of customer.
2. Default in payment to the banks / FIs and other statutory bodies, etc., Default in payment to Sundry Creditors / bouncing of cheques issued.
3. RTGS / NEFT Inward:
   Funds coming from other banks to liquidate the outstanding overdue loan amount.
4. Invocation / Frequent rollover of BGs / crystallization of ILC / FLC bills.
5. Funding of the interest by sanctioning additional facilities.
6. Circular movement of funds – within company bank accounts and bank accounts of group company.
7. Concentration of debits.
8. Default within 3 months of loan disbursed (early defaults), i.e, default of payment for more than one installment / interest in our banks.
9. Floating front / associate companies by investing borrowed money.
10. Large number of transactions with inter-connected companies / related parties and large outstanding from such companies.
11. ILCs issued for local trade / related party transactions.
12. High value RTGS / cheque payment to unrelated parties / business.
13. Heavy withdrawal of cash in cash credit account or withdrawals by promoters by cash / transfer or high value cash deposits in loan accounts.
14. Under insured or over insured inventory.
15. Delay observed in payment of outstanding dues (creditors/ employee salary, etc).
16. High contingent liability in financial statements.
17. Significant movements in inventory, disproportionately higher than the growth in turnover (inventory turnover ratio).
18. Significant movements in receivables, disproportionately higher than the growth in turnover and/or increase in aging of the receivables (debtors velocity ratio).
19. Disproportionate increase in other current assets (non - current assets).
20. Significant increase in working capital borrowing as percentage of turnover.
21. Critical issues highlighted in the stock / internal audit report or Borrower not providing debtors / stock statements for review.
22. Increase in Fixed Assets, without corresponding increase in turnover (when project is implemented).
23. Increase in borrowings, despite huge cash and cash equivalents in the borrower’s balance sheet.
24. Discrepancies in the financial records as per ROC Search vis a vis financial records submitted by the borrower.
25. Material discrepancies in the annual report or Significant inconsistencies within the annual report (between various sections).
26. Poor disclosure of materially adverse information and no qualification by the statutory auditors.
27. Frequent change in accounting period and / or accounting policies.
28. Increasing debtors and decreasing creditors in last 2 years.
29. Borrower incurring loss in last 2 years.
30. High value of slow moving inventory in last 6 months.
31. Resignation of the key personnel and frequent changes in the management.
32. High pledging of promoter holding to banks.
33. Raid by Income tax /sales tax / central excise duty officials or internal / external rating downgrade / any negative information about borrower / promoter / group company.
34. Frequent change in the scope of the project to be undertaken by the borrower.

35. Costing of the project which is in wide variance with standard cost of installation of the project.
36. Request received from the borrower to postpone the inspection of the godown for flimsy reasons.
37. Financing the unit far away from the branch.
38. Reduction in the stake of promoter / director.
39. Invoices devoid of TAN and other details.
40. Dispute on title of the collateral securities or Same collateral charged to a number of lenders (excluding inter se collateral accepted in consortium and multiple banking).
41. Import collection bills remaining outstanding for a long time and tendency for bills to remain overdue.
42. Onerous clause in issue of BG / LC / standby letters of credit.
43. In merchanting trade, import leg not revealed to the bank.
44. Concealment of certain vital documents like master agreement, insurance coverage.
45. Frequent request for general purpose loans.
46. Movement of an account from one bank to another.
47. Frequent adhoc sanctions.
48. Not routing of sales proceeds through bank (sole or multiple banking cases).
49. Non submission of original bills (sole or multiple banking cases).
50. Significant increase in salary / wages and staff welfare and no corresponding increase in revenue.
51. High value of donation / gifts & entertainment / overseas travelling / bad debts and write offs.

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