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Module-C Unit-1

CAIIB PAPER-1

Advanced Bank Management (ABM)



CAIIB Paper 1 (ABM) Module C Unit 1: Overview of Credit Management

Credit

Credit is the trust which allows one party to provide money or resources to another party wherein the second party does not reimburse the first party immediately, but promises either to repay or return those resources at a later date.

Principles of Credit

Over a period of time, bankers have evolved certain basic principles for their lending operations. Bank's loan policies, and other aspects of credit management, are influenced to a great extent by these unwritten principles, **which are as under:**

- Safety of funds
- Purpose
- Profitability
- liquidity
- Security
- Risk spread

Types of Borrowers

A borrower can be:

- An individual
- Sole proprietary firm
- Partnership firm and joint ventures
- Hindu undivided family
- Companies
- Statutory corporations
- Trusts and co-operative Societies

Types of Credit

- **Fund Based:** In fund-based credit, there is actual transfer of money from the bank to the borrower.
- **Non-Fund Based:** In non fund based credit, there is no transfer of money, but the commitment by the bank on behalf of the client, may result in future transfer of money to the beneficiary of such a commitment. **Example** of this is a bank

guarantee issued in favour of government departments (or any other beneficiary) on behalf of a contractor, who is bank's customer.

- **Credit can also be classified based on purpose**, like working capital finance, project finance, export finance, crop loan, etc. Banks often classify their credit portfolio based on the type of the customers like, Corporate, retail, agriculture, international, institutional credit, etc.

The laws applicable to all these different kinds of borrowers are different.

| Type of Borrower | Applicable Law |
|------------------------|---|
| Individuals | Indian Contract Act |
| Partnership firms | Indian Partnership Act |
| Hindu undivided family | Customary laws pertaining to Hindus |
| Companies | Companies Act |
| Statutory corporations | Acts that created them |
| Trusts | Indian Trusts Act, Public Trusts Act, Religious and Charitable Endowments Act, Wakf Act |
| Co-operative Societies | Co-operative Societies Act or Societies Registration Act. |

Components of Credit Management

- Loan Policy of the Bank
- Appraisal
- Delivery
- Control and Monitoring
- Rehabilitation and Recovery
- Credit Risk Management
- Refinance

Role of RBI's Guidelines In Bank's Credit Management

End Use of the Funds:

- It is the primary responsibility of banks to ensure proper end use of bank funds/monitor the funds flow. It is, therefore, necessary for banks to evolve such arrangements as may be considered necessary to ensure that drawals from cash

credit/overdraft accounts are strictly for the purpose for which the credit limits are sanctioned by them.

Priority Sector:

The main sectors, included in the priority sector are as follows:

- Agricultural finance
- Finance to micro and small enterprises
- Loans to individuals up to **₹35 lakh** in metropolitan centres (with population of ten lakh and above) and up to **₹25 lakh** in other centres for purchase/construction of a dwelling unit per family provided the overall cost of the dwelling unit in the metropolitan centre and at other centres does not exceed ₹45 lakh and ₹30 lakh respectively.
- Educational loans (up to **Rs 10 lakh for studies in India and Rs 20 lakh** for studies abroad)
- **Export credit:** export credit by domestic banks is not treated as finance to priority sector for the purpose of priority sector target. But, export credit by foreign banks is treated as finance to priority sector.
- **Micro-credit provided by banks either directly or through any intermediary:** Loans to self help groups (SHGs) [Non Governmental Organizations (NGOs) for on-lending to SHGs]
- Retail trade
- Khadi and Village Industries Sector (KVI); All loans to units in the KVI sector will be eligible for classification under the sub-target of **7.5 percent** prescribed for Micro Enterprises under priority sector.

Targets for Priority Sector Lending

The targets and sub-targets set under priority sector lending for domestic and foreign banks operating in India are furnished here: (Figures are given as per cent of Adjusted Net Bank Credit (ANBC) or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher)

| Categories | Domestic commercial banks (excl. RRBs & SFBs) & foreign banks with 20 branches and above | Foreign banks with less than 20 branches | Regional Rural Banks | Small Finance Banks |
|------------------------------|--|--|---|---|
| Total Priority Sector | 40 per cent of ANBC as computed in para 6 below or CEOBE whichever is higher | 40 per cent of ANBC as computed in para 6 below or CEOBE whichever is higher; out of which up to 32% | 75 per cent of ANBC as computed in para 6 below or CEOBE whichever is higher; However, lending to Medium Enterprises, | 75 per cent of ANBC as computed in para 6 below or CEOBE whichever is higher. |

| | | | | |
|------------------------------------|---|---|--|--|
| | | can be in the form of lending to Exports and not less than 8% can be to any other priority sector | Social Infrastructure and Renewable Energy shall be reckoned for priority sector achievement only up to 15 per cent of ANBC. | |
| Agriculture | 18 per cent of ANBC or CEOBE, whichever is higher; out of which a target of 10 percent# is prescribed for Small and Marginal Farmers (SMFs) | Not applicable | 18 per cent ANBC or CEOBE, whichever is higher; out of which a target of 10 percent# is prescribed for SMFs | 18 per cent of ANBC or CEOBE, whichever is higher; out of which a target of 10 percent# is prescribed for SMFs |
| Micro Enterprises | 7.5 per cent of ANBC or CEOBE, whichever is higher | Not applicable | 7.5 per cent of ANBC or CEOBE, whichever is higher | 7.5 per cent of ANBC or CEOBE, whichever is higher |
| Advances to Weaker Sections | 12 percent# of ANBC or CEOBE, whichever is higher | Not applicable | 15 per cent of ANBC or CEOBE, whichever is higher | 12 percent# of ANBC or CEOBE, whichever is higher |

| | | | |
|-----------------------------|---|----------------|----------------|
| Total Priority Sector | 40 per cent of ANBC or CEOBE, whichever is higher, which shall stand increased to 75 per cent of ANBC or CEOBE, whichever is higher, with effect from March 31, 2024. UCBs shall comply with the stipulated target as per the following milestones: | | |
| | March 31, 2022 | March 31, 2023 | March 31, 2024 |
| | 50% | 60% | 75% |
| Micro Enterprises | 7.5 per cent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher | | |
| Advances to Weaker Sections | 12 per cent# of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher. | | |

The weaker sections under priority sector include the following:

- Small and Marginal Farmers.
- Artisans, village and cottage industries where individual credit limits do not exceed `1 lakh.
- Beneficiaries under Government Sponsored Schemes such as National Rural Livelihood Mission (NRLM), National Urban Livelihood Mission (NULM) and Self Employment Scheme for Rehabilitation of Manual Scavengers (SRMS).
- Scheduled Castes and Scheduled Tribes.
- Beneficiaries of Differential Rate of Interest (DRI) scheme.
- Self Help Groups.
- Distressed farmers indebted to non-institutional lenders.
- Distressed persons other than farmers, with loan amount not exceeding `1 lakh per borrower to prepay their debt to non-institutional lenders.
- Individual women beneficiaries up to `1 lakh per borrower.
- Persons with disabilities.

- Overdraft availed by PMJDY account holders as per limits and conditions prescribed by Department of Financial Services, Ministry of Finance from time to time.
- Minority communities as may be notified by Government of India from time to time.

MSMED Act 2006

| Composite Criteria : Investment And Annual Turnover | | | |
|---|--|--|--|
| Classification | Micro | Small | Medium |
| Manufacturing & Services | Investment < Rs. 1 cr. and Turnover < Rs.5 cr. | Investment < Rs. 10 cr. and Turnover < Rs.50 cr. | Investment < Rs. 20 cr. and Turnover < Rs. 250 cr. |

Common guidelines for priority sector loans

Banks should comply with the following common guidelines for all categories of advances under the priority sector.

- **Rate of interest:** The rates of interest on bank loans will be as per directives issued by Department of Regulation (DoR), RBI from time to time.
- **Service charges:** No loan related and ad hoc service charges/inspection charges should be levied on priority sector loans up to ₹25,000. In the case of eligible priority sector loans to SHGs/ JLGs, this limit will be applicable per member and not to the group as a whole.
- **Receipt Sanction/Rejection/Disbursement Register:** A register/ electronic record should be maintained by the bank wherein the date of receipt, sanction/rejection/disbursement with reasons thereof, etc. should be recorded. The register/electronic record should be made available to all inspecting agencies.
- **Issue of acknowledgement of loan applications:** Banks should provide acknowledgement for loan applications received under priority sector loans. Bank Boards should prescribe a time limit within which the bank communicates its decision in writing to the applicants.

The following credit restrictions have been placed on the banks:

(Details as per RBI circular No. Dir. BC. 13113.03.00/2009-10 dated 1, July 2009)

- Advances against Bank's own shares: In terms of Section 20(1) of the Banking Regulation Act, 1949, a bank cannot grant any loans and advances on the security of its own shares.
- Restrictions on granting loans and advances to relatives of Directors
- Restrictions on Grant of Loans & Advances to Officers and Relatives of Senior Officers of Banks

- Restrictions on Grant of Financial Assistance to Industries Producing or Consuming Ozone Depleting Substances (ODS)
- Restrictions on Advances against Sensitive Commodities under Selective Credit Control (SCC)
- Advances against Fixed Deposit Receipts (FDRs) Issued by Other Banks
- Loans against Certificate of Deposits (CDs)
- Restrictions on Credit to Companies for Buy-back of their Securities

Asset Classification

In terms of Reserve Bank of India guidelines, all advances are required to be reviewed and classified into two principal categories at regular intervals as follows:

(a) Performing Assets or Standard Assets, i.e., where the advances are earning interest income on an actual realisation basis. This includes regular and temporarily irregular accounts, as specified from time to time by the RBI.

(b) Non-Performing Assets (NPA), i.e., where advances are not earning interest on an actual realisation basis. An asset, including a leased asset, is considered as non-performing when it ceases to generate income for the bank. This includes irregular accounts and sticky accounts with deep-seated irregularities. A loan or an advance accounts will be considered as NPA where:

- Interest and/or installment of principal remain overdue for a period of more than 90 days in respect of a term loan.
- The account remains 'out of order' in respect of an Overdraft/Cash Credit (OD/CC).
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- The installment of principal or interest thereon remains overdue for two crop seasons for short duration crops in respect of agriculture loan and advances,
- The installment of principal or interest thereon remains overdue for one crop season for long duration crops in respect of agriculture loan and advances,
- In respect of derivative transactions, the overdue receivables representing positive mark-to market value of a derivative contract, **if these remain unpaid for a period of 90 days from the specified due date for payment.**
- In case of interest payments, banks should, classify an account as NPA only if the interest due and charged during any quarter is not serviced fully within 90 days from the end of the quarter.

Categories of NPAs

Banks are required to classify non performing assets further into the following three categories based on the period for which the asset has remained non performing and the reliability of the dues:

- **Substandard Assets:** A substandard asset would be one, which has remained NPA for a period less than or equal to 12 months. Such an asset will have well defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.
- **Doubtful Assets:** An asset would be classified as doubtful if it has remained in the substandard **category for a period of 12 months**. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as sub-standard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable. When the realizable value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be, such NPAs may be straightaway classified under doubtful category.
- **Loss Assets:** A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection, but the amount has not been written off wholly. In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value. If the realizable value of the security, as assessed by the bank/approved valuers/**RBI is less than 10 per cent** of the outstanding in the borrowing accounts, the existence of security should be ignored and the asset should be straightaway classified as loss asset.

Provisioning Norms

The Banks are required to make certain amount of provision on standard assets on fund based outstanding as follows:

- Farm credit for Agriculture Activities: 0.25%
- Advances to Small and Micro Enterprises: 0.25%
- Advances to Commercial Real Estate (CRE) Sector: 1%
- Advances to Commercial Real Estate-Residential Housing Sector (CRE-RH): 0.75
- All other loans and advances not included above including advances to Medium Enterprises: 0.40% The normal provisioning requirement, and the accelerated provisioning in respect of NPA accounts are as follows:

| Asset Classification | Period of NPA | Normal provisioning (%) | Accelerated provisioning (%) |
|------------------------------------|--------------------|--------------------------|--|
| Sub-Standard (Secured) | Up to 6 months | 15 | 15 |
| | 6 months to 1 year | 15 | 25 |
| Sub-Standard (Unsecured ab initio) | Up to 6 months | 25 | 25 |
| | | (Other than infra loans) | |
| | | 20 | |
| | | (Infrastructure Loans) | |
| | Above 6 months | 25 | 40 |
| | | (Other than infra Loan) | |
| | | 20 | |
| | | (Infrastructure Loans) | |
| Doubtful I | 2nd Year | 25 | 40 |
| | | (secured portion) | (secured portion) |
| | | 100 | 100 |
| | | (unsecured portion) | (unsecured portion) |
| Doubtful II | 3rd & 4th Year | 40 | 100 both secured and unsecured portion |
| | | (secured portion) | |
| | | 100 | |
| | | (unsecured portion) | |
| Doubtful III | 5th year onwards | 100 | 100 |
| Loss Assets | Ab Initio | 100 | 100 |

Modification in Extent of Guarantee Cover

In order to enhance the effectiveness of the Credit Guarantee Scheme for Financial inclusion programme and create greater support to underserved/weaker segments, the extent of guarantee cover for credit facility has been increased to 85% for ZED certified MSEs, units under Aspirational District, Women & SC/ST Entrepreneur.

The trust shall provide guarantee coverage as under:

| Category (including trading activity) | Maximum extent of Guarantee Coverage | | |
|--|--------------------------------------|------------------------------------|--------------------------------------|
| | Where credit facility is | | |
| | Up to ₹ 5 Lakhs | Above ₹ 5 Lakhs & Up to ₹ 50 Lakhs | Above ₹ 50 Lakhs & Up to ₹ 200 Lakhs |
| Micro Enterprises | 85% | 75% | 75% |
| MSEs located in North East Region (incl. Sikkim) | 80% | | |
| Women Entrepreneurs | 85% | | |
| MSEs situated in Aspirational District | 85% | | |
| ZED certified MSEs | 85% | | |
| SC/ST Entrepreneurs | 85% | | |
| All other category of borrowers | 75% | | |

Aligning Guarantee for Retail/Wholesale Trade with Other Segments

Retail/Wholesale Trade is an eligible activity under Credit Guarantee Scheme with an exposure limit up to 100 Lakhs. In view of growing credit needs of MSEs under trading activity, it has been decided to align trading activity (MSE Retail Trade & Wholesale Trade) with other activities of CGS-I in respect of the following parameters:

- Ceiling of credit guarantee cover increased from ` 100 Lakhs to ` 200 Lakhs.
 - Extent of Guarantee Coverage at par with other activities.
 - Rate of Annual Guarantee Fee at par with other activities. The revised extent of guarantee coverage shall not be applicable in case of enhancement of existing working capital accounts already covered under Guarantee scheme and shall remain 50%.
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