

LOAN CLASSIFICATION AND PROVISIONING

Bangladesh Bank issued a master circular regarding “Loan Classification and Provisioning” on June 14, 2012. (BRPD Circular No. 07)

According to the circular, all loans and advances will be grouped into four (4) categories for the purpose of classification namely-

- a. Continuous Loan
- b. Demand Loan
- c. Fixed Term Loan
- d. Short-term Agricultural & Micro- Credit.

Basis for Loan Classification:

a) OBJECTIVE CRITERIA:

Criterion	Remarks
(1) Past Due/Over Due	<p>I. Any Continuous Loan if not repaid/renewed within the fixed expiry date for repayment or after the demand by the bank will be treated as past due/overdue from the following day of the expiry date.</p> <p>II. Any Demand Loan if not repaid within the fixed expiry date for repayment or after the demand by the bank will be treated as past due/overdue from the following day of the expiry date.</p> <p>III. In case of any installment(s) or part of installment(s) of a Fixed Term Loan is not repaid within the fixed expiry date, the amount of unpaid installment(s) will be treated as past due/overdue from the following day of the expiry date.</p> <p>IV. The Short-term Agricultural and Micro-Credit if not repaid within the fixed expiry date for repayment will be considered past due /overdue after six months of the expiry date.</p>
(2) Standard	All unclassified loans other than Special Mention Account (SMA) will be treated as Standard.
(3) Special Mention Account (SMA)	A Continuous loan, Demand loan or a Term Loan which will remain overdue for a period of 02 (two) months or more, will be put into the "Special Mention Account (SMA)" and interest accrued on such loan will be credited to Interest Suspense Account, instead of crediting the same to Income Account.
(4) Defaulted loan	Loans in the "Special Mention Account" and “Sub-Standard” will not be treated as defaulted loan for the purpose of section 27KaKa(3) [read with section 5(GaGa)] of the Banking Companies Act, 1991.

5. Classification of Continuous Loan:

Category	Details
Sub-standard	If the loan is past due/overdue for 03 (three) months or beyond but less than 06 (six) months.
Doubtful	If the loan is past due/overdue for 06 (six) months or beyond but less than 09 (nine) months.
Bad/Loss	If the loan is past due/overdue for 09 (nine) months or beyond.

6. Classification of Demand Loan:

Category	Details
Sub-standard	If it remains past due/overdue for 03 (three) months or beyond but not over 06 (six) months from the date of expiry or claim by the bank or from the date of creation of forced loan.
Doubtful	If it remains past due/overdue for 06 (six) months or beyond but not over 09 (nine) months from the date of expiry or claim by the bank or from the date of creation of forced loan.
Bad/Loss	If it remains past due/overdue for 09 (nine) months or beyond from the date of expiry or claim by the bank or from the date of creation of forced loan.

7. Classification of Fixed Term Loan:

Category	Details
Sub-standard	If the amount of past due installment is equal to or more than the amount of installment(s) due within 03 (three) months.
Doubtful	If the amount of past due installment is equal to or more than the amount of installment(s) due within 06 (six) months
Bad/Loss	If the amount of ' past due installment is equal to or more than the amount of installment(s) due within 09 (nine) months

Note: If any Fixed Term Loan is repayable on monthly installment basis, the amount of installment(s) due within 06 (six) months will be equal to the sum of 06 monthly installments. Similarly, if the loan is repayable on quarterly installment basis, the amount of installment(s) due within 06 (six) months will be equal to the sum of 2 quarterly installments.

8) The Short-term Agricultural and Micro-Credit will be considered irregular if not repaid within the due date as stipulated in the loan agreement. If the said irregular status continues, the credit will be classified as 'Substandard ' after a period of 12 months, as 'Doubtful' after a period of 36 months and as 'Bad/Loss' after a period of 60 months from the stipulated due date as per the loan agreement.

B) QUALITATIVE JUDGEMENT:

- › If any uncertainty or doubt arises in respect of recovery of any Continuous Loan, Demand Loan or Fixed Term Loan, the same will have to be classified on the basis of qualitative judgement be it classifiable or not on the basis of objective criteria.
- › If any situational changes occur in the stipulations in terms of which the loan was extended or if the capital of the borrower is impaired due to adverse conditions or if the value of the collateral decreases or if the recovery of the loan becomes uncertain due to any other unfavorable situation, the loan will have to be classified on the basis of qualitative judgement.
- › Despite the probability of any loan being affected due to the reasons stated above or for any other reasons, if there is any hope for change of the existing condition by resorting to proper steps, the loan, on the basis of qualitative judgement, will be classified as 'Sub-standard'. But even after resorting to proper steps, there exists no certainty of total recovery of the loan, it will be classified as 'Doubtful' and even after exerting the all-out efforts, there exists no chance of recovery, it will be classified as 'Bad/Loss' on the basis of qualitative judgement.

Maintenance of Provision:

Particulars	% of Provision	Revised Provision
General Provision		
All unclassified loans of Small and Medium Enterprise (SME)	-	0.25%
Against all unclassified loans (other than loans under Consumer Financing, Loans to Brokerage House, Merchant Banks, Stock dealers etc. and Special Mention Account.)	1%	1%
On the unclassified amount for Consumer Financing	5%	1%
On the unclassified amount for (i) Housing Finance and (ii) Loans for Professionals to set up business under Consumer Financing Scheme.	2%	2%
On the unclassified amount for Loans to Brokerage House, Merchant Banks, Stock dealers, etc.	2%	2%
On the outstanding amount of loans kept in the 'Special Mention Account' after netting off the amount of Interest Suspense.	5%	5%
On the off-balance sheet exposures. (Provision will be on the total exposure and amount of cash margin or value of eligible collateral will not be deducted while computing Off-balance sheet exposure.)	1%	1%
Special Provision (Classified Continuous, Demand and Fixed Term Loans)		
Sub-standard	20%	20%
Doubtful	50%	50%
Bad/Loss	100%	100%
Provision for Short-term Agricultural and Micro-Credits		
All credits except ' Bad/Loss' (i.e. ' Doubtful', ' Sub-standard', irregular and regular credit accounts)	5%	5%
Bad/Loss	100%	100%

Base for Provision:

The provision will be maintained at the above rate on the balance calculated as the greater of the following two amounts:

- a) The outstanding balance of the loan less the amount of Interest Suspense and the value of eligible collateral; and
- b) **15%** of the outstanding balance of the loan instead of 20%.

Eligible Collateral:

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

- 100% of deposit under lien against the loan
- 100% of the value of government bond/savings certificate under lien
- 100% of the value of guarantee given by Government or Bangladesh Bank
- 100% of the market value of gold or gold ornaments pledged with the bank.
- 50% of the market value of easily marketable commodities kept under control of the bank
- Maximum 50% of the market value of land and building mortgaged with the bank
- 50% of the average market value for last 06 months or 50% of the face value, whichever is less, of the shares traded in stock exchange.

Rescheduling:

- **Application for first time rescheduling will be taken into consideration upon receiving cash payment of at least 15% of the overdue installments or 10% of the total outstanding amount of loan, whichever is less; instead of 20% earlier.**
- Application for second time rescheduling will be considered upon receiving cash payment of minimum 30% of the overdue installments or 20% of the total outstanding amount of loan, whichever is less.
- Application for rescheduling third time will be considered upon receiving cash payment of minimum 50% of the overdue installments or 30% of the total outstanding amount of loan, whichever is less.
- The rate of down payments for Short-term Agricultural and Micro-Credit will be same as above.

At A Glance:

The Bangladesh Bank (BB) issued the circular to the banks on June 14, asking them to make a continuous loan classification for non-repayment within three months instead of six months and limit rescheduling scopes within three times.

The sub-standard loans had been considered as default loans before the issuance of the circulars if a borrower did not pay any installment and interest of a loan for more than six months after overdue. According to the new master circulars, a loan will be considered as sub-standard one if a borrower does not pay any installment or interest of the loan for more than three months after overdue.

Under the revised provisions, a continuous loan will be classified for non-repayment within three months instead of six months fixed earlier. The base for provisioning has been fixed at minimum 20 per cent of the outstanding balance of the loan while rescheduling will be limited to three times. The loans in the 'Special Mention Account (SMA)' will not be treated as default loan.

There is now no scope to treat the sub-standard loan as default loan and the BB's circular dated July 19, 2012, has cleared the issue. The circular said –

- › Any continuous loan if not repaid or renewed within the fixed time limit for repayment would be treated as 'overdue' from the following day of the expiry date.
- › Any demand loan if not repaid within the fixed time limit for repayment or after the demand by the bank will be treated as 'overdue' from the following day of the expiry date or demand date.
- › In case of any installment(s) or part of installment(s) of a fixed term loan is not repaid within the fixed expiry date or due date, the amount of unpaid installment(s) as well as the loan will be treated as 'overdue' from the following day of the expiry date or due date.
- › The short-term agricultural loan or microcredit if not repaid within the fixed time limit for repayment will be considered 'overdue' after six months of the expiry date, the circular said

Time Frame:

The revised instruction on loan classification and provisioning will come into effect from **December 31, 2012** instead of **September 30, 2012**.

Impact on Non-Performing Loan & Financial Statement:

Quick implementation of the loan rescheduling rules may give a rise to non-performing loans and an additional requirement for provisioning will force the banks to keep greater provision in the income statement which will eat up banks' profits and as a consequence equity per share will be reduced significantly.

Due to the new rules, the provision for classified loans is expected to increase by 2.47%. Good borrowers will not face any adverse impact; instead, credit flow will increase to new entrepreneurs and productive sectors. The number of habitual defaulters will fall and depositors' interest will be better protected.

Reference:

A Bangladesh Bank study found that the amount of default loans may increase by only 2.38 percent over the existing amount under the new rules.

On March 31, the total default loans in the banking sector stood at 6.57 percent of their outstanding loans. The percentage could be 8.95 percent on the same day if the amount was calculated under the new rules, the BB found in the study.

The central bank in the study said, if the rules are followed strictly, the amount of default loans as well as the banks' insolvency will fall in the long run.

(Source: The Daily Star, July 17, 2012)

Appendix:

Impact on Financial Performance:

Status of loan (Figure as on Year End 2011):

Figure in Crore

Bank	Total Loan	Unclassified & SMA	Classified Loan	% of classified loan
ABBANK	9,341.12	9,073.94	267.18	2.86%
ALARABANK	7,934.54	7,859.43	75.11	0.95%
BANKASIA	8,282.00	8,057.00	225.00	2.72%
BRACBANK	9,082.22	8,558.26	523.95	5.77%
CITYBANK	7,680.70	7,416.27	264.43	3.44%
DHAKABANK	7,598.33	7,335.93	262.40	3.45%
DUTCHBANGL	7,966.07	7,747.39	218.68	2.75%
EBL	8,105.79	7,949.73	156.06	1.93%
EXIMBANK	9,969.96	9,807.31	162.65	1.63%
FIRSTSBANK	6,946.73	6,812.16	134.57	1.94%
ICBIBANK	1,422.24	607.71	814.54	57.27%
IFIC	6,355.80	6,097.99	257.81	4.06%
ISLAMIBANK	30,584.06	29,754.82	829.23	2.71%
JAMUNABANK	5,661.18	5,499.31	161.87	2.86%
MERCANBANK	7,999.98	7,791.52	208.46	2.61%
MTBL	4,700.55	4,581.04	119.51	2.54%
NBL	11,606.30	11,279.81	326.50	2.81%
NCCBANK	7,273.35	7,079.52	193.83	2.66%
ONEBANKLTD	4,781.41	4,567.69	213.72	4.47%
PREMIERBAN	4,977.49	4,764.26	213.23	4.28%
PRIMEBANK	13,940.89	13,750.06	190.82	1.37%
PUBALIBANK	10,632.96	10,418.33	214.64	2.02%
RUPALIBANK	7,652.49	7,197.83	454.66	5.94%
SHAHJABANK	8,059.25	7,907.30	151.95	1.89%
SIBL	5,390.86	5,122.27	268.59	4.98%
SOUTHEASTB	10,754.64	10,377.69	376.95	3.51%
STANDBANKL	5,534.68	5,413.56	121.12	2.19%
TRUSTBANK	5,080.17	4,926.74	153.43	3.02%
UCBL	11,550.63	11,343.88	206.75	1.79%
UTTARABANK	552.08	545.56	6.52	1.18%
Total	247,418.50	239,644.30	7,774.19	

Assumptions:

To estimate the required provision, we have used the following assumptions:

Criterion	Assumption
STANDARD	Will decrease by 25%
SMA	Will decrease by 25%+25% of Standard
SUBSTANDARD	Will decrease by 25%+25% of SMA
DOUBTFUL	Will decrease by 50%+25% of Substandard
BAD/LOSS	Existing+50% of Doubtful

Basis of Assumptions:

Classification of Loan:

Category	New	Existing
Sub-standard	If the loan is past due/overdue for 03 (three) months or beyond but less than 06 (six) months.	If the loan is past due/overdue for 03 (three) months or beyond but less than 06 (six) months.
Doubtful	If the loan is past due/overdue for 06 (six) months or beyond but less than 09 (nine) months.	If the loan is past due/overdue for 06 (six) months or beyond but less than 12 (Twelve) months.
Bad/Loss	If the loan is past due/overdue for 09 (nine) months or beyond.	If the loan is past due/overdue for 12 (nine) months or beyond.

** Any loan will turn into a 'Special Mention Account (SMA)' which is overdue for two months instead of three months fixed earlier. The loans in the SMA will not be treated as default loan.

Status of Provision:

Figure in Crore

Bank	Total Loan	Provision					Expected Provision				
		Unclassified		Classified			Unclassified		Classified		
		Standard	SMA	SUBSTANDARD	DOUBTFUL	BAD/LOSS	Standard	SMA	SUBSTANDARD	DOUBTFUL	BAD/LOSS
ABBANK	9,341.12	110.41		103.05			108.20		107.69		
ALARABANK	7,934.54	82.30	4.34	2.66	3.08	3.08	3.08	30.69	3.08	16.15	12.45
BANKASIA	8,282.00	96.71		77.24			94.77		80.72		
BRACBANK	9,082.22	106.84	10.68	30.16	25.29	25.29	25.29	43.62	25.29	52.17	231.52
CITYBANK	7,680.70	129.91	9.01	10.47	10.10	10.10	10.10	50.06	10.10	11.66	71.43
DHAKABANK	7,598.33	80.21	4.59	9.62	8.37	8.37	8.37	30.18	8.37	10.57	88.56
DUTCHBANGL	7,966.07	91.53	2.03	6.42	5.32	5.32	5.32	32.04	5.32	17.33	83.97
EBL	8,105.79	110.99	3.97	5.21	4.90	4.90	4.90	39.97	4.90	6.38	75.36
EXIMBANK	9,969.96	97.75	8.71	0.99	2.92	2.92	2.92	39.12	2.92	9.28	29.92
FIRSTSBANK	6,946.73	89.94	0.10	3.88	2.94	2.94	2.94	30.05	2.94	1.50	54.92
ICBIBANK	1,422.24	7.15	2.49	0.18	0.76	0.76	0.76	4.25	0.76	0.55	515.23
IFIC	6,355.80	73.32	5.72	3.96	4.40	4.40	4.40	28.73	4.40	43.77	53.04
ISLAMIBANK	30,584.06	399.60		305.40			391.61		319.14		
JAMUNABANK	5,661.18	57.70	3.99	5.59	5.19	5.19	5.19	22.22	5.19	2.33	56.21
MERCANBANK	7,999.98	88.36	0.60	9.56	7.32	7.32	7.32	29.91	7.32	24.11	39.96
MTBL	4,700.55	55.73	5.20	1.63	2.52	2.52	2.52	22.48	2.52	5.06	65.37
NBL	11,606.30	127.08		116.68			124.54		121.93		
NCCBANK	7,273.35	79.52		78.00			77.92		81.51		
ONEBANKLTD	4,781.41	83.31	1.94	11.07	8.79	8.79	8.79	29.22	8.79	3.87	86.15
PREMIERBAN	4,977.49	50.77	1.09	0.66	0.77	0.77	0.77	17.74	0.77	12.73	46.64
PRIMEBANK	13,940.89	13,702.14	108.59	41.87	58.55	58.55	58.55	4,648.82	58.55	28.26	58.82
PUBALIBANK	10,632.96	130.85	7.40	4.84	5.48	5.48	5.48	49.17	5.48	6.69	67.06
RUPALIBANK	7,652.49	73.04	2.16	0.44	0.87	0.87	0.87	25.96	0.87	0.47	242.17
SHAHJABANK	8,059.25	84.82	1.81	4.21	3.61	3.61	3.61	29.63	3.61	1.91	30.47
SIBL	5,390.86	69.05	0.03	1.02	0.77	0.77	0.77	23.04	0.77	2.94	65.49
SOUTHEASTB	10,754.64	107.15	10.21	9.09	9.37	9.37	9.37	43.37	9.37	21.34	94.03
STANDBANKL	5,534.68	89.94	0.10	3.88	2.94	2.94	2.94	30.05	2.94	1.50	54.92
TRUSTBANK	5,080.17	70.64	2.10	5.78	4.86	4.86	4.86	25.12	4.86	3.43	26.18
UCBL	11,550.63	137.57	4.16	1.48	2.15	2.15	2.15	48.98	2.15	11.36	57.42
UTTARABANK	552.08	66.50		42.70			65.17		44.62		

Total Provision Status:

Total Unclassified (Actual)	Total Classified (Actual)	Total Unclassified (Estimated)	Total Classified (Estimated)
16751.85	3356.71	16684.01	3439.50
Change		-0.41%	2.47%