



Credit Management :
Loan Classification and Provisioning ,
Rescheduling, Written off and Interest waiver.

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Credit Risk Appraisal

- The purpose of credit analysis is to support the decision making process to accept credit risk on an obligor, as well as decisions about the size and nature of the risks that are deemed acceptable.
- The extent and scope of credit analysis depends on factors such as the type of obligor, the nature of the obligation, the timeframe, prior experience with the obligor, the availability of mitigation, and the availability of credit ratings.

Credit Administration

Banks should have a system for:

- the ongoing administration of their various portfolios that contain credit risk.
- monitoring the condition of individual credits, including determining the adequacy of provisions and reserves.
- monitoring the overall composition and quality of the credit portfolio.

Credit Risk Management

Bangladesh Bank (BB) has revisited the credit risk management guidelines through BRPD Circular No-04 dated 08 March 2016. These guidelines have outlined the following-

- Overview on Credit Risk Management
- Organizing Credit Risk Management
- Managing Credit Risk in the Origination Process
- Credit Risk Mitigation Strategies
- Managing Credit Risk in the Administration Process

Credit Risk Grading

In order to deal with growing complexities in a more dynamic banking industry, Bangladesh Bank has updated the Credit Risk Grading mechanism through issuing **BRPD Circular No 16 dated 30 October 2018- 'GUIDELINES ON INTERNAL CREDIT RISK RATING (ICRR) SYSTEM FOR BANKS'** .

Credit Risk Rating Components

In the ICRR, 60 percent weights are assigned to quantitative indicators while 40 percent are assigned to qualitative indicators.

Quantitative indicators in ICRR fall into six broad categories; leverage, liquidity, profitability, coverage, operational efficiency, and earning quality.

Quantitative indicators/Financial Ratios

Quantitative Indicators		Definition
Leverage	Debt to Tangible Net Worth (DTN)	Total Interest-bearing liabilities or Financial Debt/ Total Tangible Net Worth [Total Tangible Net Worth= Total Equity- Intangible Asset]
	Debt to Total Assets (DTA)	Total Interest-Bearing Liabilities or Financial Debt/ Average Total Assets
Liquidity	Current Ratio (CR)	Current Assets/ Current Liabilities
	Cash Ratio (Cash)	Cash and easily marketable securities/ Current Liabilities

Quantitative indicators/Financial Ratios

Quantitative Indicators		Definition
Profitability	Net Profit Margin (NPM)	Net profit after tax/ Net Sales
	Return on Assets (ROA)	Net profit after tax/ Average Total Assets
	Operating Profit to Operating Assets (OPOA)	Operating Profit/ Average Operating Assets
Coverage	Interest Coverage (IC)	Earnings Before Interest and Tax/Interest Expense
	Debt Service Coverage Ratio (DSCR)	Earnings Before Interest Tax Depreciation Amortization/ Debts to be Serviced

Quantitative indicators/Financial Ratios

Quantitative Indicators		Definition
Coverage	Financial Debt to Operating Cash Flow (FDOCF)	Financial Debt / Operating Cash Flow
	Cash flow Coverage Ratio (CCR)	Cash flow from operation / Debts to be Serviced
Operational Efficiency	Stock Turnover Days (STD)	$(\text{Total Inventory} / \text{Cost of Goods Sold}) * 360$
	Trade Debtor Collection Days (TDCD)	$(\text{Total Accounts Receivable} / \text{Sales}) * 360$
	Asset Turnover (AT)	Sales / Average Total Assets

Quantitative indicators/Financial Ratios

Quantitative Indicators		Definition
Earning Quality	Operating Cash Flow to Sales (OCFS)	Operating Cash flow / Sales
	Cash flow based accrual ratio (CAR)	$NI - (CFO + CFI) / \text{Average Net Operating Assets}$

Qualitative indicators covers six broad aspects of the firms : i) business/industry risk ii) credit quality enhancement iii) performance behavior iv) management risk v) relationship risk and vi) compliance risk.

Loan Classification & Provisioning

Bangladesh Bank's mandate on issuing circular on these issues.

As per Sec-49 Cha of BCA, 1991 (amended up to 2013)

(চ) ঋণ শৃঙ্খলার স্বার্থে বাংলাদেশ ব্যাংক সাধারণভাবে সকল ব্যাংক-কোম্পানী বা কোন বিশেষ ব্যাংক-কোম্পানী বা বিশেষ শ্রেণীর ব্যাংক-কোম্পানীর জন্য ঋণ শ্রেণীকরণ ও সঞ্চিতি সংরক্ষণ, ঋণ মওকুফ, পুনঃতফসিলীকরণ কিংবা পুনর্গঠন সংক্রান্ত বিষয়সমূহে বাধ্যতামূলকভাবে অনুসরণীয় নির্দেশ প্রদান করিতে পারিবে।^{১৯৩}



BRPD Circular regarding Loan Classification and Provisioning covers the following area:

- 1. Categories of Loans and Advances***
- 2. Basis for Loan Classification***
- 3. Accounting of the Interest of Classified Loans***
- 4. Maintenance of Provision***
- 5. Base for Provision***
- 6. Eligible Collateral***



Classification Categories

1. Standard (STD)	Unclassified
2. Special Mention Account (SMA)	
3. Sub-standard (SS)	Classified
4. Doubtful (DF)	
5. Bad/Loss (BL)	

Basis for Loan Classification

_Objective Criteria

Loan Type	Sub-standard	Doubtful	Bad/Loss
Continuous Loan-If past due/ overdue for	≥03 months but <06 months	≥06 months but <09 months	≥09 months
Demand Loan -If past due/ overdue for	≥03 months but <06 months	≥06 months but <09 months	≥09 months
Fixed Term Loan (amounting more than 10 lac) – If defaulted installments are equals payables for	≥03 months but <06 months	≥06 months but <09 months	≥09 months
Fixed Term Loan (amounting upto 10 lac)	≥06 months but <09 months	≥09months but <12 months	≥12 months
Short-term Agricultural and Micro-Credit -If past due/ overdue for	≥12 months but <36 months	≥ 36 months but <60 months	≥60 months

Section 27KaKa(3) [read with section 5(GaGa)] of the Banking Companies Act, 1991

Section 27KaKa(3)

কোন খেলাপী ঋণ গ্রহীতার অনুকূলে কোন ব্যাংক-কোম্পানী বা আর্থিক প্রতিষ্ঠান কোনরূপ ঋণ সুবিধা প্রদান করিবে না।

Section 5(GaGa)

খেলাপী ঋণ গ্রহীতা’ অর্থ কোন দেনাদার ব্যক্তি বা প্রতিষ্ঠান বা কোম্পানী যাহার নিজের বা স্বার্থ সংশ্লিষ্ট প্রতিষ্ঠানের অনুকূলে প্রদত্ত অগ্রীম, ঋণ বা অন্য কোন আর্থিক সুবিধা বা উহার অংশ বা উহার উপর অর্জিত সুদ বা উহার মুনাফা বাংলাদেশ ব্যাংক কর্তৃক জারীকৃত সংজ্ঞা অনুযায়ী মেয়াদোত্তীর্ণ হওয়ার ৬ (ছয়) মাস অতিবাহিত হইয়াছে;

Basis for Loan Classification

Qualitative Judgement

Classification Category	Assessment Factors
Special Mention Account	<ul style="list-style-type: none"> ✓ The loan was not made in compliance with the bank's internal policies. ✓ Failure to maintain adequate and enforceable documentation. ✓ <u>Poor control over collateral.</u> ✓ Occasional overdrawn within the past year. ✓ Below-average or declining profitability. ✓ <u>Barely acceptable liquidity.</u>
Sub-standard	<ul style="list-style-type: none"> ✓ <u>Recurrent overdrawn, low account turnover,</u> location in a volatile industry, very low profitability, cash flow less than repayment of principal and interest, conflict in corporate governance, unjustifiable lack of external audit, pending litigation of a significant nature. ✓ Primary sources of repayment are insufficient to service the debt and the bank must look to secondary sources of repayment, including collateral. ✓ The banking organization has acquired the asset without the types of <u>adequate documentation</u> that are required in the banking organization's lending policy,

Basis for Loan Classification

_ Qualitative Judgement

Classification Category	Assessment Factors
Doubtful	<ul style="list-style-type: none"> ✓ <u>Permanent overdrawn.</u> ✓ Location in an industry with poor aggregate earnings. ✓ Serious competitive problems. ✓ Failure of key products; ✓ Illiquidity, including the necessity to sell assets to meet operating expenses. ✓ Cash flow less than required interest payments. ✓ <u>Doubts about true ownership.</u>
Bad/Loss	<ul style="list-style-type: none"> ✓ The obligor seeks new loans to finance operational losses. ✓ <u>Location in an industry that is disappearing.</u> ✓ <u>Technological obsolescence, very high losses.</u> ✓ Cash flow less than production costs, no repayment source except liquidation. ✓ Presence of money laundering, fraud, embezzlement, or other criminal activity, no further support by owners.

Maintenance of Provision

NOTE THAT- @1% 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.

- No provision required against Bills for Collection.

Reporting

The banks will conduct their classification- activities on quarterly basis.

(i) CL-1 is the compilation/summary of 5 other forms. This form is for showing summary of classification status for different loan categories mentioned earlier along with staff loan.

(ii) CL-2 is for reporting Continuous Loan

(iii) CL-3 is for reporting Demand Loan

(iv) CL-4 is for reporting Term Loan

(v) CL-5 is for reporting Short-term Agricultural and Micro-Credit.

Loan Rescheduling

Circulars in force

Loan Rescheduling

- ✓ BRPD Circular No. 15/2012 dated Sep 23, 2012
- ✓ BRPD Circular No. 06/2013 dated May 29, 2013

Loan Rescheduling

Banks shall comply with the instructions given in BRPD 15/2012 while considering application for loan rescheduling of non-performing loan (loans classified as Sub-standard, Doubtful and Bad/Loss)

Time limit for rescheduling

Note:

Time limits instructed in the circular are absolute maximums only, and banks are encouraged to establish shorter time limits in their internal policies. Each loan that is being considered for rescheduling should be evaluated on its own merits and not automatically rescheduled for the maximum time period or rescheduled for the maximum number of three (03) times.

Continuous Loan
[max months from the date of Rescheduling]

	SS	DF	BL
1st Rescheduling	18	12	12
2nd Rescheduling	12	9	9
3rd Rescheduling	6	6	6

Demand Loan
[max months from the date of Rescheduling]

	SS	DF	BL
1st Rescheduling	12	9	9
2nd Rescheduling	9	6	6
3rd Rescheduling	6	6	6

Fixed Term Loan
[max months from the date of Rescheduling following the expiry date]

	SS	DF	BL
1st Rescheduling	36	24	24
2nd Rescheduling	24	18	18
3rd Rescheduling	12	12	12

d) Time limit for rescheduling Short-term Agricultural and Micro-Credit :

In case of rescheduling of any classified Short-term Agricultural and Micro-Credit, **6 months may be added with following time-limit from the day after the expiry date/repayment date of last installment to determine the repayment schedule which will be started from the date of rescheduling.** If the loan is rescheduled after the expiry date, the following time-limit will be applicable:

Time limit for rescheduling Short-term Agricultural and Micro-Credit :

First Rescheduling	Repayment time limit for rescheduling should not exceed 2 (two) years from the date of rescheduling.
Second Rescheduling	Maximum 1(one) year from the date of rescheduling.
Third Rescheduling	Maximum 6(six) months from the date of rescheduling.

- If the loan becomes default after third rescheduling, the borrower will be treated as a habitual loan defaulter and the bank shall not consider for further loan rescheduling.
- Approval of loan rescheduling cannot be made below the level at which it was originally sanctioned.

3. Down payment of term loans:

- a) 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;
- b) 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.
- c) 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.
- d) The rate of down payments for Short-term Agricultural and Micro-Credit will be same as above.

4. Down payment of demand and continuous loan:

- a) If a Demand or Continuous Loan is converted into a Term loan, first rescheduling may take place against down payment on the basis of loan amount in the following manner.

Amount of Overdue Loan	Rate of Down payment
Up to Tk.1.00 (one) crore	15%
Above Tk.1.00(one) crore and up to Tk.5.00(five) crore	10% (but not less than Tk.15.00 lac)
Above Tk. 5.00(five) crore	5% (but not less than Tk.50.00 lac)

Loan Write-off

Circulars in force

Write off

- ✓ BRPD Circular No. 02/2003 dated Jan 13, 2003
- ✓ BRPD Circular No. 13/2013 dated Nov 07, 2013

Writing off bad loans having adequate provision is an internationally accepted normal phenomenon in banking business. Owing to the reluctance of banks in Bangladesh in resorting to this system their balance sheets are becoming unnecessarily and artificially inflated. In this context the policies for writing off loans are being issued (BRPD 02/2003 & BRPD 13/2013) for compliance by banks

- * Banks may, at any time, write off loans classified as bad/loss for which 100% provisions have been kept and cases have been filed in the court of law. However, banks may write-off default loans below Tk 50,000 without filing suit against the borrowers. Under the process the oldest bad/loss classified loans should be considered first for written off.**
- * Banks may write off loans by debit to their current year's income account where 100% provision kept is not found adequate for writing off such loans.**
- * All out efforts should be continued for realizing written off loans. Cases must be filed in the court of law before writing off any loan for which no legal action has been initiated earlier.**

*** A separate "Debt Collection Unit" should be set up in the bank for recovery of written off loans.**

*** In spite of writing off the loans the concerned borrower shall be identified as defaulter as usual. Like other loans and advances, the writing off loans and advances shall be reported to the Credit Information Bureau (CIB) of Bangladesh Bank.**

Prior approval of Bangladesh Bank shall have to be obtained in case of writing off loans sanctioned to the director or ex-director of the bank or loans sanctioned during the tenure of his directorship in the bank to the enterprise in which the concerned director has interest (as per explanation contained in section 27(2) of the Bank Company Act, 1991).

Interest Waiver

The only rule that prevails regarding the interest waiver is that Banks can waive interest as per their own policy provided that 'principal' cannot be waived.

Letter BCD(P)760/34-1681 dated 07/10/1991.

N.B. MoF has specific instructions for SOCBs regarding interest waiver .

**Thank you
all.**



