Directive for Treatment of Fixed Equated Installment Facility (FEIF)

June 27, 2022

This directive is issued as an addendum to SOP for Phase IV Monetary Measures to provide guidance to the Financial Service Providers (FSPs) for the treatment of Fixed Equated Installment Facility (FEIF). It provides guidance on income recognition and other prudential requirements for FEIF accounts.

1. Rationale

The FSPs are required to create FEIF accounts for transfer of accumulated interest during the deferment period under the Monetary Measures. If these transactions are not carried out in a prudent manner, there are possibilities of causing distortions in the books of the FSPs which could undermine fair presentation of financial statements. Therefore, to carry out these transactions prudently with minimal distortions to the books of the FSPs, this directive is issued for compliance by all the FSPs.

2. Existing Interest Regime under Prudential Regulations 2017

As per the existing 'Interest Regime' covered under Section 4.10 of Prudential Regulations 2017, the FSPs are currently required to comply with the following:

a) Suspension of Interest (Clause 4.10.5 of PR 2017)

Interest accrued on a credit exposure which is classified as a non-performing loan shall not be recognized as income, but shall be suspended and booked in a valuation reserve designated as "Interest-in-Suspense account." Thereafter, any payments received against the individual accounts must be first applied towards interest arrears, and the remaining balance, if any, towards the principal.

b) Reversal of Interest Income (Clause 4.10.6 of PR 2017)

When a loan is classified as non-performing, all interest on the loan must be suspended from the date of the first default. Thus, any accrued interest taken to income prior to the loan being classified as non-performing must be reversed out of income. Subsequently, interest on non-performing loan will be recognized as income only on a cash basis.

3. Treatment of FEIF Accounts

Since FEIF accounts are essentially accumulated interest during deferment and forms part of the interest income, the treatment of FEIF accounts shall be guided by the following:

a) <u>For Performing Loans</u>

i. The FSPs shall transfer accumulated interest during the deferment period after adjustment of Interest Payment Support (IPS), repayments and interest rebate (if eligible) to FEIF accounts.

ii. In line with the Interest Regime of PR 2017, the accumulated interest on performing loans shall be treated as interest income prior to the transfer to FEIF accounts.

iii. Any repayment received on FEIF accounts for performing loans shall be cash/bank collections and shall not be routed through Profit or Loss account since the income is already recognized prior to transfer to FEIF account.

iv. The FEIF accounts created in respect of performing loans shall follow asset classification and loan loss provision as per Section 4 of the Prudential Regulations 2017. The loan loss provisions (GP/SP) shall be maintained separately for FEIF accounts.

v. The FEIF accounts created in respect of performing loans shall attract risk weight for the purpose of regulatory capital as per the Prudential Regulations 2017 or any other subsequent directive issued by the RMA.

b) <u>For Non-Performing Loans (NPLs)</u>

i. The FSPs shall transfer accumulated interest during the deferment period after adjustment of Interest Payment Support (IPS), repayments and interest rebate (if eligible) to FEIF accounts.

ii. In line with the Interest Regime of PR 2017, the accumulated interest on NPLs shall not be recognized as income, but shall be suspended and booked in a valuation reserve designated as “Interest-in-Suspense account” prior to the transfer to FEIF accounts.

iii. On transfer of accumulated interest to FEIF accounts for NPLs, the Interest-in-Suspense account maintained by the FSPs shall not be routed through Profit or Loss account but transferred to regulatory provision titled “Provision against FEIF”.

iv. Any repayments made on FEIF accounts for NPLs shall be first adjusted against FEIF balance in the balance sheet. The income on these FEIF accounts shall be recognized by transferring back equivalent amount from “Provision against FEIF” to other income (Profit or Loss account).

v. To enable FSPs to continuously monitor and evaluate the performance of FEIF accounts, it shall follow asset classification as per Section 4 of the Prudential Regulations 2017. However, it shall not attract loan loss provision since these FEIF accounts are already fully provided by creation of ‘Provision against FEIF’ at the time of transfer to FEIF accounts.

vi. The FEIF accounts created in respect of NPLs shall not attract any risk weight for the purpose of regulatory capital since these accounts are fully covered by ‘Provision against FEIF’.

c) Other Matter

i. The transfer of accumulated interest to FEIF account shall not be treated as repayment. Therefore, it shall not affect the overdue days and asset classification of the original loan account due to such transactions.

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