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Reserve Bank of India (Local Area Banks – Resolution of Stressed Assets) Directions, 2025

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Introduction

These Directions are issued with a view to providing a framework for early recognition, reporting and time bound resolution of stressed assets. These Directions also rationalise and harmonise the instructions on compromise settlements and technical write-offs, in order to provide impetus to resolution of stressed assets in the system.

Some of the Local Area Banks (LABs) may also be involved in implementation of various forms of Debt Relief Schemes (DRS) announced by State Governments that inter alia entail sacrifice / waiver of debt obligations of a targeted segment of borrowers, against fiscal support. If such schemes are announced frequently, incommensurately, or without due consideration to the principles of financial discipline, they would negatively affect credit discipline and in the long run, may be counter-productive to the credit flow to such borrowers. Apart from the broader implications for the credit discipline and moral hazard issues, DRS also raises certain prudential concerns, which include delay in receipt of dues; mismatch between the claims admitted / submitted by the LABs and accepted by the concerned Government as per the terms of the scheme; mandatory requirement of fresh credit by the LABs, etc. These Directions also lay down certain broad principles regarding participation of LABs in DRS and specifies a model operating procedure, which has been shared with the State Governments for their consideration while designing and implementing such DRS to avoid any non-alignment of expectations of the stakeholders involved, including the Government, lenders, borrowers, etc.

Accordingly, in exercise of the powers conferred by the Sections 21 and 35A of the Banking Regulation Act, 1949, the Reserve Bank, being satisfied that it is necessary and expedient in public interest so to do, hereby, issues these Directions hereinafter specified.

Chapter I - Preliminary

A. Short title and commencement

1. These Directions shall be called the Reserve Bank of India (Local Area Banks – Resolution of Stressed Assets) Directions, 2025.

2. These Directions shall come into force with immediate effect unless specified otherwise.

B. Applicability

3. These Directions shall be applicable to Local Area Banks (hereinafter collectively referred to as 'banks' and individually as a 'bank').

C. Definitions

4. In these Directions, the following definitions shall apply, unless the context otherwise requires:

(1) '*compromise settlement*' shall refer to any negotiated arrangement with the borrower to fully settle the claims of a bank against the borrower in cash.

Explanation: Compromise settlement may entail some sacrifice of the amount due from the borrower on the part of the bank with corresponding waiver of claims of the bank against the borrower to that extent.

(2) *'default*' shall mean non-payment of debt (as defined under the Insolvency and Bankruptcy Code, 2016) when whole or any part or instalment of the debt has become due and payable and is not paid by the debtor or the corporate debtor, as the case may be.

Provided that for revolving facilities like cash credit, default would also mean, without prejudice to the above, the outstanding balance remaining continuously in excess of the sanctioned limit or drawing power, whichever is lower, for more than thirty days.

(3) *'technical write-off' shall refer to cases where the non-performing assets remain outstanding at borrowers' loan account level but are written-off (fully or partially) by the bank only for accounting purposes, without involving any waiver of claims against the borrower, and without prejudice to the recovery of the same.*

5. All other expressions, unless defined herein, shall have the same meaning as have been assigned to them under the Banking Regulation Act, 1949 or the Reserve Bank of India Act, 1934 or the Companies Act, 2013, or any statutory modification or re-enactment thereto or other regulations issued by the Reserve Bank or the Glossary of Terms published by the Reserve Bank or as used in commercial parlance, as the case may be.

Chapter II - General Requirements

A. Board approved policies:

6. A bank shall put in place a Board-approved policy for restructuring / rehabilitation of stressed assets.

7. A bank shall put in place Board-approved policies for undertaking compromise settlements with the borrowers as well as for technical write-offs, which shall *inter alia* include the following:

   (1) comprehensive prescription of the process to be followed for all compromise settlements and technical write-offs, with specific guidance on the necessary conditions precedent such as minimum ageing, deterioration in collateral value etc.;

   (2) graded framework for examination of staff accountability in such cases with reasonable thresholds and timelines as may be decided by the Board;

   (3) provisions relating to permissible sacrifice for various categories of exposures while arriving at the settlement amount, after prudently reckoning the current realisable value of security/collateral, where available;

   (4) methodology for arriving at the realisable value of the security in respect of compromise settlements.

   (5) delegation of powers for approval / sanction of compromise settlements and technical write-offs, subject to the following:

      (i) delegation of power for such approvals rests with an authority (individual or committee, as the case may be) which is at least one level higher in hierarchy than the authority vested with power to sanction the credit / investment exposure.

      Provided that any official who was part of sanctioning the loan (as individual or part of a committee) shall not be part of the approving the

proposal for compromise settlement of the same loan account, in any capacity.

(ii) proposals for compromise settlements in respect of borrowers classified as fraud or wilful defaulter, as permitted in terms of paragraphs 16 to 31, shall require approval of the Board in all cases.

B. Early identification and reporting of stress

8. A bank shall recognise incipient stress in loan accounts, immediately on default, by classifying such assets as special mention accounts (SMA) as per the following categories:

Loans other than revolving facilities		**Loans in the nature of revolving facilities like cash credit/overdraft**	
SMA Sub-categories	**Basis for classification – Principal or interest payment or any other amount wholly or partly overdue**	**SMA Sub-categories**	**Basis for classification –** Outstanding balance remains continuously in excess of the sanctioned limit or drawing power, whichever is lower, for a period of:
SMA-0	Up to 30 days		
SMA-1	More than 30 days and up to 60 days	SMA-1	More than 30 days and up to 60 days
SMA-2	More than 60 days and up to 90 days	SMA-2	More than 60 days and up to 90 days

9. The instructions on classification of borrower accounts into SMA categories are applicable for all loans (including retail loans), other than agricultural advances governed by crop season-based asset classification norms, irrespective of size of exposure of the bank.

10. A bank shall adhere to the relevant provisions on submission of financial information to information utilities of Insolvency and Bankruptcy Code, 2016 and Insolvency and Bankruptcy Board of India (Information Utilities) Regulations, 2017 and put in place appropriate systems and procedures to ensure compliance to the provisions of the Code and Regulations.

C. Disclosures

11. A bank shall make suitable disclosures in its financial statements in the 'Notes to Accounts', as specified in the Reserve Bank of India (Local Area Banks – Financial Statements: Presentation and Disclosures) Directions, 2025.

Chapter III - Prudential Norms Applicable to Restructuring

A. Restructuring of accounts – General Instructions

12. An asset where the terms of the loan agreement regarding interest and principal have been renegotiated or rescheduled, should be classified as sub-standard and should remain in such category for at least one year of satisfactory performance under the renegotiated or rescheduled terms.

13. The classification of an asset shall not be upgraded merely as a result of rescheduling unless there is satisfactory compliance of the above condition.

14. Borrowers who have committed frauds/ malfeasance/ wilful default as well as any entity with which a wilful defaulter is associated shall remain ineligible for restructuring.

15. A wilful defaulter or any entity with which a wilful defaulter is associated shall be eligible for restructuring subsequent to removal of the name of wilful defaulter from the List of Wilful Defaulters, subject to penal measures applicable to borrowers classified as wilful defaulter in terms of the Reserve Bank of India (Local Area Banks – Treatment of Wilful Defaulters and Large Defaulters) Directions, 2025.

Chapter IV - Special Cases of Restructuring

A. Compromise Settlements and Technical Write-offs

16. The objective of compromise settlements shall be to maximise the possible recovery from a distressed borrower at minimum expense, in the best interest of the bank.

17. Compromise settlement is not available to borrowers as a matter of right; rather it is a discretion to be exercised by a bank based on its commercial judgement.

18. The compromise settlements and technical write-offs shall be without prejudice to any mutually agreed contractual provisions between a bank and a borrower relating to future contingent realizations or recovery by the bank, subject to such claims not being recognised in any manner on the balance sheet of the bank at the time of the settlement or subsequently till actual realization of such receivables.

    Provided that any such claims recognised on the balance sheet of the bank shall render the arrangement to be treated as restructuring.

19. Notwithstanding paragraph 18, compromise settlements where the time for payment of the agreed settlement amount exceeds three months shall be treated as restructuring.

20. Any arrangement involving part settlement with the borrower shall also fall under the definition of restructuring and shall be governed by the provisions applicable thereto.

21. Technical write-off is an accounting procedure undertaken by a bank to cleanse the balance sheets of bad debts which are either considered unrecoverable or whose recovery is likely to consume disproportionate resources of the lenders. However, such technical write-offs do not entail any waiver of claims against the borrower and thus the bank's right to recovery shall not undermined in any manner. The legal obligation of the borrowers as well as the costs of such defaults for them remain unchanged vis-à-vis the position prior to technical write-offs.

22. In case of partial technical write-offs, the prudential requirements in respect of residual exposure, including provisioning and asset classification, shall be with reference to the original exposure.

Provided that the amount of provision including the amount representing partial technical write-off shall meet the extant provisioning requirements, as computed on the gross value of the asset.

23. There shall be a reporting mechanism to the next higher authority, at least on a quarterly basis, with respect to compromise settlements and technical write offs approved by a particular authority.

    Provided that compromise settlements and technical write-offs approved by the MD & CEO / Board Level Committee shall be reported to the Board.

24. The Board shall mandate a suitable reporting format so as to ensure adequate coverage of the following aspects at the minimum:

    (1) trend in number of accounts and amounts subjected to compromise settlement and/or technical write-off (q-o-q and y-o-y);

    (2) out of (1) above, separate breakup of accounts classified as fraud, red-Flagged, wilful default and quick mortality accounts;

    (3) amount-wise, sanctioning authority-wise, and business segment / asset-class wise grouping of such accounts;

    (4) extent of recovery in technically written-off accounts.

25. In respect of borrowers subject to compromise settlements, there shall be a cooling period as determined by the respective Board approved policies before the bank can assume fresh exposures to such borrowers.

    Provided that the cooling period in respect of exposures other than farm credit exposures shall be subject to a floor of 12 months with a bank being free to stipulate higher cooling periods in terms of their Board approved policies.

    Provided further that the cooling period for farm credit exposures shall be determined by a bank as per their respective Board approved policies.

Explanation: Farm credit for the above purpose shall refer to credit extended to agricultural activities as listed in the Reserve Bank of India (Local Area Banks – Income Recognition, Asset Classification and Provisioning) Directions, 2025.

26. The cooling period to be adopted in respect of exposures subjected to technical write-offs shall be as per the Board approved policies of a bank.

27. A bank may undertake compromise settlements or technical write-offs in respect of accounts categorised as wilful defaulters or fraud without prejudice to the criminal proceeding underway against such borrowers.

28. The penal measures applicable to borrowers classified as fraud or wilful defaulter in terms of the Reserve Bank of India (Fraud Risk Management in Commercial Banks (including Regional Rural Banks) and All India Financial Institutions) Directions, 2024 and the Reserve Bank of India (Local Area Banks – Treatment of Wilful Defaulters and Large Defaulters) Directions, 2025, respectively, shall continue to be applicable in cases where a bank enter into compromise settlement with such borrowers, and the cooling periods specified in paragraphs 25 and 26 above, in respect of such borrowers, shall be without prejudice to such penal measures.

FAQ 1: From a public policy perspective, what is the rationale for permitting a bank to enter into compromise settlement with borrowers classified as fraud or wilful defaulter?

The primary regulatory objective is to enable multiple avenues to a bank to recover the money in default without much delay. Apart from the time value loss, inordinate delays result in asset value deterioration which hampers ultimate recoveries. Compromise settlement is recognized as a valid resolution mechanism under these Directions. The imperatives for a bank are no different when it comes to recovery from borrowers classified as fraud or wilful defaulter. Continuing such exposures on the balance sheets of a bank without resolution due to legal proceedings would lock the bank's funds in an unproductive asset, which would not be a desirable position. As long as larger policy concerns are suitably addressed and the costs of malafide actions are made to be borne by the perpetrators, early recoveries by a bank should

be a preferred option, subject to safeguards. Further, continuation of criminal proceedings underway or to be initiated against the borrowers classified as fraud or wilful defaulter, would ensure that perpetrators of any malafide action do not go scot-free.

FAQ 2: A bank is not permitted to restructure borrower accounts classified as fraud or wilful defaulter. Why a different treatment is prescribed for compromise settlements for such borrowers?

Restructuring in general entails a bank having a continuing exposure to the borrower entity even after restructuring and hence, in case of borrowers classified as fraud or wilful defaulter, permitting the bank to continue its credit relationship with the borrower entity would be fraught with moral hazard. On the other hand, a compromise settlement entails a complete detachment of the bank with the borrower. Therefore, permitting a bank to settle with the borrowers as per their commercial judgement would enhance recovery prospects.

29. The compromise settlements with the borrowers under these Directions shall be without prejudice to the provisions of any other statute in force.

30. In addition to the requirement under paragraph 29, wherever a bank had commenced recovery proceedings under a judicial forum and the same is pending before such judicial forum, any settlement arrived at with the borrower shall be subject to obtaining a consent decree from the concerned judicial authorities.

31. The monetary ceiling of cases referred to the Lok Adalats organised by Civil Courts for compromise settlements shall be ₹20 lakh.

Chapter V - Government Debt Relief Schemes (DRS)

A. Prudential treatment in respect of Government Debt Relief Schemes (DRS):

32. A bank may decide on participating in a particular DRS notified by a Government, based on its Board approved policy, subject to the extant regulatory norms.

33. Any provision of the scheme that may warrant modification in long term interest of the borrowers or for prudential reasons may be duly brought to the notice of the concerned authority/ies through the State Level Bankers' Committee / District level Consultative Committee, during the consultation phase while designing the DRS.

34. A bank shall clearly determine the eventual outstanding that may crystallise in their books in respect of the borrowers proposed to be covered under the DRS, including the accumulated interest in non-performing accounts, by the time the dues are settled under the DRS, to enable the Government to suitably arrange for the extent of fiscal participation.

35. A bank shall ensure that the borrowers to be covered under DRS are selected strictly as per terms of such schemes so as to avoid subsequent non-admission by the authorities on technical grounds.

36. The terms and conditions of the scheme as well as the prudential aspects, including cooling period for extending fresh credit, impact on credit score etc., shall be clearly communicated to the borrowers at the time of obtaining explicit consent from the borrower for availing benefits under a proposed DRS.

37. Any waiver of accrued but unrealised interest and/ or sacrifice of principal undertaken by a bank in the borrower accounts of beneficiaries of the DRS, either as part of the implementation of the scheme or subsequent to its implementation, shall be treated as a compromise settlement and shall attract the prudential treatment contained in paragraphs 16 to 31.

38. If the funds received by a bank as part of the DRS covers the entire outstanding dues of the borrower, including principal and interest accrued till the date of receipt

of funds by the bank, the same shall lead to extinguishment of borrower's debt obligations.

39. In cases where the funds received by a bank as part of the scheme are not adequate to cover the entire outstanding dues of the borrower, leading to residual exposure (principal and / or accrued interest), the asset classification of the residual exposure shall be evaluated as per the terms and conditions of the original loan contract.

    Provided that any changes / modifications to the terms and conditions of the original loan contract in such cases shall be evaluated against the test of restructuring as defined in these Directions and shall attract the prudential treatment therein.

40. Any fresh credit exposure to such borrowers shall be as per the commercial discretion of the bank under relevant internal policy, subject to extant applicable regulations.

41. A bank's reporting in respect of the borrowers under the scheme to the credit information companies shall be guided by the extant guidelines in this regard.

42. There shall not be creation of any receivable against the Government on account of the DRS and the exposure shall continue to be on the borrower till receipt of funds by the bank.

43. Till receipt of funds, a bank shall continue to apply the prudential norms including prudential norms on income recognition, asset classification and provisioning, and wherever the accounts are non-performing, the bank may pursue recovery measures as per their Board approved policy against such borrowers.

44. The instructions contained in paragraphs 32 to 43 shall apply in respect of DRS notified on or after December 31, 2024 and shall be without prejudice to the instructions on resolution of stressed assets contained in these Directions.

45. In the context of these instructions, a model operating procedure (MOP) has also been shared with the State Governments (Annex) for their consideration while designing and implementing such DRS through a consultative approach, to avoid

any non-alignment of expectations of the stakeholders involved, including the Government, lenders, borrowers, etc.

46. In respect of relief measures announced prior to December 31, 2024, any dues pending receipt from Government, for more than 90 days shall attract specific provision of 100%.

47. A bank shall take necessary action and actively follow up with the respective Governments for settlement of dues referred to in paragraph 46.

Chapter VI - Special Measures

A. Trade Relief Measures

48. To mitigate the burden of debt servicing brought about by trade disruptions caused by global headwinds and to ensure the continuity of viable businesses, bank may extend relief measures to eligible borrowers, as specified under Reserve Bank of India (Trade Relief Measures) Directions, 2025 dated November 14, 2025. The Directions, *inter-alia*, include a defined sunset clause for the measures.

Chapter VII - Repeal and Other Provisions

A. Repeal and saving

49. With the issue of these Directions, the existing directions, instructions, and guidelines relating to Resolution of Stressed Assets as applicable to Local Area Banks stands repealed, as communicated vide circular DOR.RRC.REC.302/33-01-010/2025-26 dated November 28, 2025. The directions, instructions and guidelines already repealed vide any of the directions, instructions, and guidelines listed in the above notification shall continue to remain repealed.

50. Notwithstanding such repeal, any action taken or purported to have been taken, or initiated under the repealed Directions, instructions, or guidelines shall continue to be governed by the provisions thereof. All approvals or acknowledgments granted under these repealed lists shall be deemed as governed by these Directions. Further, the repeal of these directions, instructions, or guidelines shall not in any way prejudicially affect:

    (1) any right, obligation or liability acquired, accrued, or incurred thereunder;

    (2) any, penalty, forfeiture, or punishment incurred in respect of any contravention committed thereunder;

    (3) any investigation, legal proceeding, or remedy in respect of any such right, privilege, obligation, liability, penalty, forfeiture, or punishment as aforesaid; and any such investigation, legal proceedings or remedy may be instituted, continued, or enforced and any such penalty, forfeiture or punishment may be imposed as if those directions, instructions, or guidelines had not been repealed.

B. Application of other laws not barred

51. The provisions of these Directions shall be in addition to, and not in derogation of the provisions of any other laws, rules, regulations, or directions, for the time being in force.

C. Interpretations

52. For the purpose of giving effect to the provisions of these Directions or in order to remove any difficulties in the application or interpretation of the provisions of these Directions, the Reserve Bank may, if it considers necessary, issue necessary clarifications in respect of any matter covered herein and the interpretation of any provision of these Directions given by the Reserve Bank shall be final and binding.

(Vaibhav Chaturvedi)
Chief General Manager

Annex

Model Operating Procedure (Government Debt Relief Schemes)

Coverage and Meaning

1. For the purpose of the Model Operating Procedure (MOP), Debt Relief Schemes (DRS) refer to Schemes notified by the State Governments that entail funding by the fiscal authorities to cover debt obligations of a targeted segment of borrowers that the regulated entities are required to sacrifice / waive.

2. Announcement / notification of any such DRS should include the specific stress or distress situation necessitating announcement of such support. Given the broader implications of such DRS for the credit culture, while broad based relief measures can be addressed through pure fiscal support in the form of Direct Benefit Transfer (DBT), DRS should be considered only as a measure of last resort when other measures to alleviate financial stress have failed.

Pre-Notification Consultation

3. Before announcing any DRS, Governments may engage with the State Level Bankers' Committee (SLBC)/ District level Consultative Committee (DCC) to evolve a coordinated action plan for conceptualisation, design, and implementation of the DRS. The schemes should, cover critical aspects of the scheme like identification of borrowers, impact assessment, implementation timelines, resolution of issues concerning settlement of dues by Government to the lending institutions, etc.

4. The design features should ensure that the DRS do not impact the financial stability aspects of the region / State or create moral hazards in the borrower segments. Conformance to relevant regulatory guidelines on loan settlement, reporting to credit information companies etc. should also be taken into account.

Funding of Scheme

5. Detailed budgetary provisions / funding may be provided upfront towards any proposed DRS to fully cover the required settlement amounts. Where regulated entities have dues

from the Government, pertaining to earlier DRS schemes, new schemes should be announced only on a fully pre-funded basis.

Design of Scheme

6. The DRS should be targeted only at the impacted borrowers and should not contain any restrictive covenant against timely repayments. Further, it should specify the criteria for determining eligible borrowers on an objective basis, detailed timeline of critical / material events, including cut-off dates for filing/ submission, acknowledgement, approval and settlement of claims along with compensation clauses for delays in settling the funds, on part of the Government.

7. The DRS should cover the entire outstanding dues of the borrowers being covered, including principal and accumulated interest till the date of receipt of funds by the regulated entities from the Government.

8. The DRS should not require the creation of a receivable in the books of the regulated entity against the Government. The exposure of regulated entities to the borrower shall continue and shall be reduced to the extent of funds received from the Government.

9. The entire implementation of the Scheme and settlement of claims by the Governments to the regulated entities, should generally be completed within 45 to 60 days.

10. The DRS should not contain any provision contrary to any regulatory instruction issued by the Reserve Bank / National Bank for Agriculture and Rural Development (NABARD).

11. The design of the DRS should not contain any provision that casts any obligations on the regulated entities, directly or indirectly, to:

a. waive/ sacrifice a part or whole of its dues from the borrower;

b. extend fresh credit to borrowers whose debt has been waived;

c. make any commitments in anticipation of future budgetary support;

d. stop pursuing legal avenues available to them, for recovery of dues from the borrower, pending receipt of funds from the Government.

However, if the regulated entities agree to any of the above at the time of design of DRS or subsequently, as per their Board-approved policies, it shall be subject to the applicable prudential guidelines.