Monetary and Credit Policy Measures- Mid-Term Review for the Year 2000-2001

BP. BC. 31 /21.04.048/00-01
October 10, 2000

All Commercial Banks
(Excluding Regional Rural Banks and Local Area Banks)

Dear Sirs,

Monetary and Credit Policy Measures- Mid-Term Review for the Year 2000-2001

Please refer to the Governor's letter No. MPD. BC. 201/ 07.01.279/ 2000-2001 dated October 10, 2000 enclosing a copy of the Statement on "Mid-term Review of Monetary and Credit Policy for the year 2000-2001". The guidelines in regard to some of the policy measures contained in paragraphs 41, 44 and 49 of the Statement are given below:-

1. **Certificates of Deposits (CDs) Scheme**

In terms of circular DBOD No.Dir. BC.36/13.03.00/98 dated April 29, 1998, the minimum lock-in period for CDs was reduced to 15 days from the date of issue. With a view to providing flexibility and depth to secondary market, it has now been decided to withdraw the restriction on transferability period for CDs issued by banks.

2. Provision on Standard Assets – Inclusion in Tier II capital

In terms of paragraph 3 of circular DBOD No.BP.BC.164/ 21.04.048/2000 dated April 24, 2000 , the provision on 'Standard Assets' is not eligible for inclusion in Tier II capital. In line with the international best practices followed in this regard, it has been decided to allow banks to include the 'General Provisions on Standard Assets' in Tier II capital. However, the provisions on standard assets together with other 'general provisions/ loss reserves' will be admitted as Tier II capital up to a maximum of 1.25 per cent of the total risk weighted assets.

3. **Annexing Balance Sheets of Subsidiaries**

to Parent Bank's Balance Sheet

Banks were advised, vide paragraph 3 of circular DBOD No. BP. BC. 169 /21.01.002/2000 dated May 3, 2000, to voluntarily build in the risk-weighted components of their subsidiaries into their own balance sheet on notional basis, at par with the risk weights applicable to the bank's own assets and earmark additional capital in their books, in phases, beginning from the year ending March, 2001. In this connection, it may be mentioned that at present public sector banks are not required to annex the balance sheets of their subsidiaries to their balance sheet unlike other banking companies which are required to do so under the provisions of the Companies Act, 1956. In order to bring more transparency to the balance sheets of the public sector banks and as a further step towards consolidated supervision and to provide additional disclosures, it has been decided that beginning from the year ending March, 2001, public sector banks should also annexe the Balance Sheet, Profit and Loss account, Report of the Board of Directors, and the Report of the Auditors in respect of each of their subsidiaries, to their own balance sheets.

4. **Asset Classification –'Past Due' Concept**

Under the extant guidelines on income recognition, asset classification and provisioning, an asset is classified as NPA based on the period for which the amounts due in the account remained 'past due'. In paragraph 1 of our circular DBOD.BP.BC.59/21.04.043-92 dated December 17,1992, it has been clarified that an amount should be considered "past due" when it remains outstanding for 30 days beyond due date. Due to the improvements in the payment and settlement systems, recovery climate, upgradation of technology in the banking system, etc., it has been decided to dispense with 'past due' concept, with effect from March 31, 2001. Accordingly, as from that date, a Non-performing Asset (NPA) shall be an advance where

- i) interest and/or instalment of principal remain overdue for a period of more than 180 days in respect of a Term Loan,
- ii) the account remains 'out of order' for a period of more than 180 days, in respect of an Overdraft/Cash Credit (OD/CC),
- iii) the bill remains overdue for a period of more than 180 days in the case of bills purchased and discounted,

iv) interest and/or instalment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purposes, and

v) any amount to be received remains overdue for a period of more than 180 days in respect of other accounts.

5. Charging of Penal Interest

In terms of circular DBOD.No.DIR.BC.70/C-96-76 dated 26th June 1976, read with circular DBOD.No.DIR.BC.88/C-96-89 dated March 8, 1989, banks have been advised about the overall penal/additional interest to be charged by banks, which should not exceed 2 per cent over and above the rate of interest applicable/normally charged to the respective borrowers. It may be mentioned that since issue of the above instructions, interest rates on loans and deposits have been substantially deregulated and banks' Boards have been empowered to formulate policy on lending rates taking into account their cost of fund, the underlying credit risk, etc. Since the Boards have been empowered to decide the Prime Lending Rate (PLR) as also the spread over PLR, it is felt that the decision on penal interest that should be levied for reasons such as default in repayment, non-submission of financial statements, etc., should also be left to the Boards of each bank. This would also give further operational autonomy to the banks. It has, therefore, been decided that banks may formulate transparent policy for charging penal interest rates, with the approval of their Boards. The policy should be governed by well accepted principles of transparency, fairness, incentive to service the debt and due regard to genuine difficulties of customers.

6. Margins on credit for free sale sugar

In terms of circular DBOD.No.DIR.BC.126/13.08.01/97 dated October 21, 1997, the minimum margin on levy sugar was 10 per cent while the free sale sugar was subject to a margin of 15 per cent and the buffer stock was at zero per cent margin. On a review of market conditions and with a view to providing the flexibility to banks in prescribing margins, it has been decided to withdraw the existing prescriptions under selective credit control on free sale sugar. Margins in respect of free sale sugar will be decided by the banks based on their commercial judgement. The prescribed margins of 10 per cent in respect of levy stock and zero margin in respect of buffer stocks will continue without change. An amending directive dated October 10, 2000 in this regard is enclosed and the revised instructions shall come into effect from the same date.

7. Please acknowledge receipt of this circular

Yours faithfully,
Sd/-
(A.L.Narasimhan)
Chief General Manager

Encl.1
Endt. DBOD No.BP 838 /21.04.048/00-01 of date
Copy forwarded for information to:
(Addressees as per mailing list)

sd/-
(K.Damodaran)
Deputy General Manager