

**Monetary and Credit Policy for the
year 2001–2002 – Interest Rate Policy**

DBOD No. Dir. BC. 107/13.03.00/2000-01

April 19, 2001
Chaitra 29, 1923(S)

All Commercial Banks
(including RRBs and LABs)

Dear Sirs,

Monetary and Credit Policy for the
year 2001–2002 – Interest Rate Policy

Please refer to Governors' letter No. MPD.BC 206/07.01.279/2000-01, dated April 19, 2001 enclosing a copy of the statement on "Monetary and Credit Policy for the year 2001-2002". As a step towards progressive deregulation of interest rates on deposits and advances and providing more operational flexibility to banks and eliminating rigidities, the following measures have been introduced with immediate effect.

(i) Shortening of Minimum Maturity Period of Term Deposits

Interest rates on all term deposits are currently free and banks now offer an array of rates across maturities of 15 days (and above) which is the minimum maturity for domestic term deposits. With a view to moving further towards deregulation, providing opportunities for non-banks to invest short-term surplus funds in a more flexible manner when they are phased out from call money market and to enable banks to have more flexibility in their Asset Liability Management (ALM), it has been decided to reduce the minimum maturity period for domestic/Ordinary Non-Resident/Non-Resident Special Rupee (NRSR) term deposits to 7 days from the present 15 days, at the discretion of individual banks. But, this facility will be available only in respect of single term deposits of Rs. 15 lakh and above where banks have the freedom to offer differential rates of interest according to size of deposits. However, the stipulation of minimum maturity of 15 days for Certificates of Deposit (CDs) and Commercial Paper (CP) will continue.

(ii) Deposit Scheme for Senior Citizens

As per the present regulations (cf: paragraphs 22(c) of Master Directive DBOD No. Dir. BC. 46/13.03.00/2000-2001 dated November 4, 2000), banks are prohibited to discriminate in the matter of rates of interest paid on deposits, except in respect of single term deposits exceeding Rs. 15 lakh. Based on the requests from several senior citizens and their organizations, it has been decided to permit banks to formulate, with the approval of their Boards of Directors, fixed deposit schemes specifically for senior citizens offering higher and fixed rates of interest as compared to normal deposits of any size. These schemes should also incorporate simplified procedures for automatic transfer of deposits to nominees of such depositors in the event of death. For the sake of uniformity, IBA will be advising the banks about the eligibility criteria for Senior Citizens.

(iii) Term Deposits – Flexibility

- a) As per the extant guidelines on domestic/NRE term deposits (cf: paragraph 9 of Master Directive DBOD No. Dir BC 46/13.03.00/2000-2001, dated November 4, 2000), it is mandatory for banks to allow premature withdrawals, if requested by the depositors. However, banks are free to prescribe penal rates of interest for allowing premature withdrawal except in the case of reinvestment in term deposits with the same bank. Premature withdrawal of large sums may impact the ALM function of the banks. It has, therefore, been decided to give freedom to banks to exercise their discretion to disallow premature withdrawal of large deposits held by entities other than individuals and Hindu Undivided Families. Banks would, however, have to notify such depositors of their policy of disallowing premature withdrawals in advance, i.e. at the time of accepting such deposits. In regard to existing deposits, present provision will continue until the time of renewal of individual deposits.
- b) At present, in terms of paragraph 1(i) of Master Directive DBOD No. Dir.BC 46/13.03.00/2000-2001, dated November 4, 2000, banks are free to renew overdue domestic term deposits at an interest rate applicable on the date of maturity. In order to facilitate better ALM, it has been decided that renewal of overdue term deposits at the rate of interest prevailing on the date of maturity be allowed only for an overdue period of 14 days. In case, the overdue period exceeds 14 days and if the depositor places entire amount of overdue deposit

or a portion thereof as a fresh term deposit, banks may prescribe their own interest rate for the overdue period on the amount so placed as a fresh deposit. Banks, however, have to inform the depositors in advance of their policy for renewal of overdue deposits.

(iv) Interest rates on FCNR(B) Deposits

At present, banks are free to accept FCNR (B) deposits for a maturity period of 1-3 years and to offer fixed or floating rates, the latter with an interest reset period of six months, subject to the ceiling of LIBOR/SWAP rates plus 50 basis points for the corresponding maturity. It has now been decided to revise the above ceiling downward to LIBOR/SWAP rates for the corresponding maturity.

(The above guidelines will not be applicable to RRBs/LABs).

(v) Review of Norms Relating to Prime Lending Rate

At present, loans upto Rs. 2 lakh carry the prescription of not exceeding the Prime Lending Rate (PLR) and on the loans above Rs. 2 lakh, banks are free to determine rate of interest subject to PLR and spread guidelines. Keeping in view the international practice and to provide further operational flexibility to commercial banks in deciding their lending rates, it has been decided to relax the requirement of PLR being the floor rate for loans above Rs. 2 lakh. Banks may now offer loans at below PLR rates to exporters or other creditworthy borrowers including public enterprises on the lines of a transparent and objective policy approved by the respective Boards.

Banks will continue to declare the maximum spread of interest rates over PLR. However, given the prevailing credit market in India and the need to continue with concessionality for small borrowers, the practice of treating PLR as the ceiling for loans upto Rs. 2 lakh will continue.

(The above guidelines will not be applicable to RRBs/LABs).

(Amending Directives DBOD No. Dir BC 104,105,106/13.03.00/2000-2001 dated April 19, 2001 are enclosed).

(vi) Preference for Dematerialised Holding

In terms of the circular DBOD No. Dir. BC. 115/13.07.05/98-99 dated December 9, 1998, banks were advised to settle the transactions in securities as notified by Securities and Exchange Board of India (SEBI) only through depositories. Banks

were also advised that after the commencement of mandatory trading in demat form, they would not be able to sell the shares of listed companies if they were held in physical form.

In order to extend the demat form of holding to other instruments like bonds, debentures and equities, it has now been decided that with effect from October 31, 2001, banks, FIs, PDs and SDs will be permitted to make fresh investments and hold bonds and debentures, privately placed or otherwise, only in dematerialized form. Outstanding investments in scrip forms should also be converted into dematerialized form by June 30, 2002. As regards equity instruments, they will be permitted to be held by the above mentioned institutions only in dematerialized form, from a date to be notified in consultation with SEBI.

Yours faithfully,

(M. R. Srinivasan)
Chief General Manager-in-Charge