Charging of interest at monthly rests

Dear Sir,

Charging of interest at monthly rests

Please refer to our circular DBOD.No.Dir.BC.73/13.03.00/2001-02 dated March 9, 2002 advising banks to switch over to system of charging interest on advances at monthly rests with effect from April 1, 2002.

2. We have received queries from banks seeking clarifications on these instructions. The matter has been examined and we advise that in terms of item (i) of our Directive DBOD.No.Dir.BC.72/13.03.00/2001-02 dated March 9, 2002, the existing practice of charging / compounding of interest on agricultural advances would be linked to crop seasons and the instructions regarding charging of interest on monthly rests shall not be applicable to agricultural advances. However, banks are required to charge interest at monthly rests in respect of other advances as detailed in items (ii) to (iv) of the said Directive. In this connection, it is clarified that the move over to charging of interest at monthly rests effective from April 1, 2002 was envisaged in the context of adopting 90 days' norm for recognition of loan impairment from the year ending March 31, 2004, and consequential need for close monitoring of borrowers' accounts.   Banks are, therefore, advised not to compound interest at monthly rests till March 31, 2003 and to move over to monthly compounding from April 1, 2003.

3.   While compounding interest at monthly rests effective from April 1, 2003 banks may ensure that in respect of advances where administered interest rates are applicable, they should re-align the rates suitably [in view of the freedom given to them for fixing Prime Lending Rates (PLR)] so that they comply with the same. In all other cases also, banks should ensure that the effective rate does not go up merely on account of the switchover to the system of charging interest on monthly rests.

Yours faithfully,

(**M.R. Srinivasan**)
Chief General Manager