**Charging of interest at monthly rests:
Consolidated Instructions**

DBOD.No.Dir.BC. 8 /13.03.00/2002-03

July 26, 2002

All Scheduled Commercial Banks
(excluding RRBs and LABs)

Dear Sir,

Charging of interest at monthly rests:
<u>Consolidated Instructions</u>

Please refer to circular DBOD.No.Dir.BC.73/13.03.00/2001-02 dated March 9, 2002 enclosing Directive DBOD No. Dir. BC.72/13.03.00/2001-02 of the same date advising banks to switchover to system of charging interest on advances at monthly rests with effect from April 1, 2002 to facilitate adoption of 90 days' norm for recognition of loan impairment from the year ending March 31, 2004. We had also issued circulars DBOD.Nos.Dir.BC.107 & 114 /13.03.00/ 2001-02 dated May 28, and June 8, 2002 respectively containing certain clarifications on the captioned subject. Based on certain suggestions received and discussions with banks on some operational and procedural issues in this regard, the instructions contained in the aforesaid circulars have been reviewed by the Reserve Bank.

2. In supersession of the instructions contained in the above circulars on the subject, banks are now advised to follow the undernoted consolidated instructions in regard to switchover to the system of charging monthly interest on loans and advances:

i. Banks have option to compound interest at monthly rests effective either from April 1, 2002, or July 1, 2002 or April 1, 2003.

ii. With effect from quarter beginning July 1, 2002, banks should ensure that the effective rate does not go up merely on account of the switchover to the system of charging / compounding interest at monthly rests and increase the burden on the borrowers.

<u>Illustratively:</u>
If a bank is charging in a borrower's account an interest rate of 12 percent with quarterly rests, the effective rate is 12.55 percent. If the bank charges in the same account an interest rate of 12 percent at monthly rests, the effective rate comes to 12.68 percent. Banks should, therefore, adjust the 12 percent interest rate charged to the borrower in such a way that the effective interest rate to the borrower does not exceed 12.55 percent as hitherto. Thus, in the above example, banks should charge interest at 11.88

percent (and not 12 percent). If this is done, the effective rate, even after compounding at monthly rests will be 12.55 percent.

iii. Application of interest on monthly rests shall be restricted to all running accounts, e.g. Cash Credit, Overdraft, Export Packing Credit Accounts, etc. At the time of changing over to monthly rests, banks may obtain consent letter / supplemental agreement from the borrowers for the purpose of documentation.

iv. Interest at monthly rests shall be applied in case of all new and existing term loans and other loans of longer / fixed tenor.

v. In the case of existing loans of longer / fixed tenor, banks shall move over to application of interest at monthly rests at the time of review of terms and conditions or renewal of such loan accounts or after obtaining consent from the borrower.

vi. Since instructions contained in paragraph 2 (ii) are effective from July 1, 2002, in case a bank had followed a different system from one explained therein in the quarter ended June 30, 2002, it is not required to make adjustment for that quarter.

3. Instructions on charging interest at monthly rests shall not be applicable to agricultural advances and banks shall continue to follow the existing practice of charging / compounding of interest on agricultural advances linked to crop seasons. In this regard, banks are advised to follow the instructions contained in circular RPCD.No.PLFS.BC.129/ 05.02.27/97-98 dated June 29, 1998 issued by our Rural Planning and Credit Department. As indicated therein, banks should charge interest on agricultural advances for long duration crops at annual rests. As regards other agricultural advances in respect of short duration crop and allied agricultural activities such as dairy, fishery, piggery, poultry, bee-keeping, etc., banks may take into consideration due dates fixed on the basis of fluidity with borrowers and harvesting / marketing season while charging interest and compounding the same if the loan / instalment becomes overdue.

4. Please acknowledge receipt.

Yours faithfully,

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