

Interest Rates on Advances

Ref No. DBOD. Dir. BC. 10/13.03.00/2003-04

August 14, 2003
Shravana 25, 1925 (S)

The Chief Executives of all Scheduled Commercial
Banks (Excluding RRBs & Local Area Banks)

Dear Sir,

Master Circular - Interest Rates on Advances

Please refer to the Master Circular DBOD. No. Dir. BC.11/13.03.00/2002-2003 dated July 30, 2002 consolidating instructions / guidelines issued to banks till 30 June 2002 on matters relating to Interest Rates on Advances. The Master Circular has been suitably updated by incorporating instructions issued upto 30 June 2003 and has also been placed on the RBI website (<http://www.rbi.org.in>).

2. It may be noted that all the instructions contained in circulars listed in the Appendix have been consolidated.

Yours faithfully

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

Encl: As above

Master Circular on Interest Rates on Advances

1. General

- 1.1 The banks should charge interest on loans/advances/cash credits/overdrafts or any other financial accommodation granted/provided/renewed by them or discount usance bills in accordance with the directives on interest rates on advances issued by Reserve Bank of India from time to time.
- 1.2 The interest at the specified rates shall be charged at monthly rests from April 1, 2002 subject to the conditions laid down in paragraph 11 below. The Interest to be charged shall be rounded off to the nearest rupee.
- 1.3 Banks should club the term loans and working capital advances together for the purpose of determining the size of the loan and the applicable rate of interest.
- 1.4 The schedule of rates of interest as per current directive in force is given in Annexure-I.

2. Prime Lending Rate (PLR) and Spreads

- 2.1 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.

Separate PLRs may be fixed for short term credit and Prime Term Lending Rate (PTLR) for term loans of 3 years and above. The PLR/PTLR fixed should be declared and should also indicate the maximum spread over the PLR for all advances other than consumer credit. The banks could also prescribe separate PLRs for loan component and cash credit component and also prescribe separate spreads for both.

- 2.2 The interest rate on credit limits of Rs. 2 lakh and below, other than consumer credit, shall not exceed the Prime Lending Rate which is available to the best borrowers of the concerned bank.
- 2.3 PLR will be made uniformly applicable at all branches of a bank.

3. Determination of Benchmark Prime Lending Rate (PLR)

- 3.1 In order to enhance transparency in banks' pricing of their loan products as also to ensure that the PLR truly reflects the actual costs, banks may consider the following suggestions for determination of their benchmark PLR:
- (a) Banks should take into account their (i) actual cost of funds, (ii) operating expenses and (iii) a minimum margin to cover regulatory requirement of provisioning/capital charge and profit margin, while arriving at the benchmark PLR. Banks should announce a benchmark PLR with the approval of their Boards.
 - (b) The benchmark PLR would be the ceiling rate for credit limit up to Rs.2 lakh, as hitherto.
 - (c) Since all other lending rates can be determined with reference to the benchmark PLR arrived at as above by taking into account term premia and/or risk premia, the system of tenor-linked PLR deserves to be discontinued. These premia can be factored in the spread over or below the PLR.

As regards the effective date for discontinuation of the tenor-linked PLR, the same will be further discussed with banks and a decision will be announced separately in due course.

- 3.2 Banks are also advised in the interest of the customer protection and to have greater degree of transparency in regard to actual interest rates charged to borrowers, to continue to provide information on maximum and minimum interest rates charged together with the benchmark PLR.
- 3.3 The system of determination of benchmark PLR by banks and the actual prevailing spreads around the benchmark PLR is proposed to be reviewed in September 2003. Banks may, therefore, advise to the Reserve Bank, the action taken on the above suggestions as early as possible.

4. Freedom to fix Lending Rates

Banks enjoy freedom to stipulate lending rates without reference to their own Prime Lending Rates in respect of the following categories:

- (i) Loans covered by refinance schemes of term lending institutions;
- (ii) Interest rates on bank lending to intermediary agencies including housing finance intermediary agencies (cf. list at 'Annexure II');
- (iii) Bill discounting by banks;
- (iv) Advances/overdrafts against domestic/NRE/FCNR(B) deposits with the bank, provided that the deposit/s stands/stand either in the name(s) of the borrower himself/borrowers themselves, or in the names of the borrower jointly with another person;
- (v) To a co-operative bank or to any other banking institution;
- (vi) To its own employees.

5. Tenor Linked PLRs

Banks have been given freedom to operate different PLRs for different maturities, provided the transparency and uniformity of treatment is maintained. Banks should not declare stand-alone PLR in addition to tenor linked PLRs. The banks, which have moved over to declaration of tenor-linked PLRs should invariably indicate the specific tenor for which the declared PLR is applicable.

6. Fixed Interest Rate for Loans

Banks have freedom to offer all categories of loans on fixed or floating rates, subject to conformity to Asset-Liability Management (ALM) guidelines. However, the banks should ensure that the PLR stipulations as applicable are complied with. The nature of alignment with PLR i.e. whether it is at the time of sanction or disbursement of the loan, should be made explicit at the time of sanction of the loan. For small loans up to Rs. 2 lakh, the stipulation of 'not exceeding PLR' (for relevant maturity) should be made applicable.

7. Levying of penal rates of interest

Since the Boards of the banks have been empowered to decide the Prime Lending Rate (PLR) as also the spread over PLR, it has been decided with effect from 10 October 2000, that banks may formulate transparent policy for charging penal interest with the approval of their Board of Directors. ***However, in case of loans to borrowers under priority sector, no penal interest should be charged for loans up to Rs. 25, 000.*** Penal interest may be levied for reasons such as default in repayment, non-submission of financial statements, etc. However, the policy on penal interest should be governed by well-accepted principles of transparency, fairness, incentive to service the debt and due regard to genuine difficulties of customers.

8. Enabling clause

8.1 The banks are required to invariably incorporate following proviso in the loan agreements in the case of all advances, including term loans, enabling banks to charge the applicable interest rate in conformity with the directives issued by RBI from time to time.

“Provided that the interest payable by the borrower shall be subject to the changes in interest rates made by the Reserve Bank from time to time.”

8.2 Since banks are bound by the Reserve Bank's directive on interest rates on loans and advances which are issued under Sections 21 and 35A of the Banking Regulation Act, 1949, banks are obliged to give effect to any revision of interest rates whether upwards or downwards, on all the existing advances from the date the directive/revised interest rate (change in PLR and spread) come into force, unless the directives specifically provide otherwise.

8.3 Paragraphs 8.1 and 8.2 will not be applicable in case of Fixed Rate Loans.

9. Withdrawals against uncleared effects

Where withdrawals are allowed against cheques sent for clearing, i.e. uncleared effects (e.g. uncleared local or outstation cheques) which are in the nature of unsecured advances, the banks should charge interest on such drawals as per the directive on interest rate on advances.

It may be noted that this instruction will not apply to the facility afforded to depositors for immediate credits in respect of cheques sent for collection as a measure of customer service.

10. Loans under consortium arrangement.

The banks need not charge a uniform rate of interest even under a consortium arrangement. Each member bank should charge rate of interest on the portion of the credit limits extended by it to the borrower subject to its PLR.

11. Charging of Interest at monthly rests

The banks were required to switchover to the system of charging interest at monthly rests with effect from April 1, 2002. While switching over to the new system the banks were to follow the under noted instructions in regard to switchover to the system of charging monthly interest on loans and advances:

- i. Banks had 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.

Illustratively:

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. 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.

- v. Since instructions contained in paragraph 11 (ii) were 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 was not required to make adjustment for that quarter.
- 11.2 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. As indicated in circular RPCD.No.PLFS.BC.129/ 05.02.27/97-98 dated June 29, 1998 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.

12. Zero percent Interest Finance Schemes for Consumer Durables

Banks should refrain from offering low/zero percent interest rates on consumer durable advances to borrowers through adjustment of discount available from manufacturers/dealers of consumer goods, since such loan schemes lack transparency in operations and distort pricing mechanism of loan products. These products do not also give a clear picture to the customers regarding the applicable interest rates. Banks should also not promote such schemes by releasing advertisement in different newspapers and media indicating that they are promoting/financing consumers under such schemes. They should also refrain from linking their names in any form/manner with any incentive-based advertisement where clarity regarding interest rate is absent.

Annexure – I

Interest Rate Structure for rupee advances of commercial banks

<i>Size of limit</i>	<i>All advances including Term loans Rate of interest (Per cent per annum)</i>
1.(a) Upto and inclusive of Rs.2 lakh	Not exceeding Prime Lending Rate (PLR)
(b) Over Rs.2 lakh	Free#
2. (i) Loans for purchase of consumer durables	Free@
(ii) Loans to individuals against shares and debentures/bonds	Free@
(iii) Other non-priority sector personal loans	Free@
3. Lending rate for commodities coming within the purview of Selective Credit Control (SCC)	
Loans/Advances/Cash Credit/Overdrafts against commodities subject to SCC	Free
4. <u>Export Credit</u>	<u>Effective from May 1, 2003 to October 31, 2003</u> (\$)
(1) <u>Pre-shipment Credit</u>	
(a)(i) Upto 180 days	Not exceeding PLR <u>minus</u> 2.5 percentage points
(ii) Beyond 180 days and upto 270 days	Free
(b) Against incentives receivable from Government covered by ECGC Guarantee (upto 90 days)	Not exceeding PLR <u>minus</u> 2.5 percentage points
(2) <u>Post-shipment Credit</u>	
(a) On demand bills for transit period (as specified by FEDAI)	Not exceeding PLR <u>minus</u> 2.5 percentage points

(b) Usance Bills (for total period comprising usance period of export bills, transit period as specified by FEDAI and grace period wherever applicable)	
(i) Upto 90 days	Not exceeding PLR <u>minus</u> 2.5 percentage points
(ii) Beyond 90 days and upto 6 months from the date of shipment	Free
(c) Against incentives receivable from Government covered by ECGC Guarantee (upto 90 days)	Not exceeding PLR <u>minus</u> 2.5 percentage points
(d) Against undrawn balances (upto 90 days)	Not exceeding PLR <u>minus</u> 2.5 percentage points
(e) Against retention money (for supplies portion only) payable within one year from the date of shipment (upto 90 days)	Not exceeding PLR <u>minus</u> 2.5 percentage points
(3) <u>Deferred Credit</u>	
Deferred credit for the period beyond 180 days	Free
(4) Export Credit not otherwise <u>specified</u> (ECNOS)	
(a) Pre-shipment credit	Free
(b) Post-shipment credit	Free
5. <u>DRI Advances</u>	4.0
6(a) Advances/overdrafts against domestic/ NRE/FCNR(B) deposits with the bank, provided that the deposit/s stands/stand either in the name(s) of the borrower himself/borrowers themselves, or in the names of the borrower jointly with another person	Free to charge interest rates without reference to PLR

Rate of interest (Per cent per annum)

6(b) Finance granted to intermediary agencies(excluding those of housing) for on lending to ultimate beneficiaries and agencies providing input support	Free to charge interest rates without reference to PLR
6(c) Finance granted to housing finance intermediary agencies for on lending to ultimate beneficiaries	Free to charge interest rates without reference to PLR
7. Loans covered by participation in refinancing schemes of term lending institutions	Free to charge interest rates as per stipulations of the refinancing agencies without reference to PLR
8. Discounting of Bills	Free to charge interest rates without reference to PLR

Notes

1. Free#: The banks may offer loans above Rs. 2 lakh at below PLR rates to exporters or other creditworthy borrowers including public enterprises based on a transparent and objective policy approved by their Boards.
2. Free@ : The banks are free to determine the rates of interest without reference to PLR. However, it is not the intention to allow any concessionality in case of such loans and therefore banks should not charge rates below PLR, regardless of the size of the loan amount.
3. Free : The banks are free to determine rates of interest subject to PLR and spread guidelines.
4. (\$): Since these are ceiling rates, banks would be free to charge any rate below the ceiling rates.
5. Intermediary agencies are indicated in Annexure II.

Annexure II
An Illustrative list of Intermediary Agencies

1. State sponsored organisations for on-lending to weaker sections. Weaker sections include -
 - (i) Small and marginal farmers with landholdings of 5 acres and less, landless labourers, tenant farmers and share-croppers.
 - (ii) Artisans, village and cottage industries where individual credit requirements do not exceed Rs. 25,000/-.
 - (iii) Small and marginal farmers, sharecroppers, agricultural and non-agricultural labourers, rural artisans and families living below the poverty lines are the beneficiaries. The family income should not exceed Rs. 11,000/- per annum.
 - (iv) Scheduled Castes and Scheduled Tribes.
 - (v) Beneficiaries are persons whose family income from all sources does not exceed Rs. 7,200/- per annum in urban or semi-urban areas or Rs. 6,400/- per annum in rural areas. They should not own any land or the size of their holdings does not exceed one acre in the case of irrigated land and 2.5 acres in the case of unirrigated land (land holdings criteria do not apply to SC/ST).
 - (vi) Beneficiaries under scheme of Liberation and Rehabilitation of Scavengers (SLRs).
 - (vii) Advances granted to Self-Help Groups (SHGs) for reaching the rural poor.
2. Distributors of agricultural inputs/implements.
3. State Financial Corporations (SFCs)/State Industrial Development Corporations (SIDCs) to the extent they provide credit to weaker sections.
4. National Small Industries Corporation (NSIC).
5. Khadi and Village Industries Commission (KVIC).
6. Agencies involved in assisting the decentralised sector.
7. State sponsored organisations for on-lending to the weaker sections.
8. Housing and Urban Development Corporation Ltd. (HUDCO).
9. Housing Finance Companies approved by National Housing Bank (NHB) for refinance.
10. State sponsored organisations for SCs/STs (for purchase and supply of inputs to and/or marketing of output of the beneficiaries of these organisations).
11. Micro Finance Institutions/Non-Government Organisations (NGOs) on-lending to SHGs.

Appendix

List of circulars/directives consolidated in this Master Circular which may be referred to for rationale and logic of the instructions

	Reference Number, etc.	Date
1)	DBOD No. Dir.BC11/13.03.00/2002-03	30.07.2002
2)	RPCD. Plan. BC. 15/04.09.01/20001-02	17.08.2001
3)	DBOD No. Dir.BC.8/13.07.00/2002-03	26.07.2002
4)	DBOD No. Dir.BC. 19/13.07.01/2002-03	19.08.2002
5)	DBOD No. Dir.BC. 25/13.03.00/2002-03	19.09.2002
6)	IECD No. 18/04.02.01/2002-03	30.04.2003
7)	DBOD No. BC 103/13.07.01/2003	30.04.2003
8)	DBOD No. Dir.BC 103A/13.03.00/2002-03	30.04.2003