

Monetary and Credit Policy Measures

DBOD.No.BP.BC. 35 /21.01.002/99

April 24 , 1999
Chaitra 4, 1921 (Saka)

All commercial banks (excluding RRBs)

Dear Sir,

Monetary and Credit Policy Measures

Please refer to Governor's letter No.MPD.BC.185/07.01.279/98-99 dated April 20, 1999 enclosing a copy of the statement on "Monetary and Credit Policy for the year 1999-2000". The guidelines in regard to the policy measures indicated therein, are given below:

1) Rationalisation of Interest Rates

In terms of our circular DBOD.No.DIR.BC.115/13.07.01/94 dated October 17, 1994 banks are free to prescribe their own lending rates, which should be the Prime Lending Rate (PLR), for credit limits of over Rs.2 lakhs, with the approval of their Boards after duly taking into consideration their cost of funds, transaction cost and minimum spread over the PLR. The only lending rates now prescribed by the Reserve Bank are the concessional rates below the PLR of the respective banks for certain sectors like exports, small loans upto Rs.2 lakh, and under the Differential Rate of Interest scheme. Banks have been permitted to prescribe separate PLRs for short-term credit and long-term credit for 3 years and above. With a view to providing some more flexibility to banks, the following measures in respect of interest rates have been introduced with immediate effect:

(i) Tenor Linked PLRs

The PLR system with a spread between PLR and the maximum lending rate that is determined by the banks' Boards has been in operation for some time now and has by and large served the purpose of ensuring transparency and objectivity. There have been requests from banks and borrowers for tenor linked PLR i.e. PLR for different maturities.

It has, therefore, been decided to provide banks with freedom to operate different PLRs for different maturities provided the transparency and uniformity of treatment originally envisaged continues to be maintained.

(ii) Fixed Rate Loans for project finance

Similarly, industries, especially those requiring project finance, have been requesting for fixity of interest rates on term loans.

It has been decided to permit banks to offer fixed rate loans subject to conformity to Asset Liability Management (ALM) guidelines.

(iii) Advances against domestic/NRE term deposits

As per the instructions contained in Item 2(ii) of RBI circular DBOD No. Dir.BC. 36/13.03.00/98 dated April 29,1998, interest rates chargeable on loans and advances granted to depositors against their domestic/NRE term deposits should not exceed PLR. While PLR has been coming down, the interest rates on deposits have remained unaltered on the existing deposits. In certain cases, this has resulted in the interest rates on advances based on PLR being lower than the interest rates on deposits themselves.

In order to remove this anomaly, it has been decided that in cases where deposit rates are equal to or more than PLR or less than one percentage point below PLR, the banks will have freedom to charge suitable rates of interest on advances against domestic/NRE term deposits without reference to the ceiling of PLR. Thus, the interest rates on advances shall invariably be more than the interest rates paid on respective deposits.

The effective date of changes mentioned above shall be announced by the banks as early as possible.

The amending Directive DBOD No. Dir.BC. 36 /13.01.04/99 dated April 23, 1999 is enclosed.

(iv) Asset-Liability Management Committee

Banks have been representing that the present requirement that changes in deposit rates and lending rates should be approved by the Board of Directors of the bank restricts the ability of banks to respond promptly to changes in interest rates environment.

Accordingly, it has been decided that the Boards of Directors of banks may authorise the Asset-Liability Management Committee to fix interest rates on Deposits and Advances, subject to reporting to the Board immediately thereafter.

2) Prudential Norms

(i) Valuation of banks' investments in approved securities.

With a view to adopting prudent accounting standards and moving towards "mark to market" valuation of the investment portfolio, banks were advised in paragraph 5 of Circular DBOD.No.Dir.BC. 36/13.03.00/98 dated April 29, 1998 to classify a minimum of 70 per cent of their investment in approved securities as "current" investments for the year ended March 1999.

It has been decided that for the year ending March 31, 2000, banks shall classify a minimum of 75 per cent of their investments in approved securities as "current" investments.

(ii) Issue of sub-ordinated debt for raising Tier II Capital.

In terms of instructions contained in Circular DBOD.No.BP.BC.5/21.01.002/ 98-99 dated February 8, 1999, banks were given autonomy to raise rupee denominated subordinated debt as Tier II Capital, subject to the terms of issue of the bonds being in conformity with the conditions indicated therein. It has been observed that there has been a high level of cross holding of such instruments among banks and financial institutions, without necessarily leading to accretion of capital to the financial system.

It has been decided that a bank's aggregate investment in Tier II bonds issued by other banks and financial institutions shall be permitted up to 10 per cent of the investing bank's total capital. The total capital for this purpose will be the same as that reckoned

for the purpose of capital adequacy. In case any bank has already exceeded this limit of 10 per cent, a reference may be made to RBI indicating the period within which the exposure would be brought within the stipulated limit.

It is reiterated in this connection that investments by banks in Tier II bonds of other banks/financial institutions would carry 100 per cent risk weight [vide paragraph 2(d)] of Circular DBOD.No.BP.BC.103/21.01.002/98 dated 31st October, 1998].

(iii) Asset Classification - Rescheduled Loans.

As per the present guidelines contained in Para 2.B (ii) of Circular BP.BC.129/21.04.043/92 dated April 27, 1992, an advance where the terms of the loan agreement regarding interest and principal have been renegotiated or rescheduled after commencement of production, should be classified as sub-standard and should remain in that category for at least two years of satisfactory performance under the renegotiated or rescheduled term. We have been receiving representations from banks that in certain situations (e.g. cyclical down-turn) where loans have been rescheduled, but where borrowers have started servicing their loans on a regular basis after a short gap, the prescribed waiting period of two years is too long.

It has been decided that the period of two years may be reduced to one year (or four quarters) if the interest and instalment of loans have been serviced regularly as per the terms of reschedulement. The above instructions will be applicable for asset classification with effect from the year ended March 31, 1999.

(iv) Bank's investments in Venture Capital

In terms of circular DBOD.No.Dir.BC.78/13.07.05/98-99 dated August 8, 1998 banks have been permitted to invest in units of dedicated venture capital funds meant for information technology within the ceiling of 5% of incremental deposits of the previous year prescribed for investment in equity shares including PSU shares, convertible debentures of corporates and in units of Mutual Funds Schemes the corpus of which is not exclusively invested in corporate debt instruments.

In order to encourage the flow of finance for venture capital, it has been decided that the above overall ceiling of 5% will stand automatically enhanced to the extent of bank's investment in venture capital (including units of dedicated Venture Capital funds meant for Information Technology), subject to the condition that the venture capital funds/companies are registered with SEBI.

Please acknowledge the receipt.

Yours faithfully,

(**A.Ghosh**)

Chief General Manager in- Charge

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