PRINCIPLES OF LENDING

1. General :

a. Banking is both an art and science, which cannot be guided by merely a set of rules. It is to be guided by general principles only. Even then there is no rigidity in the application of the set of principles in banking.

b. The banker has to shift good things out of the elements which he comes across and, in it lies his skill and diligence. No set of uniform rules can be invariably applied even in two similar circumstances. In other words, he cannot be static. He should be changing according to the changing types, times and conditions.

c. The banker should take into consideration the following aspects while dealing with a lending proposition.

2. Safety of funds :

a. Safety is the first and foremost thing that the banker has to consider, especially because he has to disburse depositors' money. As it is his primary duty to safeguard the monies of others, he has to exercise caution, prudence and tact. Only out of experience the banker generally gets the necessary caution and tact which go a long way in ensuring the safety of the money lent. Sometimes a Bank gets such experience at a huge price.

b. The banker ensures that the money advanced by him go to the right type of borrowers and is utilized in such a way that it will not only be safe at the time of lending but remains so throughout and is repaid with interest after serving an useful purpose in trade, industry and agriculture etc. for which the money is lent.

3. Identification of borrower :

a. The lending banker should satisfy himself by using all available sources of information as regards the prospective borrower's character, integrity and business acumen. The usual sources are :

i. observation,
ii. market enquiry and if possible,
iii. study his past connections with any other institution

b. Generally, the banker should not be carried away by the appearance of the borrower The banker should tap other sources to know on the character and integrity at all times and not merely at the time of taking the loan.

c. Branches should apply the parameters prescribed by the Bank under the Customer Acceptance Policy and Customer Identification Procedures before opening an account The KYC norms as envisaged in the Bank's Anti-Money Laundering Standard should strictly be adhered to since the borrower customers are treated as low risk category.

d. In the case of partnership firms, the banker should collect extensive material and record comments regarding the integrity, worth, etc. of all the partners. The collection and updation of information about the borrowers/guarantors should be an on-going process.

4. Purpose :

a. Purpose for which the loan is required is very important. The banker should be clear about the purpose for which the loan is required and the sources wherefrom the borrower is expected to repay the loan. If the advance is for hoarding stocks or for speculation, it should be discouraged. These are anti-national and anti-social activities. Again, if the money required is for liquidation of prior borrowings or to make good the loss incurred or for unproductive expenditure, then the banker should cautiously appraise the proposal.

b. The borrower may require stop-gap finance till the money from other sources flows in. Such proposals may be favourably considered for good parties depending upon merits of each case and subject to RBI guidelines from time to time.

c. After nationalisation financing of agriculture, small scale industries and rural economy had gathered momentum. Banks were asked to extend credit facilities to new classes of people namely professionals, self-employed persons, retail traders, agriculturists and transport operators for productive purposes and generation of employment.

d. Bank's lending has to be purpose oriented and the purpose shall be socially and economically desirable.

5. Liquidity / Repayment:

a. Due emphasis on repayment should be there. The sources and method of repayment should be decided upon while disbursing credit and the borrower should adhere to it. The security offered should be preferably easily realizable and/or self-liquidating. The reason why banker attaches more importance to repayment is to recycle the funds and make available these funds for other needy borrowers apart from the fact that deposits raised are required to be paid on demand or at short notice. For example, an advance of Rs.50 lakhs on the security of legal mortgage of posh building in the heart of a Metropolitan City with a market value of Rs.l 00 lakhs is safe indeed. If however, the recovery is to be made through a Court process, it may take a few years, in which case the loan is not liquid, in essence, the borrower should pay-off the loan on due date and the banker should reserve the right to call back the advance at any time.

b. In short term loans, there is more liquidity than in medium or long term advances. Although much of the credit extended by the banks is in the forms of CC/OD/loans repayable on demand and mostly-for the purpose of Working Capital, they also evince interest in providing Term Loans for asset creation etc. The refinance facility offered by RBI/SIDBI/NABARD etc. have been helpful to banks in providing liquidity in their term loans. However, refinance is availed from respective refinancing agencies for all eligible advances subject to the interest spread and bank's liquidity position.

c. In recent times, commercial banks have been increasing their term lendings either singly or in participation with financial institutions. Banks should ensure that such increased participation in term loans does not result in any asset liability mismatch i.e. the maturity of term loans should commensurate with the maturity period of deposits and/or any borrowings made.

6. Security:

a. The banker should take into consideration the security aspect also. It can be compared to the lifeboat in a ship, where the passenger takes recourse to it in times of emergency and extreme difficulty. Likewise, under circumstances which affect the safety and liquidity of the advance, the banker grabs the security, realises it and reimburses himself. It is incorrect to approach an advance from the point of view of security alone. Credit is granted on its own merits with regard to safety, liquidity, purpose etc., after looking into character, capacity, capital etc., of the borrower.

b. Security may be classified as personal and tangible as well as primary and collateral.

(i) Personal security means personal liability of the borrower and or guarantor. The banker has got a right of action against the borrower and it is not a tangible security.

(ii) Tangible security is something that can be realised by sale or transfer (example: shares, stocks, lands and goods).

(iii) Primary security is that which is regarded as the main cover for an advance; generally, the assets created out of the credit disbursed and against which the advance is made, e.g .. Stocks for cash credits, machinery for term loans.

(iv) Additional/Collateral security is the security other than the primary security created out of the advance and lodged by the borrower or by a third party.

c. Characteristics of Securities :

(i) Marketability : The main consideration which weighs with the banker is the ready marketability of the security. Articles of necessity, primary commodities, seasonal goods, raw materials etc., are generally in good demand. Articles of luxury or valuables (example: pearls, diamonds) have a limited market. A rich person might have constructed a bungalow at a heavy cost in a remote place but it will fetch a low value in a distress sale.

(ii) Ascertainment of title: The borrower's title to the security must be clear and undisputed. It has to be verified; if there are any prior charges or encumbrances. The solicitors have to verify the title of the borrower to the property.

(iii) Stability : The banker must make sure that the value of the security does not fluctuate violently over short periods. Due to hoarding, commomtles like pepper, onion, chillies, cement are at times subject to heavy variations in prices. In such cases, the margin taken will be such as to cover the extra risk

(iv) Storability : Certain securities such as Life Policies, Government Promissory Notes (GPN s), can be easily stored even in the smallest place. Large logs of timber, iron girders etc., present peculiar problems of storage. Film and certain chemicals are to be stored in air-conditioned godown.

(v) Transferability:

- Physical Transfer: The security must be transferable from one place to another without much difficulty. For example, certain cloth varieties, which do not find a favourable market in a place, can be moved quickly to another ready market by rail or road transport.
- Legal Transfer: The title to the security should be easily transferable. In case of LIC policy, shares etc. the transfer formalities are simple/quick. In case of immovable properties the transfer is comparatively cumbersome.

(vi) Yield : Certain securities are a source of income (example: shares and Government Promissory Notes (GPN) yield dividend and interest).

(vii) Durability : Vegetables, mutton, fruits, etc., are perishables. Gur, cement etc., require special care. Otherwise, they deteriorate in quality. Grains and oil seeds last for one or two seasons. In other words, the goods stored should not be perishable during the period of advance.

7. Remuneration / Profitabiiity:

a. Equally important is the principle of profitability in bank's advance. Banks have to pay interest on deposits, incur expenses on establishment, rent, stationery, make provision for depreciation of fixed assets and Non-Performing Assets. After meeting all these items of expenditure which enter the running cost of banks, a reasonable profit must be made.

b. Different rates are charged depending upon the borrower's Credit Rating, nature of security, mode of charge, etc. The Term Loan and other Working Capital limits of the borrower including those under Priority Sector shall be aggregated and the applicable interest rate be determined.

Direct personal loans against our own deposits and Government securities need not be taken into account for determining the size of the credit. The transaction on the whole must be profitable to the Bank.

c. In the present context of liberalization, integration with global economy, which leads to more competition among various financial intermediaries, banks should pay more attention on their profitability and viability.

8. Risk Management:

a. Another important principle of good lending is the diversification of advances. An element of risk is always present in every advance and the banking business is one of taking calculated risks.

b. A successful banker is keen on mitigating the risks, by lending to a large number of borrowers in a number of industries and areas and against different types of securities. If the Bank has many branches, it gets a wide assortment of securities. A business slump in particular sphere does not affect all these borrowers simultaneously.

9. National Interest :

a. Even if the advance satisfies all the aforesaid principles, it may not be suitable if it runs counter to the national "interests. RBI may issue directives restricting advances against commodities such as food grains, cotton, oil etc. In the changing concept of banking, factors such as purpose of the advance and national interest are also of greater importance like adequacy of security.

b. Due to liberalization measures initiated by the government, banks have to operate in a competitive environment. More emphasis should therefore be given to aspects of increasing market share of business, profitability, diversification of advance and investment portfolio etc.

10. Norms on credit exposure :

a. The Norms of NABARD have to be followed for ensuring that the norms on Credit exposure for individuals, units and industry/Sector are strictly followed. The NABARD's circular on Credit and Monitoring Arrangements will have to be referred to for complying with the exposure limits.

11. Fair Lending Practices Code (FLPC):

a. FLPC came into effect from 1st November 2003. FLPC is put in place for retail credit facilities up to Rupees two lakhs. The purpose of FLPC is to render courteous and speedy services to all the borrowal customers.

b. All necessary information like range of loan products available, securities, interest, service charges, other terms and conditions, the likely timefrarne for sanction etc., should be furnished to a prospective borrowal customer.

c. The general Terms and Conditions for Advances and Schedule of service charges as advised by Head Office from time to time should be furnished to the prospective borrower along with the Application form.

d. The chart showing interest rate and service charges for advances to public should be displayed by the branches on their Notice Board.

e. On receipt of loan application complete In all respects, branches should give an acknowledgement.

f. If any additional details are required while processing the application, the same should be immediately intimated to the customer. In case of loan applications under Priority Sector Advances upto Rs 2 lakh, the acknowledgement should also indicate the timefrarne. for disposal of such applications.

g. On sanction of the loan, branches should obtain the customer's signature for acceptance of the terms and conditions of the sanction in the copy of the sanction ticket.

h. Statement of accounts should be regularly provided to the customers, unless the borrower expressly states that it is not required.

I. In case of rejection of loan applications, branches should furnish reasons for the same to the loan applicant through a letter.

J. FLPC provides for Grievance Redressal Mechanism by which any grievance of the customer shall be attended to within the time frame mentioned in Para 3.10 of FLPC for redressal. Branch Manager will attend to the grievances during bank hours on any working day and inform the customer within one week, if the customer is not satisfied with the reply, he can approach the next higher level officers for redressal.

12. Bank's Loan Policy :

a. The Loan Policy is formulated by Head Office with long term perspective to achieve a well-structured Loan portfolio. The Policy enumerates strategies for branches/ will include to improve advances, monitoring of Standard Assets and focus on recovery of NPA. The Policy Document include the concept of Risk Management in loan administration.

b. The Policy is based on the following factors:

(i) RBI's Monetary and Credit Policy

(ii) RBI's new thrust on Risk Management

(iii) The Bank's strategy for profit through qualitative credit expansion

(iv) An analytical study of the industries- their present position and future prospects

(v) The views and suggestions are solicited and received from HO Executives and the field level functionaries

(vi) The Enterprise Resources Plan (ERP) evolved by the Head Office

(vii) Comparative market forces emerging in the economy due to liberalization of the market .

(viii) Targets prescribed by RBI NABARD in regard to social and other lending

(ix) Comments made in the LFAR Reports

(x) The long term objective of the Bank to build up a loan portfolio which is both qualitative and remunerative.

13. Types of Credit :

a. Bank, normally considers the following types of Loans and Advances:

(i) Temporary overdrafts / Clean Cash Credits

(ii) Demand Loans

(iii) Cash Credits

(iv) Bills discounted and Purchased which included LC Bills receivable (LCBR)

(v) Term Loans

14. Pricing of Loan Products:

a. The Bank staff should be conversant with the concept of Pricing of loan products. The various terms involved in the pricing mechanism are explained below:

(i) Base Rate : Bench mark PLR has given way to Base rate. The banks have to follow the RBI rules relating to Base rate calculation while determining the rates of interest for different types of advances and loan products. As per RBI regulations, barring the exceptions mentioned by RBI no loan product shall be priced below the base rate.

(ii) Commercial Rate: Commercial Rate is the rate applicable for public or staff without any relaxation. For staff, commercial rate means, the rate quoted for loans other than concessional loans such as SRL, Conveyance Loan, etc., and shall be applicable to public.

(iii) Penal Interest.: It is the penalty charged over the contracted rate, for the portion of the loan which is overdue / irregular part as per guidelines issued from time to time. It may be on account of financial irregularity or non-financial irregularity or both.

(iv) Fixed Interest Rate: If the interest rate quoted at the time of sanction/disbursement will not undergo any change despite change in base rate/ spread for the stated period, it is known as fixed rate.

- Fixed rate can be offered only for the schemes/ products/ category for which it is specifically permitted by RO. EMI will not undergo any change throughout the repayment period, unless there is a major policy change like periodicity of charging interest.
- In fixed rate accounts, for overdues, penal interest is to be charged at Contracted Rate + Penal Rate. For considering fixed interest rate for term loans to good Corporates requiring project finance, the proposal should be taken up with the Sanctioning Authority.
- Fixed Interest Rates may also undergo change whenever Bank exercise the interest reset option.

(v) Variable Interest Rate : Unlike fixed rate, this rate of interest varies/ changes along with the change in the Base Rate or Spread.

(vi) **Finer Rate of Interest :** Customers having high volume/hi-tech facilities may be considered for finer rate of interest from card/commercial rate as per rating of borrowal accounts, business consideration, value addition, cost of servicing the advance and other internal parameters. The system of Finer Rate of Interest is not popular in Cooperative Banks. But with changing times and evolving challenges, Cooperative Banks can also consider finer interest rates on a case by case basis with due Board Level approvals.

(vii) Bank Rate:It is the rate at which RBI is prepared to lend to Banks or rediscount Bills of Exchange or buy other Commercial Paper eligible for purchase under Section 49 of RBI Act.

(viii) Call Money Rate: Prevailing interest rate for overnight/short duration borrowing by banks in the interbank market.

15. Charging of Interest :

a. As per RBI guidelines Banks switched over to charging of interest on loans / advances at "Monthly Rests" with effect from April 01,2002.

b. Accounts brought under this system are all loans/advances such as loans on deposit, personal loan products, structured loan products (for both of the schemes under variable rate of interest and fixed rate of interest), Cash Credits, OD, etc. Advance Bills, Defaulted Guarantees, Short term loans/Demand loans such as WCDL, Premises loan accounts/certain category of Staff Loans, etc.

c. Bills Purchased:For all bill finance (DP/ DAI Supply etc.,) recovery of interest should be on the date of purchasing/discounting the bill, for the specific/notional number of days. For the front-end recovery, it should not be compounded for every 30 days/calendar months. For Bills purchased/negotiated/discounted (InlandlForeign), besides recovering usual charges, the interest at applicable rate for the period from the date of Purchase to the notional/committed due date (in supply bills) of the bill shall also be collected as Up Front.

d. In case the bill is realised/ reversed after the notional due date, the interest for the extended/delay period, at the penal rate, shall be compounded at monthly rests and recovered.

d. Exceptions from monthly compounding:

(i) Agricultural loans: As the agricultural advances are linked to crop seasons, branches shall follow the periodicity of charging/compounding of interest as per RBI/NABARD/HO guidelines.

(ii) Accounts permitted for longer rests than quarterly : Accounts under simple interest will not have any impact. Wherever the 'Simple Interest' moves over to quarterly compounding as per the in-built terms of an advance, the same shall be put on monthly compounding instead of quarterly from that point of switch over (e.g., after holiday period in Educational Loan) and also when such loans become overdue.

(iii) While charging interest on monthly compounding, branches should ensure that the effective rate does not go up on account of charging compounding interest at monthly rests. In other words, branches should charge discounted rate of interest for monthly rest vis-a-vis effective rate of interest for quarterly rests.

(iv) Recovery of Interest: The monthly interest debited has to be recovered immediately as and when charged. Customers shall be informed well in advance about the monthly charging of interest and to service the same. However, on a case to case basis, Branch Managers can grant time as per HO guidelines, for adjustment of the interest, from the date of debit.

16. Service charges on Advances :

a. The rates of commission and other service charges on various advances including Non fund based facilities will have to be charged as per rules framed for the purpose by the Bank from time to time.

17. RBI Regulations and Restrictions on Loans and Advances:

a. Reserve Bank of India has, from time to time, issued a number of circulars containing guidelines/instructions, directives to banks on Loans and Advances. These guidelines are on the aspects of eligible borrowers, eligible securities, bankable purposes, margin stipulations, creation of charges over securities etc. The segments of Loans and Advances which are regulated! restricted would be communicated through, internal circulars as and when required by the respective Banks.

b Statutory Restrictions :

(i) Advances against banks' own shares: A Bank cannot grant any loan or advance on the security of its own shares in terms of Section 20 (1) of the Banking Regulation Act, 1949 either during the initial public offer or thereafter.

(ii) Also, lending should not be made against the shares of its own subsidiaries.

(iii) Advances to Banks' Directors: Banks are prohibited from entering into any commitment for granting any loan or advance to or on behalf of any of their directors or any firm/company in which any of their directors is interested as Director or as Partner, Manager, employee or guarantor. However, the restrictions shall not apply to,

- Loans and Advances made against Govt. Securities, LIC polices, Fixed Deposits. A Credit limit granted under credit card facility provided by a bank to its Directors to the extent the credit limit so granted is determined by the bank by applying the same criteria as applied by it in the normal conduct of the credit card business.

(iv) Loans and Advances to Chairman and Managing Director/Executive Director for the purpose of purchasing furniture, car, personal Computer or constructing/acquiring house for personal use, Festival advance can be given with the prior approval of RBI and on such terms & conditions as may be stipulated by RBI.

(v) The Banks may refer to the RBI's Master Circulars (issued by RPCD) for latest clarifications/ guidance on matters of restrictions on loans and advances:

- to Bank's Directors
- restriction on holding shares in companies
- advances against sensitive commodities under selective credit control
- restriction on payment of commission to staff, etc.

LOAN AGAINST TDR / RD / NSC / KVP / DDS Deposit

1.0 PURPOSE OF LOAN

This facility is provided to an individual, firm, institution and company for meeting his personal financial need by pledging Term Deposit Receipt / Recurring Deposit / National Saving Certificate / Kisan Vikas Patra duly discharged in favour of the Bank.

2.0 ELIGIBILITY

An individual, institution, firm, company or trust who is holder of Term Deposit Receipt / Recurring Deposit / National Saving Certificate / Kisan Vikas Patra can avail loan against their own Term Deposit Receipt / Recurring Deposit / National Saving Certificate / Kisan Vikas Patra.

3.0 AMOUNT OF LOAN

The loan under this scheme shall be limited to 75% 'Of the face value (principal plus accumulated interest) of the Term Deposit Receipt / Recurring Deposit / National Saving Certificate / Kisan Vikas Patra pledged with the Bank.

4.0 RATE OF INTEREST

The rate of interest for loan facility is 2% per annum over and above the prescribed rate of interest of Term Deposit Receipt / Recurring Deposit. In case of National Saving Certificate / Kisan Vikas Patra the rate of interest will be 11 % per annum compounded at quarterly rest.

5.0 REPAYMENT PERIOD AND INSTALMENTS

The loan will be recovered from the maturity proceeds of the Term Deposit Receipt / Recurring Deposit / National Saving Certificate / Kisan Vikas Patra. Alternatively, the monthly / quarterly repayment instalments may be fixed in a manner that the loan is fully recovered on or before the date of maturity of the Term Deposit Receipt / Recurring Deposit / National Saving Certificate / Kisan Vikas Patra.

6.0 SECURITY

Duly discharged Term Deposit / Receipt Recurring Deposit will be pledged in favour of the Bank.

6.1 Pledging of National Saving Certificate / Kisan Vikas Patra by marking lien in favour of the Bank by the issuing post office.

7.0 PROCEDURE AND DOCUMENTATION

Application has to be collected in the prescribed form (A-9).

7.1 Term Deposit Receipt / Recurring Deposit will be pledged with the Bank by duly discharging the Term Deposit Receipt / Recurring Deposit. Letter of set off (D-12) by the holder of the instrument, demand promissory note (D-17) and nominal membership form (A-23) duly executed should be obtained from the borrower.

7.2 In case of National Saving Certificate/ Kisan Vikas Patra, lien marking should be done by deputing Banks own staff and in no case, it should not be handed over to the borrower for marking of lien in favour of the Bank. Stamped documents, letter of set off (D-12), demand promissory note (D-17) and nominal membership form (A-23) duly completed should be obtained from the borrower.

8.0 SANCTIONING POWER

The Branch Manager is delegated full authority without maximum ceiling for sanctioning loan under this scheme.

9.0 SUPERVISION AND MONITORING

All sanction and disbursement of loan under the scheme should be reported every month in the monthly advances report (AR-1).

9.1 Subsequent follow up measures for regular recovery and monitoring of the credit is responsibility of the Branch Manager. Any default should be instantly followed up with intimation to the Head Office and loan should be squared off liquidating the security.