



RESERVE BANK OF INDIA

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January 28, 2011

**The Chairman/ Managing Director/
Chief Executive Officer
[All scheduled commercial banks
(excluding Regional Rural Banks)]**

Dear Sir,

Annual Financial Inspection – Priority Sector Loans – Mis-classification by Banks

The Annual Financial Inspection conducted by the Department of Banking Supervision, Reserve Bank of India, inter-alia, reports cases of misclassification of loans under priority sector and/or its sub-sectors.

2. It has been decided that henceforth the amount of loans wrongly classified under priority sector identified and reported by Principal Inspecting Officers (PIOs) during Annual Financial Inspection of banks will be taken into account for arriving at the shortfall under priority sector lending targets.
3. Accordingly, to begin with, such misclassifications reported during the current year will be added to the shortfall reported by banks as on the last reporting Friday of following year, for allocation to various funds.
4. Besides, it has also been reported that typically when banks buy loans from intermediaries like MFI/NBFCs given to eligible priority sector borrowers, they reckon the present value of the loans arrived at by discounting at their rate of lending which

is typically much lower than the actual rate charged to end-borrowers by such intermediaries. This has the effect of overstating the actual amount of priority sector loans to the extent of premium paid by banks to such intermediaries. Banks must, therefore, report the nominal amount actually disbursed to end priority sector borrowers and not the premium-embedded amount paid to the intermediaries.

Yours faithfully,

(A.K.Misra)
General Manager