Policy Document: Adjustment of Interest Rates and Financial Management Strategy

1. Introduction and Rationale for Rate Adjustments

As part of our ongoing strategic initiative to remain competitive and better serve our customers, we have made a conscious decision to adjust the interest rates across various product categories, including Fixed Deposits (FDs), Recurring Deposits (RDs), and Loans. The objective behind this decision is to make credit more affordable and accessible to our borrowers, thus fostering a robust lending environment while simultaneously ensuring the sustainability of the bank's operations. By reducing interest rates, we align ourselves with the current market trends, enabling us to attract new capital and enhance our profitability through lower borrowing costs and competitive offerings.

However, these adjustments are not without their challenges. A significant issue arises from the existing portfolio of Fixed Deposits (FDs) at the previous interest rate of 16%, as these deposits still remain on our books. The higher interest rate we are obligated to pay on these old FDs creates a financial imbalance, as we are now earning a reduced interest rate of 12% on the loans we issue. This results in a margin squeeze, as the cost of servicing these high-interest deposits exceeds the returns from our new lending activities.

To maintain financial stability and protect the bank's capital structure, we must address this mismatch by seeking ways to manage the cost of servicing the high-interest FDs while ensuring we continue to offer competitive loan products.

2. New Interest Rates

As part of our comprehensive strategy to adjust to the current market conditions, the following interest rate adjustments have been implemented:

Product	Previous Rate	New Rate
Fixed Deposit (FD)	16%	9%
Recurring Deposit (RD)	12%	10%
Loan Interest Rate	18%	12%

These rate reductions will enable us to balance the cost of borrowing for our customers while aligning with our profitability objectives. The decision to reduce the rates for loans, FDs, and RDs comes with the intention of fostering greater accessibility and ensuring that we remain an attractive option in the current economic landscape.

3. The Financial Impact of the Previous FD Portfolio

While the new rates provide an opportunity for growth and stability moving forward, the bank is facing a challenge due to the higher interest-bearing FDs that remain on our books from the previous rate of 16%. The cost of servicing these deposits at the previous rate creates a financial mismatch, where the cost of funds is higher than the return on loans being provided.

Example Calculation:

Consider an FD of ₹1,000 at the previous rate of 16%. This deposit requires the bank to pay ₹160 annually in interest. If the bank lends ₹1,000 at the new loan rate of 12%, the interest earned on that loan is ₹120 annually. This leaves a shortfall of ₹40 (₹160 - ₹120) for every ₹1,000 FD the bank holds at the previous rate, leading to an imbalance in profitability.

In order to eliminate this mismatch, the bank must lend ₹1,335 to earn ₹160.02 (12% of ₹1,335), which will be sufficient to cover the interest payments on the ₹1,000 FD at the previous 16% rate. This creates a financial gap of ₹335, which is the amount required to bridge the difference between the cost of servicing the old deposits and the revenue generated from lending.

4. Proposed Solution: Financing through Loans and Asset Disinvestment

To address this imbalance and ensure that the bank's financial stability is maintained, we propose the following solution:

- **Financing the Gap through Loans:** The ₹335 shortfall per ₹1,000 FD will be financed by issuing new loans at the current interest rate of 12%. These loans will generate additional income that will be used to offset the cost of servicing the higher-interest FDs.
- **Asset Disinvestment:** To further ensure liquidity and maintain the bank’s overall capital position, we will undertake asset disinvestment. The proceeds from the sale of non-core assets or shares will be used to repay the loans taken to finance the shortfall, ensuring that the financial imbalance caused by the higher-interest deposits is rectified in the long term. This disinvestment strategy will allow the bank to remain agile, preserve liquidity, and reduce the burden of higher interest payments.

5. Conclusion

While the decision to adjust interest rates represents a necessary step towards maintaining competitive edge and financial health, the challenge of managing the cost of servicing the older high-interest FDs cannot be ignored. The financial mismatch caused by these legacy deposits, alongside the reduced returns from new loans, must be addressed through strategic financing and asset disinvestment. By financing the shortfall through new loans and subsequently utilising asset disinvestment, we aim to restore financial equilibrium while continuing to offer affordable loan products that serve our customers’ needs.

This approach will allow us to maintain our profitability, safeguard our long-term financial stability, and continue to provide competitive services in the evolving market landscape.