

Advance interest payment scheme creating 'duplicate' deposits

March 26: Commercial banks offering advance interest payment for depositors have prompted concerns among other bankers. They say that such scheme was creating 'artificial deposits'.

Fund-starved Nabil Bank Ltd and NIC Asia Bank Ltd last week launched separate schemes on which depositors are paid 11 percent interest upfront. Banks can count such interest as fresh deposits even though it's not a new deposit.

After Nepal Bankers Association (NBA) -- the umbrella organization of 28 commercial banks -- capped the fixed deposit rate at 11 percent, these two banks came up with a scheme of 11 percent interest rates on one-year fixed deposit, but offering advance interest payment. This implies that a depositor can get Rs 1.1 million while depositing Rs 10 million on the fixed deposit. Depositors can again deposit this advance interest payment on a separate account and reap the benefit even without having new fund.

Though these banks have announced fixed deposit rate of 11 percent, the real rate after adjustment of advance payment on the scheme stands at 12.3 percent. NBA, which isolated NIC Asia Bank Ltd, earlier for breaching the 'gentleman understanding' on deposit rate cap has kept mum over the new scheme which is likely to trigger competition in the banking industry."

"We are discussing the issue (advance payment of interests," NBA President Gyanendra Prasad Dhungana, told Republica" "We look into the practice of our members that can cause risk in the system."

However, other banks are at odds with the two banks that have circumvented the 'gentleman agreement' on the interest rate cap. According to a source at the NBA, some bankers have criticized the new scheme, stating that such practice was against the banking norms. "

"This is a very wrong practice. It has not only circumvented the agreement but has also created duplicate deposits," a commercial bank's CEO said, requesting anonymity. "It is fine as long as they offer interest on daily, weekly or monthly basis. But by paying interest upfront, they are capitalizing interest to make investment without new stocks of deposit," the CEO added.

Due to mismatch in deposit and loan mobilizations, banks are facing shortage of lendable fund. This mismatch has caused the credit to core capital plus deposit (CCD) ratio -- a prudential lending limit -- of many banks to reach to a saturation level. With CCD ratio approaching the 80 percent cap, banks are scrambling to find deposits so that they are in a comfortable to lend.

NBA capped deposit rates at 11 percent last month as competition among banks to attract deposits pushed interest rates on deposits to nearly 14 percent.

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After NBA ostracized NIC Asia Bank for offering 12 percent interest on deposits, Nabil Bank last week came up with advance interest payment scheme. NIC Asia Bank followed the suit.

However, Anil Keshary Shah, the officiating CEO of Nabil Bank, has defended the move". "We brought the scheme after we heard that another bank was coming up with similar scheme two days later," Shah said. "We will not withdraw the scheme until there is an agreement that none of the banks will increase interest rates."

Amid accusations that the scheme was creating duplicate deposit, the NRB has said that they are looking into the matter. "There is no provision as such on advance interest payment. I can comment on the matter only after holding discussion at the central bank on whether such offer is a breach of the CCD norms," NRB Spokesperson Narayan Prasad Paudel told Republica.

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