

GUIDELINES ON BASE RATE

Following the announcement in the Annual Policy Statement for the year 2009-10, the Reserve Bank constituted a Working Group on Benchmark Prime Lending Rate (Chairman: Shri Deepak Mohanty) to review the present benchmark prime lending rate (BPLR) system and suggest changes to make credit pricing more transparent.

The Working Group submitted its report on October 20, 2009 and it was placed on the Reserve Bank's website for public comments. After considering the recommendations of the Group and the suggestions from various stakeholders, the Reserve Bank has decided as follows:

The Base Rate system will replace the BPLR system with effect from April 1, 2010. Banks may determine their actual lending rates on loans and advances with reference to the Base Rate. Base Rate shall include all those elements of the lending rates that are common across all categories of borrowers. While each bank may decide its own Base Rate, some of the criteria that could go into the determination of the Base Rate are: (i) cost of deposits; (ii) adjustment for the negative carry in respect of CRR and SLR; (iii) unallocatable overhead cost for banks such as aggregate employee compensation relating to administrative functions in corporate office, directors' and auditors' fees, legal and premises expenses, depreciation, cost of printing and stationery, expenses incurred on communication and advertising, IT spending, and cost incurred towards deposit insurance; and (iv) profit margin.

The actual lending rates charged to borrowers would be the Base Rate plus borrower-specific charges, which will include product-specific operating costs, credit risk premium and tenor premium.

All categories of loans should henceforth be priced only with reference to the Base Rate. The Base Rate could also serve as the reference benchmark rate for floating rate loan products, apart from the other external market benchmark rates. The floating interest rate based on external benchmarks should, however, be equal to or above the Base Rate at the time of sanction or renewal.

Since the Base Rate will be the minimum rate for all commercial loans, banks are not permitted to resort to any lending below the Base Rate. Accordingly, the current stipulation of BPLR as the ceiling rate for loans up to Rs. 2 lakh stands withdrawn. It is expected that deregulation of lending rates will increase the credit flow to small borrowers at reasonable rate. Thus, direct bank finance will provide effective competition to other forms of high cost credit.

Interest rates on loans under the DRI scheme will continue to be fixed without reference to the Base Rate.

The Reserve Bank will separately announce the stipulation for export credit.

Since transparency in the pricing of lending products has been a key objective, banks are required to exhibit the information on their Base Rate at all branches and also on their websites. Changes in the Base Rate should also be conveyed to the general public from time to time through appropriate channels. Banks are required to provide information on the actual minimum and maximum lending rates charged to major categories of borrowers to the Reserve Bank on a quarterly basis. Apart from transparency, banks should ensure that interest rates charged to customers in the above arrangement are non-discriminatory in nature.

The Base Rate system would be applicable for all new loans and for those old loans that come up for renewal. However, if the existing borrowers want to switch to the new system before the expiry of the existing contracts, in such cases the new/revised rate structure should be mutually agreed upon by the bank and the borrower.