‘RBI move to link banks’ lending rates to external benchmarks will ensure more transparency’

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The **Reserve Bank of India’s proposal that banks link all new floating rate personal / retail and MSME loans to one of the four external benchmarks, including policy repo rate and Treasury Bill yields, from April 1, 2019, will ensure greater standardisation and** improve transparency in loan pricing, say bankers.

According to the RBI, all new floating rate personal or retail loans (housing, auto) and floating rate loans to Micro and Small Enterprises (MSE) extended by banks from April 1, 2019, will be linked to one of the four benchmarks – Reserve Bank of India’s policy repo rate, or 91 days Treasury Bill, or 182 days Treasury Bill, or any other benchmark market interest rate produced by the Financial Benchmarks India Private Ltd.

The spread over the benchmark rate – to be decided wholly at banks’ discretion at the inception of the loan – will remain unchanged through the life of the loan, unless the borrower’s credit assessment undergoes a substantial change and as agreed upon in the loan contract, the central bank said in its **Statement on Developmental and Regulatory Policies.**

The statement said: “Banks are free to offer such external benchmark-linked loans to other types of borrowers as well.

“In order to ensure transparency, standardisation, and ease of understanding of loan products by borrowers, a bank must adopt a uniform external benchmark within a loan category; in other words, the adoption of multiple benchmarks by the same bank is not allowed within a loan category. The final guidelines will be issued by the end of December 2018.”

Monetary transmission

Indian Banks’ Association Chairman Sunil Mehta said linking floating rate loans to external benchmarks for the retail and MSE segments will improve transparency and better monetary transmission.

Karthik Srinivasan, Group Head, Financial Sector Ratings, ICRA, opined that the proposal to link banks’ lending rates on new retail and MSE loans with external benchmarks is expected to improve the transparency in loan pricing by banks, as the existing benchmarks, especially the base rate, have not led to a full transmission of the benefits of decline in cost of funds for banks to borrowers.

Furthermore, the profitability of banks may see higher volatility, unless they are able to raise floating rate deposits linked to external benchmarks.

On the other hand, for borrowers, it may lead to a more frequent resets on their equated monthly instalments.

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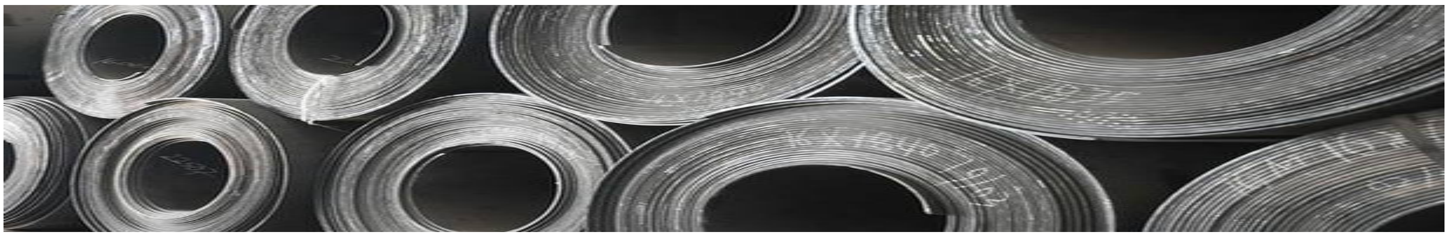

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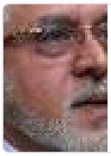

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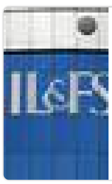

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