

<p>Benchmarks ></p> <p>Nifty CLOSED</p> <p>11,035.70 32.65</p> 	<p>NSE Gainer-Large Cap ></p> <p>Tata Motors (DVR)</p> <p>61.45 5.75</p> 	<p>SPONSORED FUND</p> <p>Mirae Asset Large Cap Fund Regular- Growth</p> <p>★★★★★</p>	<p>5Y RETURN</p> <p>10.8 %</p> <p>INVEST NOW</p>	<p>Stock Analysis, IPO, Mutual Funds, Bonds & More</p> <p>Market Watch</p>
--	---	---	---	--

Link loans to benchmarks: RBI to banks

BY ET BUREAU | UPDATED: SEP 05, 2019, 08.21 PM IST

[Post a Comment](#)

MUMBAI: The Reserve Bank of India (RBI) has made it mandatory for banks to link [loans](#) to retail customers and micro, small and medium enterprises (MSMEs) to external interest rate benchmarks in a big push to make transmission of [monetary policy](#) more effective. Home and car loan rates, along with those for personal travel, are expected to fall, benefitting borrowers.

The RBI also suggested a series of rates that lenders can choose from as the peg. The RBI has already cut the policy rate by 110 basis points this year to revive flagging growth, which sank to the slowest in six years in the June quarter. A [basis point](#) is one-hundredth of a percentage point. FM [Nirmala Sitharaman](#) had called on banks to improve rate transmission last month to help drive credit expansion, investment and consumer demand.

When the new framework goes into effect on October 1, banks will have to migrate from the Marginal Cost of Lending Rate (MCLR) regime.

The RBI has left risk premium charges to be decided by the lenders, depending on the borrower's credit profile.

RBI Struggling to Improve Rate Transmission

However, the central bank has also drawn up rules to prevent banks from gaming the system by tweaking risk premiums unless there's a material change in the status of the borrower. The interest rate under the external benchmark shall be reset at least once in three months.

"In order to ensure transparency, standardisation and ease of understanding of loan products by borrowers, a bank must adopt uniform external benchmark within a loan category," the RBI said in a release.

RELATED VIDEO



Repo-linked interest rates mandatory: What does RBI's move mean for borrowers

RELATED COMPANIES

[EXPAND](#)

SBI

Big Change:
[The end of Five-Year Plans: All you need to know](#)

What RBI Wants

1 Loans must be linked to external rate benchmarks

These could be
RBI's repo rate

3-mth or 6-mth treasury yield, or any other benchmark published by FBIL*



2 Banks can decide risk premium based on borrower's credit profile

3 Interest rate must be reset at least once in 3 months

*FBIL is owned by Fixed Income Money Market & Derivatives Association of India, Foreign Exchange Dealers' Association of India and IBA

The central bank has been struggling for more than a decade to improve the transmission of rate changes to ultimate borrowers. It tried prime lending rates and base rates before zeroing in on the MCLR, which is based on the cost structure of the bank in the latest quarter.

The new pegs include the RBI's repo rate, the three-month or sixmonth treasury yield published by Financial Benchmarks India Ltd (FBIL) or any other benchmark published by the latter, the RBI said.

While the plan was supposed to be implemented in April, governor [Shaktikanta Das](#) decided to postpone the move as the industry highlighted operational difficulties. There has been increasing clamour for linking to benchmarks because of high borrowing costs. Many, including [SBI](#) and Bank of India, have already done so.

"This makes it mandatory for banks to link rates, which we have mostly done," said SBI managing director PK Gupta. "Only thing is, we cannot have two products which we offer now, in terms of a market-linked home loan product and one that is not. It could increase volatility, given that short-term rates will be linked. Also, the liability side has not been linked, which is still a question in front of us."

POOR RATE TRANSMISSION

At a banking conference last month, Das said the transmission of policy rates at just 29 basis points (bps) this year, compared with a combined repo rate cut of 75 bps (excluding the 35bps cut in August), did not meet RBI's expectations.

While rates were roughly congruent with the movement of the repo rate, banks had the freedom to charge a premium based on the customer's risk profile. A poor credit score could lead to a high premium over the benchmark and vice versa, which couldn't be altered at will.

"Credit risk premium may undergo change only when borrower's credit assessment undergoes a substantial change, as agreed upon in

the loan contract," said the RBI. "Further, other components of spread including operating cost could be altered once in three years."

The government has announced various stimulus measures and relaxations to revive growth. The RBI will also transfer a record surplus to the government, giving it some room on the fiscal front.

FBIL is jointly owned by the Fixed Income Money Market and Derivatives Association of India (Fimmda), Foreign Exchange Dealers' Association of India (Fedai) and the Indian Banks' Association (IBA). It was formed in December 2014.

"Its aim is to develop and administer benchmarks relating to money market, government securities and foreign exchange in India," according to the FBIL website. "It is responsible for all the aspects relating to the benchmarks to be issued by it, namely, collection and submission of market data and information including polled data, formulation, adoption and periodic review of benchmark calculation methodologies, calculation, publication and administration of benchmarks confirming to the highest standards of integrity, transparency and precision."

Stay on top of business news with The Economic Times App. [Download it Now!](#)