भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA
www.rbi.org.in

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All Scheduled Commercial Banks (excluding RRBs)

Dear Sir/Madam

Guidelines on the Base Rate

Following the announcement in the Annual Policy Statement for the year 2009-10, Reserve Bank of India 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 in October 2009 and the same was placed on the Reserve Bank's website for public comments. Based on the recommendations of the Group and the suggestions from various stakeholders, the draft guidelines on Base Rate were placed on the Reserve Bank's website in February 2010.

2. In the light of the comments/suggestions received, it has been decided that banks switch over to the system of Base Rate. The BPLR system, introduced in 2003, fell short of its original objective of bringing transparency to lending rates. This was mainly because under the BPLR system, banks could lend below BPLR. For the same reason, it was also difficult to assess the transmission of policy rates of the Reserve Bank to lending rates of banks. The Base Rate system is aimed at enhancing transparency in lending rates of banks and enabling better assessment of transmission of monetary policy. Accordingly, the following guidelines are issued for implementation by banks.

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Base Rate

i. The Base Rate system will replace the BPLR system with effect from July 1, 2010. Base Rate shall include all those elements of the lending rates that are common across all categories of borrowers. Banks may choose any benchmark to arrive at the Base Rate for a specific tenor that may be disclosed transparently. An illustration for computing the Base Rate is set out in the **Annex**. Banks are free to use any other methodology, as considered appropriate, provided it is consistent and is made available for supervisory review/scrutiny, as and when required.

ii. Banks may determine their actual lending rates on loans and advances with reference to the Base Rate and by including such other customer specific charges as considered appropriate.

iii. In order to give banks some time to stabilize the system of Base Rate calculation, banks are permitted to change the benchmark and methodology any time during the initial six month period i.e. end-December 2010.

iv. The actual lending rates charged may be transparent and consistent and be made available for supervisory review/scrutiny, as and when required.

Applicability of Base Rate

v. All categories of loans should henceforth be priced only with reference to the Base Rate. However, the following categories of loans could be priced **without** reference to the Base Rate: (a) DRI advances (b) loans to banks' own employees (c) loans to banks' depositors against their own deposits.

vi. The Base Rate could also serve as the reference benchmark rate for floating rate loan products, apart from 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.

vii. Changes in the Base Rate shall be applicable in respect of all existing loans linked to the Base Rate, in a transparent and non-discriminatory manner.

viii. Since the Base Rate will be the minimum rate for all 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 the above deregulation of lending rate will increase the credit flow to small borrowers at reasonable rate and direct bank finance will provide effective competition to other forms of high cost credit.

ix. Reserve Bank of India will separately announce the stipulation for export credit.

Review of Base Rate

x. Banks are required to review the Base Rate at least once in a quarter with the approval of the Board or the Asset Liability Management Committees (ALCOs) as per the bank's practice**.** 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 to the Reserve Bank on a quarterly basis, as hitherto.

Transitional issues

xi. The Base Rate system would be applicable for all new loans and for those old loans that come up for renewal. Existing loans based on the BPLR system may run till their maturity. In case existing borrowers want to switch to the new system, before expiry of the existing contracts, an option may be given to them, on mutually agreed terms. Banks, however, should not charge any fee for such switch-over.

xii. In line with the above Guidelines, banks may announce their Base Rates after seeking approval from their respective ALCOs/ Boards.

Effective date

xiii. The above guidelines on the Base Rate system will become effective on July 1, 2010.

Yours faithfully

(P.Vijaya Bhaskar)
Chief General Manager-in-charge
Encl: as above

Annex

Illustrative Methodology for the Computation of the Base Rate

$$\text{Base Rate} = \boldsymbol{a} + \boldsymbol{b} + \boldsymbol{c} + \boldsymbol{d}$$

a – Cost of Deposits/funds $= D_{cost}$

(benchmark)

b - Negative Carry on CRR and SLR $= \left[\left[\frac{\{D_{cost} - (SLR * T_r)\}}{\{1 - (CRR + SLR)\}}\right] * 100\right] - D_{cost}$

c - Unallocatable Overhead Cost $= \left(\frac{U_c}{D_{ply}}\right) * 100$

d - Average Return on Net Worth $= \left[\left(\frac{NP}{NW}\right) * \left(\frac{NW}{D_{ply}}\right)\right] * 100$

Where:
D_{cost} : Cost of Deposits/funds
D : Total Deposits = Time Deposits + Current Deposits + Saving Deposits
D_{ply} : Deployable Deposits
= Total deposits less share of deposits locked as CRR and SLR balances, *i.e.*
$= D * [1 - (CRR + SLR)]$
CRR : Cash Reserve Ratio
SLR : Statutory Liquidity Ratio
T_r : 364 T-Bill Rate
U_c : Unallocatable Overhead Cost
NP : Net Profit
NW : Net Worth = Capital + Free Reserves

Negative Carry on CRR and SLR

Negative Carry on CRR and SLR $= \left[\left[\frac{\{D_{cost} - (SLR * T_r)\}}{\{1 - (CRR + SLR)\}}\right] * 100\right] - D_{cost}$

Negative carry on CRR and SLR balances arises because the return on CRR balances is nil, while the return on SLR balances (proxied using the 364-day Treasury Bill rate) is lower than the cost of deposits. Negative carry on CRR and SLR is arrived at in three steps. In the first step, return on SLR investment was calculated using 364-day Treasury Bills. In the second step, effective cost was calculated by taking the ratio (expressed as a percentage) of cost of deposits (adjusted for return on SLR investment) and deployable deposits (total deposits less the deposits locked as CRR and SLR balances). In the third step, negative carry cost on SLR and CRR was arrived at by taking the difference between the effective cost and the cost of deposits.

Unallocatable Overhead Cost

$$\text{Unallocatable Overhead Cost} = \left(\frac{U_c}{D_{ply}}\right) * 100$$

Unallocatable Overhead Cost is calculated by taking the ratio (expressed as a percentage) of unallocated overhead cost and deployable deposits.

Average Return on Net Worth

$$\text{Average Return on Net Worth} = \left[\left(\frac{NP}{NW}\right) * \left(\frac{NW}{D_{ply}}\right)\right] * 100$$

Average Return on Net Worth is computed as the product of net profit to net worth ratio and net worth to deployable deposits ratio expressed as a percentage.