RBI flays banks for keeping rates high

Holding a mirror:From left, RBI’s Urjit Patel, M.D. Patra,Viral Acharya and N.S. Vishwanathan.Paul Noronha

The Reserve Bank today flayed lenders for keeping interest rates high and flagged concerns over the base rate and the marginal cost of fund-based lending rate (MCLR), saying these have not improved monetary transmission.

An internal RBI group also suggested switching over to an external benchmark in a time-bound manner so that better rates are available to borrowers.

“The RBI study group has observed that internal benchmarks such as the base rate/MCLR have not delivered effective transmission of the monetary policy,” RBI said in a report today.

The group was constituted by RBI to study various aspects of the MCLR system from the perspective of improving policy transmission.

RBI introduced MCLR on April 1, 2016 after finding that the then prevailing base rate had failed to achieve the objectives of easier and faster policy transmission. Before the MCLR was rolled out, the banks were following a more rigid base rate system, which came into force on July 1, 2010, replacing the banks’ prime lending rate.

The study group submitted its report on September 25.

“Arbitrariness in calculating the base rate/MCLR and spreads charged over them has undermined the integrity of the interest rate setting process,” the study group has observed.

‘Not in sync’

The base rate/MCLR regime is also not in sync with global practices on pricing of bank loans, it said, adding that “the study group has, therefore, recommended a switchover to an external benchmark in a time-bound manner.”

Addressing the media, RBI Deputy Governor Viral Acharya said the report had proposed three possible external benchmarks to which such lending could be tied to going forward.

“We think the internal benchmarks such as the base rate and MCLR, based on data, seem to give banks very high amount of discretion..., lots of factors that are flexible to them to ensure that the lending rate can be kept high even if monetary policy is going down and [is] accommodative.” He also said the move was to address the above-mentioned lacunae by bringing in a better global benchmarks wherein these rates are tied to external benchmarks as “this will create a fair bit of transparency for borrowers and they can just compare two loans and see which is at the lower spread because the benchmark will be the same.”

The report also suggested that “the interest rate resets, which are right now at an annual frequency, creating potentially a one-year lag in transmission, can be changed on all floating rate loans to quarterly resets so that transmission would be much faster once the monetary policy changes.”

RBI will take a final view on the recommendations of the study group after taking into account the feedback [from the public] received until October 25, 2017.

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