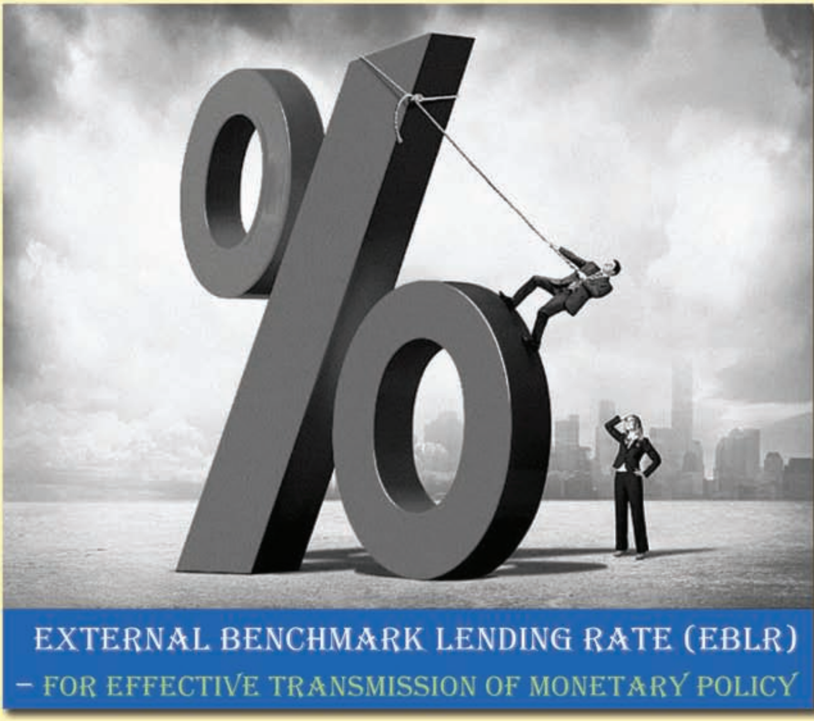
SOUTH INDIAN Bank
Experience Next Generation Banking

STUDENTS' ECONOMIC FORUM

A monthly publication from South Indian Bank

To kindle interest in economic affairs...
To empower the student community...

OPEN ACCESS www.southindianbank.com
Student's corner
ho2099@sib.co.in



DECEMBER 2019

Theme 337

EBLR

28th Year of Publication

SOUTH INDIAN Bank

Experience Next Generation Banking

SIB PAYMENT GATEWAY SERVICES

A one stop solution for accepting payments online in the most convenient, simple, fast and secure mode.

SIB PAYGATE

FEEBOOK

- **Net Banking** 45+ Banks
- **Wallets** 15+ Major wallets
- **Credit / Debit Cards** (Visa, MasterCard, American Express, Rupay)
- **BharatQR**
- **UPI**

Features

Website integration of your firm for Payment Gateway services | SMS Invoicing
E-mail Invoicing | Smart Analytics | Merchant Dashboard

For more details, contact your nearest South Indian Bank branch.

Toll Free (India): 1800-102-9408, 1800-425-1809 (BSNL), Email: customercare@sib.co.in, CIN: L65191KL1929PLC001017
www.southindianbank.com | /thesouthindianbank

SOUTH INDIAN Bank
Experience Next Generation Banking
The South Indian Bank Ltd., H.O. : 'S.I.B. House', Thrissur, Kerala

SIB STUDENTS' ECONOMIC FORUM

DECEMBER, 2019

Theme No: 337: **"EBLR"**

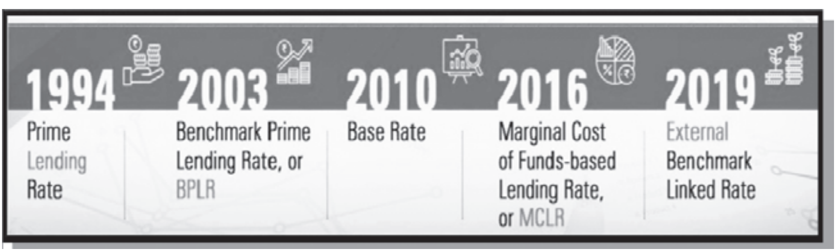
A well informed customer will make the policy makers as well as organizations which produce goods and render services more responsive to the customer needs. This will also result in healthy competition among organizations and improve the quality of its products. The "SIB Students' Economic forum" is designed to kindle interest in the minds of younger generation. We highlight one theme in every monthly meeting of the "Forum". Topic of discussion for this month is "**External Benchmark Lending Rate (EBLR)".**

The RBI has made it mandatory for banks to link all new floating-rate loans for housing, auto and MSMEs to external benchmark like Repo from October 1, 2019, a move aimed at ensuring faster transmission of policy rate cuts to borrowers. Industry and retail borrowers have been complaining that banks do not pass on the entire RBI's policy rate (repo rate) reduction to them.

Over the past several years, banks have been pegging their lending rates with various internal benchmarks. Earlier there was a concept of PLR (Primary Lending Rate) regime, which was replaced with the Base Rate regime and then most of the loans which were advanced by the banks especially post April 1, 2016 are being charged with rate of interest based on a regime called as MCLR. All these three lending rate regimes will be referred by us as internal benchmarking and the latest lending rate regime of the RBI will be referred as external benchmarking.

Internal benchmarking basically referred to a situation wherein RBI gave certain guidelines to the banks based on which they decided their own lending rate. In external benchmarking, Banks have been allowed to use RBI's policy rate among other market-driven options to arrive at lending rates.

RBI's Lending Rate Regimes



a) Primary Lending Rate (PLR)

This was the oldest practice of deciding the lending rate. Banks were given a free hand to fix lending rate to their customers. Obviously, banks taking advantage of this, used to fix high lending rates for a borrower whose credit rating was not too attractive and simultaneously used to offer a discount to the borrower whose credit rating was good. Hence, there was a huge disparity in lending rates offered to the borrowers. To avoid this parity in lending rates, RBI introduced the Base Rate Regime or BRR.

b) Base Rate Regime (BRR)

In the Base Rate Regime of lending rates, RBI instructed the banks to follow certain parameters before deciding the Base rate lending rates. RBI felt that this would remove the mismatch which was there in PLR based interest rate regime. The parameters set by RBI were as below.

i) The cost of funds
ii) The operational expenses
iii) The cost of CRR
iv) The profit margin

Combining all the four parameters, banks used to fix their lending rate under the Base Rate Regime (BRR). The basic concept was that any loan given by a bank to any kind of borrower in the market shall not have a rate of interest less than the Base rate. Banks would charge certain spread or premium over this Base rate. The spread would usually be lower for high creditworthy borrowers and high for lower creditworthy borrowers. The spread or premium was introduced because extending a loan to an individual was entirely different from a loan being extended to a business entity. Hence, based on the risk in lending, banks could set their spread or premium for the borrower.

When Base Rate based lending regime was introduced, RBI thought that whenever there was a change in policy rate by RBI, the lending rate by banks would also reduce in the same proportion. Such a change is referred to as a Monetary Policy Transmission or MPT. Now the extent to which banks change the lending rate will define whether the monetary policy transmission is efficient or inefficient. Assume that RBI reduced its repo rate by 50 basis points and a particular bank reduced its corresponding lending rate by only 5 basis points. Then we do not consider this as an efficient monetary policy transmission. This would be an inefficient monetary policy transmission.

What RBI noticed was that such efficient transmission was not happening in the Base Rate pricing method of lending. Hence, RBI introduced the MCLR effective from 1st April 2016.

c) Marginal Cost of Lending Rate (MCLR)

The argument put forward by the banking sector for not transmitting the reduction in the rates was that RBI is not the only source of borrowing for banks and they also borrow from households as well as Corporates. The reduction of repo rate by RBI didn't mean that the overall cost of borrowing for the loans had come down drastically. The banks continued to guarantee 4% rate of interest on SB accounts kept by households or higher rate of interest in case of Fixed deposits or Corporate deposits. RBI then decided to consider lending rates based on marginal cost of funds instead of just cost of funds.

To evaluate the implementation of MCLR, RBI set up an internal committee that is Janak Raj committee. Janak Raj Committee came out with certain findings and they are as below.

i) RBI had asked banks to shift the lending rates from Base rate regime to MCLR. Majority of the banks hadn't done it. Some Banks continued to charge interest based on the Base rate regime.
ii) RBI had asked the banks to change or recalculate MCLR periodically, but majority of the banks revised their MCLR once in six months or annually which led to inefficient monetary policy transmission.

Hence, considering all these aspects, the Janak Raj Committee recommended banks shifting to external benchmark lending rate rather than internally deciding their own benchmark. That was why RBI recently introduced the criteria that all loans should be under external benchmark lending rate effective from 1st October 2019.

d) External Benchmark Linked Lending Rate (EBLR)

Banks have to link their lending rates charged on various loans with an external benchmark instead of MCLR. The RBI has given the following options of external benchmark to banks:

i) RBI repo rate
ii) 91-days Treasury bill yield
iii) 182-days Treasury bill yield
iv) Any other benchmark market interest rate formulated by the Financial Benchmarks India Pvt. Ltd (FBIL)

Spread will be added by a bank to one of these benchmarks to decide the lending rate. Banks are free to decide the spread over the external benchmark. However, credit risk premium, a component of spread may undergo change only when borrower's credit assessment goes through a substantial change, as agreed upon in the loan contract. Further, other components of spread including operating cost could be altered once in three years.

Existing loans and credit limits linked to the MCLR/Base Rate/BPLR shall continue the same way till repayment or renewal, as the case may be. Existing borrowers who have the option of pre-paying without incurring pre-payment charges will be eligible to shift to the external benchmark-linked rate without any additional charges, except reasonable administrative and legal costs. For other borrowers, the option to move to an external benchmark will be available on the basis of their agreement with the bank. The interest rates under the new system shall be reset at least once in three months.

What are the Benefits of the new system of External Benchmarking?

i) It will help better transmission of policy rate cuts i.e. an RBI rate cut will immediately reach the borrower.
ii) It will make the system more transparent since every borrower will know the fixed interest rate and the spread value decided by the bank.
iii) It will help borrowers compare loans from different banks in a better manner.
iv) A bank is required to adopt a uniform external benchmark within a loan category. This will ensure transparency, standardisation and ease of understanding for the borrowers. This would mean that same bank cannot adopt multiple benchmarks within a loan category.

What is the Concern about the new lending rate regime?

Experts say that the benchmarking which has been chosen so far, such as repo rate, 91 days treasury bills, 182 days treasury bills or any other parameter formulated by FBIL, are all volatile in nature. For example in the case of 91 days treasury bills, the variation in the coupon rate or interest rate in the last one year has been more than hundred basis points. If this is taken as the external benchmark, the rate of interest charged by the bank in a span of one year will be varied by more than hundred basis points. At certain times it may provide huge benefits for the borrower whereas at certain times it may not provide any kind of benefit for the borrower.

The move is a welcome change for borrowers, aimed at faster and effective transmission of monetary policy rates and can give a much needed boost to the retail lending space, which could, in turn, enhance consumption. The central bank will first look at the experience with banks before extending it to NBFCs who are currently still calculating their benchmark interest rates based on the Prime Lending Rates. RBI is hoping that the new rate regime will fasten central bank rate actions and also remove discretionary elements from a bank's rate setting decision. RBI is hoping that once the costs of a bank are taken outside the benchmark rate, it will make pricing of rates more effective.

SOUTH INDIAN Bank
Experience Next Generation Banking

Discover a world of convenience with SIB Debit Cards.

RuPay Platinum EMV International

MasterCard Business Platinum EMV International

VISA Platinum EMV NFC International

MasterCard World EMV International

Toll Free (India): 1800-102-9408, 1800-425-1809 (BSNL), Email: customercare@sib.co.in, CIN: L65191KL1929PLC001017
www.southindianbank.com | /thesouthindianbank

SOUTH INDIAN Bank
Experience Next Generation Banking

For your every need...

South Indian Bank Gold Loan

For your trade, agriculture, vehicle purchase, house renovation, repayment of loan, marriage and other needs.

Attractive interest rate

Quick processing

Maximum loan

Toll Free (India): 1800-102-9408, 1800-425-1809 (BSNL), Email: customercare@sib.co.in, CIN: L65191KL1929PLC001017
www.southindianbank.com | /thesouthindianbank

blackswanindia.com