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भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

संचार विभाग, केंद्रीय कार्यालय, एस.बी.एस.मार्ग, मुंबई-400001
DEPARTMENT OF COMMUNICATION, Central Office, S.B.S.Marg, Mumbai-400001
फोन/Phone: 91 22 2266 0502 फैक्स/Fax: 91 22 22660358

वेबसाइट : www.rbi.org.in/hindi
Website : www.rbi.org.in
इ-मेल email: helpdoc@rbi.org.in

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RBI releases Report on 'Working Group on Pricing of Credit'

The Reserve Bank of India today placed on its website Report on Working Group on Pricing of Credit. Comments/feedback on the recommendations of the report may be sent by May 16, 2014 by email or by post to the Principal Chief General Manager, Reserve Bank of India, Department of Banking Operations and Development, 13th floor, Central Office Building, Shaid Bhagat Singh Marg, Mumbai-400 001.

Background

Despite the policy efforts to usher in transparency and fairness to the credit pricing framework, there have been certain concerns from the customer service perspective. These mainly relate to the downward stickiness of the interest rates, discriminatory treatment of old borrowers vis-à-vis new borrowers, and arbitrary changes in spreads, etc. In response, the Reserve Bank of India had constituted a Working Group under the Chairmanship of Shri Anand Sinha, the then Deputy Governor, Reserve Bank of India comprising members from banks, Indian Banks' Association (IBA), academia and the Reserve Bank of India to examine the issues related to discrimination in pricing of credit and recommend measures for transparent and appropriate pricing of credit under a floating rate regime.

Recommendations

Major recommendations made by the Working Group are:

- It would be desirable that banks, particularly those whose weighted average maturity of deposits is on the lower side, move towards computing the Base Rate on the basis of marginal cost of funds. This may result in more transparency in pricing, reduced customer complaints, better transmission of changes in the policy rate and improved asset liability management at banks. If banks use weighted average cost of funds because of their deposits profile or any other methodology that may result in differentiation between old and new customers, the boards of banks should ensure that this differentiation does not lead to any discrimination amongst borrowers. *(Para 4.31)*

- Apart from factors like specific operating cost, credit risk premium and tenor premium, broad factors, such as, competition, business strategy and customer relationship are also used to determine the spread. Banks should have a Board approved policy delineating these components. The Board of a bank should ensure that any price differentiation is consistent with bank's credit pricing policy factoring Risk Adjusted Return on Capital (RAROC). Banks should be able to demonstrate to the Reserve Bank of India the rationale of the pricing policy. *(Para 4.32)*

- Banks' internal policy must spell out the rationale for, and range of, the spread in the case of a given borrower, as also, the delegation of powers in respect of loan pricing. *(Para 4.34)*

- The spread charged to an existing customer cannot be increased except on account of deterioration in the credit risk profile of the customer. The customer should be informed of this at the time of contract. Further, this information should be adequately displayed by banks through notices/website.(*Para 4.35*)

- The floating rate loan covenant may have interest rate reset periodicity and the resets may be done on those dates only, irrespective of changes made to the Base Rate within the reset period. (*Para 4.36*)

- There may be a sunset clause for Benchmark Prime Lending Rate (BPLR) contracts so that all the contracts thereafter are linked to the Base Rate. Banks may ensure that these customers who shift from BPLR linked loans to Base Rate loans are not charged any additional interest rate or any processing fee for such switch-over.(*Para 4.38*)

- The IBA may develop a new benchmark for floating interest rate products, namely, the Indian Banks Base Rate (IBBR), which may be collated and published by IBA on a periodic basis. Banks may consider offering floating rate products linked to the Base Rate, IBBR or any other floating rate benchmark ensuring that at the time of sanction, the lending rates should be equal to or above the Base Rate of bank. To begin with, IBBR may be used for home loans. By design, the IBBR should meet the standards for benchmarks set by the Committee on Financial Benchmarks (Chairman: Shri P Vijaya Bhaskar, Executive Director, RBI). (*Para 4.44)*

- The Working Group has also made several recommendations to bring in greater transparency enabling comparability across banks and informed decision making by customers. *(Para 6.23, 6.24, 6.27 and 6.28*)

- The benefit of interest reduction on the principal on account of pre-payments should be given on the day the money is received by the bank without waiting for the next EMI cycle date to effect the credit.(*Para 6.29*)

- Both, banks and the Reserve Bank may impart financial education through consumer education drives. (*Para 6.30*)

- For retail loans, the customers should have a choice of "with exit" and "sans exit" options at the time of entering the contract. The exit option can be priced differentially but reasonably. The exit option should be easily exercisable by the customer with minimum notice period and without impediments. This would address issues of borrowers being locked into contracts, serve as a consumer protection measure and also help enhance competition. Further, IBA should evolve a set of guidelines for easier and quicker transfer of loans, particularly mortgage/housing loans. There could also be penalties for banks which do not cooperate with borrowers in this regard. (*Para 6.31*)

- The industry association, IBA, should:
    - Develop case studies and examples of best practices for customer service;
    - Conduct studies to identify areas of best market conduct practices for improvement;
    - Conduct training for industry representatives. (*Para 6.32*)
- The grievances redressal systems in banks should be made robust and responsive to customers' needs. The Reserve Bank may penalise banks which do not put in place adequate measures, as evidenced by repeated complaints. (*Para 6.25*)

Alpana Killawala
Principal Chief General Manager

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