

# **WORKING GROUP ON BPLR**

## **1. Introduction**

1.1 The ultimate objective of bank lending is to promote economic growth by channelling resources to the most productive uses at reasonable rates. Therefore, the level and structure of interest rates are critical determinants of the economic efficiency with which resources are allocated in an economy. Interest rate distortions in any form may lead to a misallocation of resources. Accordingly, lending rates of banks need to be appropriate and reasonable from the point of view of both lending institutions and borrowers. Lending rates which are either too high or low and out of sync with the realistic pricing of credit could have implications for credit quality and cause concerns about financial stability. Lending interest rates should also be responsive to the monetary policy actions, if they are to achieve the desired objective.

1.2 Till the late 1980s the interest rate structure in India was largely administered in nature and was characterised by numerous rate prescriptions for different activities, and borrowers were charged vastly different rates for the same loan amount thereby distorting the structure of lending rates. On account of the complexities of the interest rate structure under the administered rate structure, efforts since 1990 has been of rationalisation of the interest rate structure so as to ensure price discovery and transparency in loan pricing system. The process of rationalisation culminated in almost complete deregulation of lending rates in October 1994. The freeing up of lending rates of scheduled commercial banks for credit limits of over Rs. 2 lakh along with the introduction of PLR system in 1994 was a major step in this direction aimed at ensuring competitive loan pricing. The system of Benchmark Prime Lending Rate (BPLR) introduced in 2003 was expected to serve as a benchmark rate for banks' pricing of their loan products so as to ensure that it truly reflected the actual cost. However, the BPLR system has fallen short of its Original objective of bringing transparency to lending rates. Competition has forced the pricing of a significant proportion of loans far out of alignment with BPLRs and in a non-transparent manner, undermining the role of the BPLR as a reference rate. There was also widespread public perception that the BPLR system has led to cross-subsidisation in terms of underpricing of credit for corporates and overpricing of loans to agriculture and small and medium enterprises. The Annual Policy

Statement 2009-10 noted that since the bulk of bank loans were lent at sub-BPLR rates, the system of BPLR evolved in such a manner that it had lost its relevance as a meaningful reference rate. The lack of transparency in the BPLR system also caused impediment to the effective transmission of monetary policy signals. In view of the concerns pertaining to the shortcomings in the BPLR system raised by the public and those recognised by the Reserve Bank, the Annual Policy Statement of 2009-10 announced the constitution of Working Group on BPLR to review the BPLR system and suggest changes to make credit pricing more transparent. Accordingly, a Working Group was constituted with the following members:

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| Shri Deepak Mohanty<br>Executive Director<br>Reserve Bank of India                                                                     | Chairman |
| Shri Abhijit Sen<br>MD & CFO<br>Citi Bank                                                                                              | Member   |
| Shri H. S. Upendra Kamath<br>Executive Director<br>Canara Bank                                                                         | Member   |
| Dr. Jahangir Aziz<br>Chief Economist (India)<br>J.P. Morgan                                                                            | Member   |
| Dr. Janak Raj<br>Adviser-in-Charge<br>Monetary Policy Department<br>Reserve Bank of India                                              | Member   |
| Dr. K. Ramakrishnan<br>Chief Executive<br>Indian Banks' Association                                                                    | Member   |
| Shri N. S. Kannan<br>ED & CFO<br>ICICI Bank                                                                                            | Member   |
| Shri P. Vijaya Bhaskar<br>Chief General Manager-in-Charge<br>Department of Banking Operations and Development<br>Reserve Bank of India | Member   |

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| Shri R C Arora<br>Sr. V P & Compliance Head<br>Banking Codes and Standards Board of India | Member           |
| Shri R. K. Gupta<br>General Manager<br>Punjab National Bank                               | Member           |
| Shri S. S. Ranjan<br>Dy.MD & CFO<br>State Bank of India                                   | Member           |
| Dr. T T Rammohan<br>Professor<br>Indian Institute of Management<br>Ahmedabad              | Member           |
| Dr. Himanshu Joshi<br>Director<br>Monetary Policy Department<br>Reserve Bank of India     | Member Secretary |

### **Terms of Reference of the Working Group**

1.3 The Working Group had the following terms of reference:

- (i) to review the concept of BPLR and the manner of its computation;
- (ii) to examine the extent of sub-BPLR lending and the reasons thereof;
- (iii) to examine the wide divergence in BPLRs of major banks;
- (iv) to suggest an appropriate loan pricing system for banks based on international best practices;
- (v) to review the administered lending rates for small loans up to Rs 2 lakh and for exporters;
- (vi) to suggest suitable benchmarks for floating rate loans in the retail segment; and consider any other issue relating to lending rates of banks.

### **Acknowledgements**

1.4 The members of the Group place on record its appreciation to the chambers of commerce and industry such as Confederation of Indian Industry, Federation of Indian Chamber of Commerce and Industry, Associated Chamber of Commerce and Industry of India, Indian Merchant Chamber, Federation of Indian Export Organisation, Bombay

Chamber of Commerce and Industry, Small & Medium Business Development Chamber of India, Federation of Indian Micro and Small & Medium Enterprises, Federation of Association of Small Industries of India and Thane Small Scale Industries Association for their views and suggestions.

1.5 The Group also expresses its thanks to all those who have submitted their comments and suggestions, by post and by email, in response to the press release of June 11, 2009 soliciting comments on the terms of reference of the Group.

1.6 The Group places on record its deep appreciation for the excellent support provided by the Secretariat comprising Shri Deepak Mathur, Assistant Adviser of Department of Statistics and Information Management and S/Shri Asish Thomas George and Edwin Prabu, Research Officers of the Monetary Policy Department.

1.7 The Report is organised in six chapters. Chapter 2 traces the evolution of BPLR. Chapter 3 provides the methodology for appropriate pricing of loans. Chapter 4 examines the benchmarks for pricing floating rate loans. Chapter 5 evaluates the working of administered lending rates. Chapter 6 sets out the major recommendations of the Group.