RBI issues draft norms for marginal cost computation

The Reserve Bank of India (RBI) has issued draft guidelines on the computation of the base rate of banks, based on marginal costs of funds, to be effective from April 1, 2016.

Indian Banks Association (IBA) will finalise the components of the spread over and above the base rate, to ensure uniformity in lending rate calculations.

The regulator has asked banks for a clear time frame to adopt the methodology within two months from the issue of the final norms.

The components of the spread would include allocable costs, term premium, risk premium reflecting the defaults and the qualitative element of business strategy. The first three components are quantitative; the business strategy would indicate the priority for the product. If the bank wants to expand that portfolio, it would give a discount and may charge more if it wants to exit from that business line, said a senior public sector bank official.

IBA is yet to finalise the components.

These will be uniform across the banks but the weightage assigned to each one would differ, based on the business strategy and other factors. Marginal cost of funds is the incremental cost of borrowing more money to fund assets or investments.

In this financial year's first bi- monthly policy review, RBI prodded banks to use this for the base rate calculation. " A base rate based on marginal cost of funds should be more sensitive to changes in policy rates. To improve the efficiency of monetary policy transmission, (we) will encourage banks to move in a time- bound manner to marginal cost of funds- based determination of their BR," RBI had said.

Banks had earlier expressed hesitation on such a shift. They were taking the average cost to calculate the cost of funds, of which a significant part was current and savings account deposits, which are low- cost. Most banks pay four per cent on savings account deposits, 20- 40 per cent of the total deposits.

Monetary transmission by banks have been slow. In this calendar year, RBI has reduced the repo rate (at which it lends to banks) by 75 basis points. However, banks have reduced the base rate by only 25- 30 bps. Both RBI and the government had questioned this reluctance to cut. Bankers say the increase in bad loans has been putting pressure on their margins, as interest- earning assets slip into the non- performing class.

(Business Standard,)