BASE BANK RATE WILL MAKE BORROWINGS BY HIGHLY RATED COMPANIES COSTLIER: FICCI SURVEY

Small Companies Would be Able to Negotiate Rates to their Advantage

New Delhi, June 12, 2010. A FICCI Survey on Base Bank Rate Implementation reveals that the introduction of the new regime in place of the Benchmark Prime Lending Rate (BPLR) would make raising money through banks costlier for highly rated companies. These corporates might resort to other low-cost financing options like Commercial Paper (CP), Qualified Institutional Placement (QIP), External Commercial Borrowing (ECB) etc. which could result in lower credit off-take of banks.

However, the survey reveals that small companies would be able to negotiate a good rate for themselves. According to the respondent banks, the new system is transparent and the small borrower should be able to 'negotiate the rates' to their advantage. As the base rate of all the banks would be publicly available, companies will be able to compare the rates charged by banks; hence the skill to negotiate will have a greater role to play.

The FICCI survey sought the views of bankers and economist about their view as to how things would pan out post base–rate regime is implemented from July 1, 2010 and what impact will it have on both, small and big companies.

As per the recommendations of the Working Group on Benchmark Prime Lending Rate (BPLR) constituted in the Annual Policy Statement of 2009-10 to review the BPLR system and suggest changes to make credit pricing more transparent, the Reserve Bank of India (RBI) has decided that banks switch over to the system of Base Rate with effect from July 01, 2010.

The committee recommended to the apex bank that banks switch over to the system of Base Rate aimed at **bringing transparency to lending rates and enabling better assessment of transmission of monetary policy.**

According to the Working Group Committee, the BPLR has tended to be out of sync with market conditions and does not adequately respond to changes in monetary policy. In addition, the tendency of banks to lend at sub-BPLR rates on a large scale raises concerns of transparency. The Working Group also noted that on account of competitive pressures, banks were lending at rates which did not make much commercial sense.

In addition to promoting transparency the Base Rate methodology does allow banks to charge borrowers Base Rate plus borrower-specific charges, which will include product-specific operating costs, credit risk premium and tenor premium. Besides concessions are made in certain cases like education loans, credit to small borrowers (up to Rs. 2 Lakh), loans below one year.

The following are the highlights of the FICCI Survey:

On whether banks see an upward pressure on lending rates once base rate is implemented and what is the range around which they see base rate settling

- ♣ Majority of the bankers surveyed did express the feeling that there is a high probability of a 'slight' upward bias as far as lending rates are concerned. However, the degree of impact will differ from borrower to borrower and across sectors. **While an upward pressure on rates for corporates availing at ultra-low rate is imminent, the retail, priority and SME products will most-likely be able to get a relatively lower rate.** Needless to mention, irrespective of the category, borrowers with better credit rating will be able to negotiate a good deal for themselves.

- ♣ Apart from the base rate, other important determinants of future lending rates will be RBI's monetary policy stance and pick-up in credit demand. While the bankers are optimistic about the credit demand, they are apprehensive of monetary policy. If the policy indicates further tightening there could be a consequent squeeze on liquidity, which will have an upward bias on base rate.

- ♣ On the range of base rate the responses varied from an expected, range of 6.0-7.5% to 8.5-10%. Out of this, foreign banks lied at the lowest range, public sector banks are expected to settle in the range of 7.5-8.5% and private sector banks would be at the higher end of the range i.e., 8.5-9.5%.

What are the areas banks would resort to negate the adverse impact on bank's bottom-line, if any

- ♣ In order to negate the adverse impact on bank's bottom-line, they are expected to expand their fee-based income business. They would also pursue more low cost borrowings. Some respondents also foresee an aggressive treasury operations and levying of service charges to cancel out any negative impact arising out of squeeze in profitability as banks could end up paying more to depositors without a corresponding increase in their earnings once base rate is implemented

Will (Current Account and Saving Account) CASA heavy banks be at an advantage in the new regime?

- ♣ Bankers were unanimous in their view of CASA heavy banks having an advantage in the new regime. Higher proportion of CASA in total deposit would certainly offer more flexibility in maintaining a relatively lower base rate and hence will also play a decisive role in improving margins. There can't be a second thought on the fact that CASA heavy banks will have an upper hand in base rate pricing as cost of deposit is the single most determinant in the base rate calculation.

Do private sector banks have an edge over public sector banks in offering a more competitive rate?

- ♣ Public sector banks will have an edge over private sector banks in offering a more competitive rate as they have a larger deposit base which gives them access to cheaper sources of stable financing. Public sector banks have access to the government/treasury funds and thereby their cost of fund works out to be lower than private sector banks.

Note: Detailed findings of the survey.

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