

FAQ's on Base rate

1. What is the base rate?

The base rate acts as a minimum interest rate of a bank below which it cannot lend. The Base Rate is named as 'ING Vysya Base Rate' in ING Vysya Bank.

2. Are there any exemptions for the granting loans below Base Rate?

Yes, there are exemptions – These are DRI advances, loans to banks employees as per the HR Policy and loan against own deposits held with the Bank and any other category of loan / advances mentioned by RBI from time to time. Base rate would be applicable to all loans and advances sanctioned on or after July 01 2010.

3. Why has base rate being introduced?

The base rate system has been introduced to replace the benchmark Prime lending rate (BPLR) system, which was the methodology earlier followed by the banks. The base rate makes pricing more transparent as banks are not permitted to lend below base rate and also base rate has to be disclosed publicly.

The Working Group set up by RBI on Benchmark Price Lending Rate (BPLR) in its report submitted in October, 2009, strongly felt that “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. On account of competitive pressures, banks were lending at rates which did not make much commercial sense”

Therefore, the Group was of the view that the extant benchmark prime lending rate (BPLR) system has fallen short of expectations in its original intent of enhancing transparency in lending rates charged by banks and needs to be modified.

This led to the introduction of the base rate.

4. How will a bank decide its base rate?

A host of factors, like the cost of deposits, administrative costs, a bank's profitability in the previous financial year and a few other parameters, with stipulated weights, are considered while calculating a base rate. Base rate would be applicable to all loans and advances sanctioned on or after 1 July 2010.

5. Is base rate applicable to all the banks?

Yes from 1st July 2010 base rate is applicable to all the banks.

6. For how long can a customer continue with the original interest rate methodology?

The customer can continue with the old interest rate regime till maturity/Next renewal. However the customer has an option of switching over to base rate. In such cases customer will have to approach the Bank branch in this regard.

7. Once a customer migrates to base rate can he revert back to the earlier interest rate regime?

No. After 1 July 2010 loans and advances cannot be priced below the base rate.

8. What is the difference between a benchmark prime lending rate (which was used by banks prior to base rate) and the base rate?

Base Rate is much more transparent and banks are not allowed to lend below the base rate (except for cases specified by RBI). Base Rate is to be reviewed by the respective banks at least on quarterly basis and the same is to be disclosed publicly.

On the other hand, the calculation of Benchmark Prime Lending Rate (BPLR) was in many cases not transparent and banks were frequently lending below the BPLR to their prime borrowers due to competitive pressures.

9. How often are the Base Rates likely to change?

The banks have been asked to review their Base Rates every quarter. Banks are required to exhibit the information on their Base Rate at all branches and also on their websites.

10. What are the benefits of switching over to base rate?

Base rates usher in transparency for customers in pricing of loans and advances as banks are required to display the rate publicly and also review the same on a quarterly basis. The effect will be felt more by floating rate customers than fixed rate customers as the floating rate customers will be able to get the advantage in case of decreasing trend in interest rate scenario.

11. How can the customer migrate to base rate?

The customer should approach the nearest branch in this regard.

12. Is there any time limit to approach for switch over to Base Rate?

No. Customers can opt for switch over any time during the currency of the present facility.

13. How will change in base rate impact floating loans interest rates?

Any change in base rate will affect the floating rate of interest of loans that are linked to the base rate. For example, if floating rate of interest is 11% (Base rate 9% + margin 2%) and if the base rate increases to 9.25%, the floating rate will be 11.25 (base rate 9.25% + Margin 2%). Similarly, a fall in the base rate will lead to a fall in the applicable floating rates.

14. Is it compulsory for borrowers who have availed fixed rate loans to opt Base Rate?

No. But it is advisable to do so.