

**GOVERNMENT OF INDIA
FINANCE
LOK SABHA**

UNSTARRED QUESTION NO:5137

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LENDING RATE BY FOREIGN INSTITUTES

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Will the Minister of FINANCE be pleased to state:

- (a) whether the foreign lending institutions are earning huge profit in India due to higher interest rate on loans;
- (b) if so, the details thereof alongwith the reaction of the Government on high rate of interest;
- (c) whether high rate of lending adversely affects the economic condition of the common man; and
- (d) if so, the details thereof?

Answer

MINISTER OF THE STATE IN THE MINISTRY OF FINANCE (SHRI NAMO NARAIN MEENA)

(a) to (d): With effect from October 18, 1994, the Reserve Bank of India (RBI) had deregulated the interest rates on advances above Rs.2 lakh and these interest rates were determined by banks themselves with the approval of their Boards, subject to Benchmark Prime Lending Rate (BPLR) and Spread guidelines. Individual banks, including foreign banks, therefore determined interest rates to be charged to a particular borrower subject to BPLR and Spread guidelines. Interest rate on Loans up to Rs.2 lakh carried the prescription of not exceeding the BPLR. However, banks had the freedom to determine the rate of interest, without reference to BPLR and regardless of size in respect of loans for purchase of consumer durables and other non-priority sector personal loans including credit cards dues.

The BPLR system evolved in a manner that did not meet the objectives. Competition in an environment of excess liquidity had forced the pricing of a significant proportion of loans far out of alignment with BPLRs undermining its role as a reference rate. Around 78.0 per cent of the loans were extended by banks on sub-PLR. In other words, there was a growing public perception of under-pricing of credit for corporates and over-pricing of credit to agriculture as well as small and medium enterprises. The lack of transparency in the BPLR system also hindered transmission of monetary policy signals. Taking into consideration all these factors, the BPLR system has been replaced by new guidelines on the Base Rate system, which has come into force with effect from July 01, 2010.

In terms of the new guidelines, banks determine their actual lending rate on loans and advances with reference to the Base Rate. All categories of loans are priced only with reference to the Base Rate, which are announced by banks after seeking approval from their respective Boards. Since the Base Rate will be the minimum rate for all loans, banks are not permitted to resort to any lending below the Base Rate.