

# Base Rate and Differential Rate of Interest



## BASE RATE

### INTRODUCTION

Base rate is the minimum rate set by Reserve Bank of India below which banks are not allowed to lend to its customers.

### DESCRIPTION

- RBI prescribed the minimum rate of interest on loans with effect from Oct 1, 1960
- On recommendations of Working Group ( Chairman : Deepak Mohanty) RBI decided that banks should switch over to Base Rate system from July 1, 2010 for enhancing transparency in lending rates and enables better assessment of transmission of monetary policy.
- RBI replaced the bases system with Marginal Cost Based Lending Rate (MCLR) with effect from April 1, 2016

### MARGINAL COST BASED LENDING RATE

RBI introduced MCLR to determine Base Rate by banks to improve the efficiency of monetary policy transmission.

## INTERNAL BENCHMARK

All rupee loans sanctioned and credit limits to be priced with MCLR. It will be internal benchmark

The MCLR comprises of

1. Marginal cost of funds
2. Negative carry on account of CRR
3. Operating Cost
4. Tenor premium

## SPREAD

Banks should have policy delineating the components of spread which include a) Business strategy b) Credit risk premium.

The spread charged to an existing borrower should be increased except on account of deterioration in the credit risk profile of the customer.

## INTEREST RATES ON LOANS

Actual lending rates will be determined by adding components of spread to MCLR. There will be no lending below the MCLR of a particular maturity.

## EXEMPTIONS FROM MCLR

- Loans under schemes of the government of India wherein banks have to change interest rates as per the scheme
- Working Capital Term Loan, funded interest term loan etc. as part of rectification/ restructuring package.
- Loans under various refinance schemes of government of India or any government
- Undertakings wherein banks charge interest at the rates prescribed under the schemes

## REVIEW OF MCLR

Banks shall review and publish their MCLR of different maturities every month

## RESET OF INTEREST RATES

Banks can offer loans with reset dates linked either to the date of sanction of the loan/credit limits or to the date of review of MCLR  
The periodicity of reset shall be one year or lower

==>> Must read [Difference Between Interest Rate and Cash Rate](#)

## DIFFERENTIAL RATE OF INTEREST

### ELIGIBILITY

- Individuals whose family income does not exceed Rs. 18000 per annum in Rural areas and Rs. 24000 per annum in Urban and Semi Urban Areas
- Individual whose land holding does not exceed 1 acre of irrigated and 2.5 acres of un-irrigated land
- No ceiling for SC/ST engaged in allied activities
- People engaged in Cottage and Rural industries
- Physically handicapped pursuing gainful occupation
- Orphanages and women's home
- State owned corporations /cooperative societies including State corporations for supreme Court / ST's /co-operative societies, large sized Adivasi Multipurpose Co-operative Societies for Tribal areas

### PURPOSE OF LOAN

For productive Activities, pursuing higher, education by indigent students, purchase of artificial limbs, hearing aids, wheel chair by physically handicapped.

## AMOUNT

Maximum Rs. 15000, for physically handicapped additional loan Rs. 5000 for artificial limbs / Braille typewriter. Loan up to Rs. 20000 for housing to SC/ST and under INDIRA AWAS YOJANA

## TARGET

- Minimum 40% to SC/ST beneficiaries
- 2/3rd to be routed through rural and semi-urban branches

**CLASSIFICATION** - Weaker Section advances

**SUBSIDY / MARGIN** - No subsidy. No Margin

## SECURITY

- Hypothecation of assets created out of bank loan
- No collateral security

## REPAYMENT

Depending upon income generated maximum of 5 years including grace period up to 2 years depending upon the type of activity and income generation.