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MCLR Report

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Overview of MCLR

- MCLR stands for marginal cost of lending rate. From April 1 2016,all loans will be linked to MCLR in place of base rate. RBI introduced MCLR based loans to ensure quicker transmission of rate changes to loan borrowers. MCLR requirements will be applicable only to banks and not NBFC.

- It is the new benchmark lending rate at which banks will now lend to new borrowers. Till 31 March 2016, banks used base rate as the benchmark rate to lend. While MCLR will be the benchmark rate for new borrowers, for existing borrowers, the base rate regime will continue. MCLR is closely linked to the actual deposit rates. Banks have to publish at least five MCLR rates (overnight, one-month, three-month, six-month and one-year). Banks are also free to set rates for longer durations, such as two and three years.

- All floating rate loans will be linked to MCLR. “This includes home loans, loan against property and many of the corporate term loans. Those such as car and personal loans, which are fixed rate loans, will not be linked to MCLR.

- MCLR is built on four components—marginal cost of funds, negative carry on account of cash reserve ratio (CRR), operating costs and tenor premium. Marginal cost of funds is the marginal cost of borrowing and return on net worth for banks. The operating cost includes cost of providing the loan product including cost of raising funds. Tenor premium arises from loan commitments with longer tenors. According to brokerage and investment group CLSA, the source of funding for a bank is based on actual domestic funding mix. MCLR is closely linked to the actual deposit rates. “If one-year term deposit is at 7.50%. Then one-year MCLR will be 7.50% plus CRR, operation cost and tenor premium,”.

- The Reserve Bank of India (RBI) has asked banks to set at least five MCLR rates—overnight, one month, three month, six month and one year. Besides these, banks are free to set rates for longer durations as well. The rates have to be reviewed on a monthly basis, but banks that don’t have the capacity to do monthly reviews on can do so quarterly till March 2017. MCLR-linked loans will be reset for a maximum of one year. So, you will have a new interest rate on your home loan at a pre-decided time and for a maximum period of one year.

Source: Destimoney Research

How does it affect rates

❑**How MCLR is different from base rate?**

The base rate or the standard lending rate by a bank is calculated on the basis of the following factors:

- Cost for the funds (interest rate given for deposits),
- Operating expenses,
- Minimum rate of return (profit), and
- Cost for the CRR (for the four percent CRR, the RBI is not giving any interest to the banks)

On the other hand, the MCLR is comprised of the following are the main components.

- Marginal cost of funds;
- Negative carry on account of CRR;
- Operating costs;
- Tenor premium

It is very clear that the CRR costs and operating expenses are the common factors for both base rate and the MCLR. The factor minimum rate of return is explicitly excluded under MCLR.

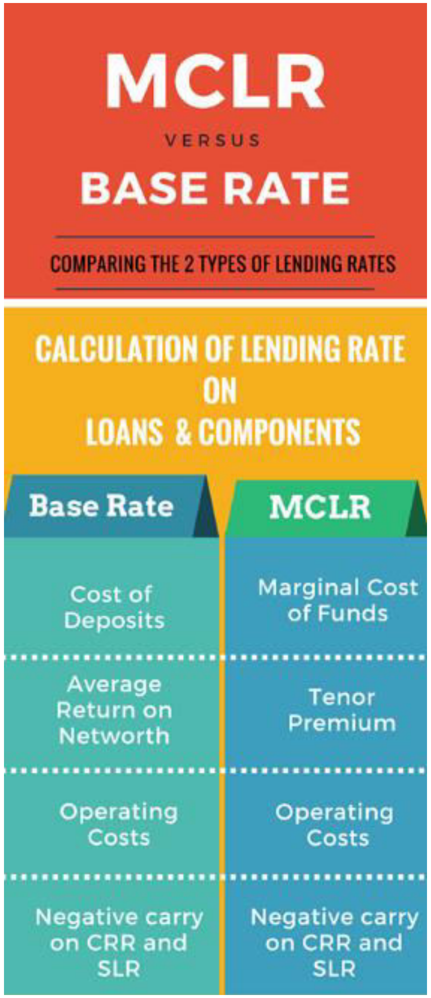
But the most important difference is the careful calculation of Marginal costs under MCLR. On the other hand under base rate, the cost is calculated on an average basis by simply averaging the interest rate incurred for deposits. The requirement that MCLR should be revised monthly makes the MCLR very dynamic compared to the base rate.

❑For existing borrowers, falling interest rates will yield a higher and quicker benefit if their loan is linked to the MCLR. But when the cycle reverses, a rising interest rate scenario will benefit borrowers with base rate-linked loans. New borrowers, in any case, do not have any option. Their loan will be linked to the MCLR. But before zeroing in on a loan, compare the tenure for reset of rates and the MCLR spread.

❑The reduction in the MCLR is expected to positively impact loan growth both in the retail consumer segment and in corporate sector lending, thereby supporting growth impulses in the economy

Source: Destimoney Research

MCLR vs Base Rate and how rate cut effects lending rates



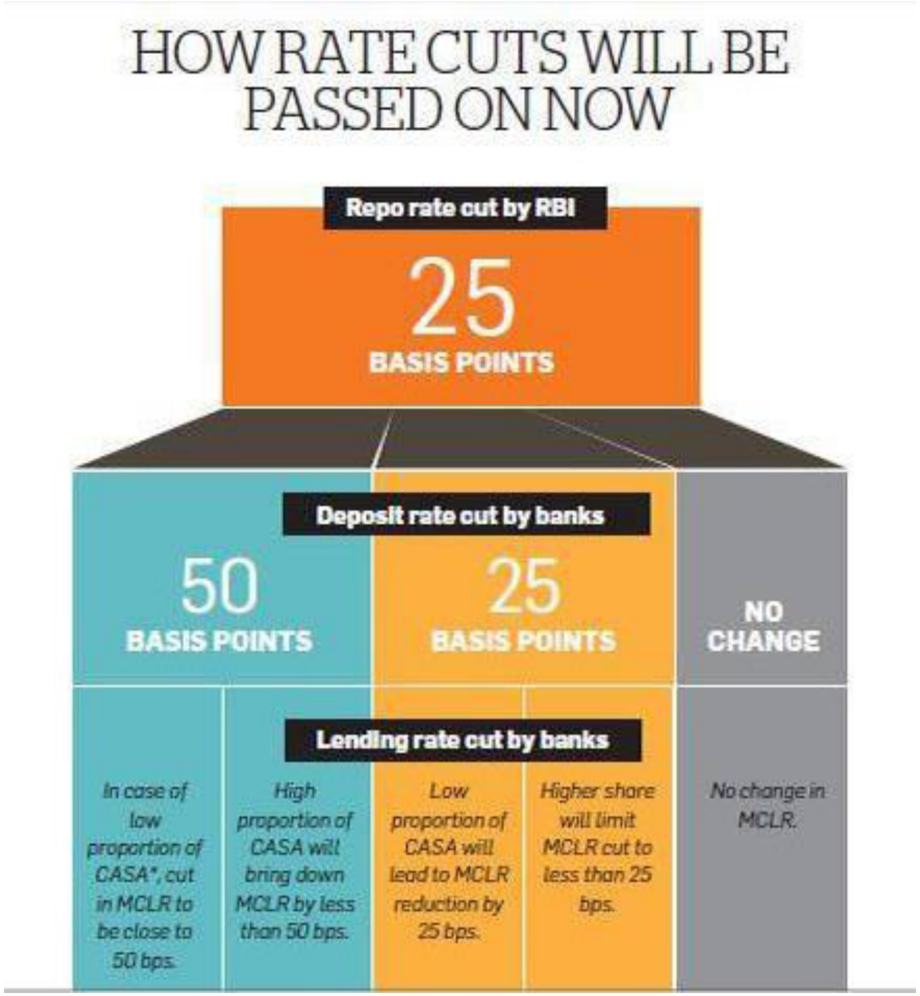


Image curtsey: Loanyantra and Economictimes

Source: Destimoney Research

Latest update in MCLR as on 1st January 2017

Sr.No.	Company Name	Latest Update	MCLR rate cut (bps) in 2017	Overnight	1 month MCLR	3 month MCLR	6 Month MCLR	1 year MCLR	2 year MCLR	3 year MCLR
1	State Bank of India	1st Jan 2017	90	7.75%	7.85%	7.90%	7.95%	8.00%	8.10%	8.15%
2	Punjab National Bank	1st Jan 2017	70	8.20%	8.25%	8.35%	8.40%	8.45%	-	8.60%
3	Union Bank of India	1st Jan 2017	65-90	8.15%	8.35%	8.40%	8.50%	8.65%	8.70%	8.75%

Source: Destimoney Research

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