

## Banks

### Pricing of Credit 101

#### Key Takeaway

**RBI released a 115-page report addressing fair credit pricing, stickiness of lending rates, customer discrimination etc. We look at some of the key recommendations below. To what extent RBI will approve these recommendations and to what extent it changes pricing behavior is hard to guess at this point. Needless to say, all RBI efforts, including introduction of term-repo, aim to make the policy rate to lending transmission seamless.**

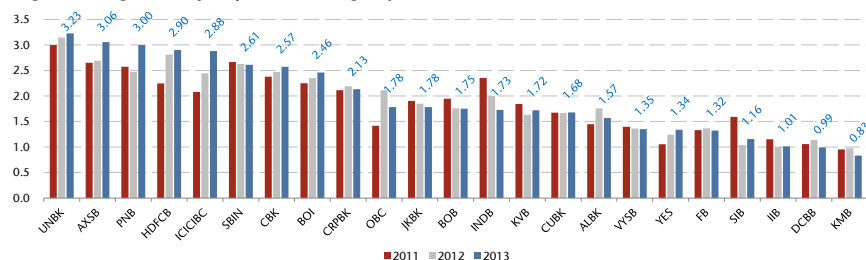
**Banks with lower wtd. avg. maturity of deposits should compute Base rate on marginal cost of funds.** In our view, these will typically be smaller banks and banks with lower CASA ratio. Recall, CASA deposits are generally placed at higher maturity buckets based on their behavior.

**Banks' boards must ensure that differentiation between new and old customers owing to changing deposit profiles and wtd. avg. cost of funds based on cost-plus pricing, does not lead to discrimination.** In short, if the credit profile of one customer is the same as the next, the loan spread over either a Base rate or any other benchmark rate can't be different between them. While at first glance this looks onerous, the Working Group (WG) has allowed leeway to banks such that they may delineate and introduce price points for softer aspects like competition, market share, future business potential from a customer etc., should they want to differentiate between customers of equal credit strength.

**Lending rate reset periodicity to take effect only on preset dates irrespective of the change in Base rate in between preset dates.** This seemed a tad bit unfair in our view, and banks would have to do effective ALM management through rate-futures, etc.. However, banks may mitigate this risk by scheduling high frequency reset dates (e.g. every 15 or 30 days) to reduce the lag in pricing.

**IBBR (Indian Banks Base Rate) to be used as new benchmark for pricing retail loans, starting with home loans.** This will be a derived index from the Base rate of a sample of 30+ banks. Banks will have to price loans linked to IBBR provided the initial rate is higher than their individual Base rate. We wonder if this will be efficient and banks with a better/cheaper fund base will gain at the cost of smaller banks. For example, should short term rates go up, smaller banks will need to raise their Base rates much more than a CASA bank. The same home loan will attract a higher spread over fund cost at a better CASA bank and vice-versa.

Weighted average maturity (deposit+borrowing) in years



Source: Jefferies estimates, company data

Nilanjan Karfa \*

Equity Analyst

+91 22 4224 6118 nkarfa@jefferies.com

\* Jefferies India Private Limited

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- Bank of Baroda (BOB IN: INR787.10, HOLD)
- HDFC Bank (HDFCB IN: INR739.40, BUY)
- ICICI Bank (ICICIB IN: INR1,247.35, BUY)

## Financials

Banks

10 April 2014

- IndusInd Bank Limited (IIB IN: INR512.20, BUY)
- Kotak Mahindra Bank Limited (KMB IN: INR784.55, HOLD)
- Punjab National Bank (PNB IN: INR782.55, UNDERPERFORM)
- State Bank of India (SBIN IN: INR2,028.05, UNDERPERFORM)

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Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
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UNDERPERFORM	150	8.25%	5	3.33%

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