

INDIA LEGAL UPDATE

August 25, 2023

RBI issues Instructions for the adoption of Fair Lending Practice by NBFCs, Banks, etc.

Notification Date:
August 18, 2023
Effective Date:
January 1, 2024
Legal Framework:
Banking Regulation Act, 1949 Reserve Bank of India Act, 1934
Government Authority:
Reserve Bank of India
Weblink:
RBI Notification

BACKGROUND

Under the extant guidelines, lending institutions have the operational autonomy to formulate board-approved policy for the levy of penal rates of interest. It has been observed by the RBI (Reserve Bank of India) that many REs (Regulated Entities) use penal rates of interest, over and above the applicable interest rates in case of defaults / non-compliance by the borrower with the terms on which credit facilities were sanctioned that leads to customer grievances and disputes. The detailed instructions for the adoption of fair lending price by the REs are summarised hereunder.

APPLICABILITY

- All Commercial Banks (including Small Finance Banks, Local Area Banks and Regional Rural Banks, excluding Payments Banks);
- All Primary (Urban) Co-operative Banks;
- **All NBFCs [Non-Banking Financial Companies] (including HFCs); and**
- All India Financial Institutions (EXIM Bank, NABARD, NHB, SIDBI and NaBFID)

LEGAL UPDATE

On a review of practices adopted by the REs, RBI has issued the instructions for the **Non-Banking Financial Company** thereby amending the following Master Directions:

- *NBFC – Non-Systematically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016*
- *NBFC - Systematically Important Non-Deposit taking Company and Deposit-Taking Company (Reserve Bank) Directions, 2016*

Instructions for charging Penal Interest / Penal Charges for Loan Accounts

- Penalty, if charged, for non-compliance shall be treated as '*penal charges*' and not as 'penal interest'.
- There shall be no capitalisation of penal charges i.e., no further interest computed on such charges.
- REs shall not introduce any additional component to the rate of interest.
- REs shall formulate a *board-approved policy* on penal charges or similar charges on loans.
- The quantum of penal charges shall be *reasonable and commensurate* with the non-compliance of material terms and conditions of the loan contract.
- The penal charges in case of loans sanctioned to 'individual borrowers, for purposes other than business', *shall not be higher than* the penal charges applicable to non-individual borrowers for similar non-compliance.
- The quantum and reason for penal charges shall be *clearly disclosed* to the customers in the loan agreement.
- Important terms and conditions / Key Fact Statement to be *displayed on the RE website* under Interest rates and Service Charges.
- Along with the reminders for non-compliance with material terms and conditions of loans to borrowers, the applicable penal charges shall also be *communicated*.
- Any instance of levy of penal charges along with the reason shall also be communicated.

Exception: These instructions shall not apply to credit cards, ECBs, trade credits and structured obligations that are covered under product-specific directions.

REs must carry out appropriate revisions in the policy framework and ensure implementation of the instructions in respect of the fresh loans availed / renewed from the effective date.

In the case of existing loans, the switchover to the new penal charges regime shall be ensured on the next review or renewal date or six months from the effective date of this circular, whichever is earlier.

The revised fair lending practices seek to set boundaries on the autonomy of lending institutions to apply disproportionately high-interest rates in case of non-compliance / borrower failure. It is a regulatory step towards promoting fairness and transparency in the lending domain and these instructions aim to safeguard borrowers from unreasonable and capricious punitive interest rates.

Queries?

If you have any queries about this article, please reach out to our experts:



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