

INDIA LEGAL UPDATE

January 30, 2024

RBI releases FAQs on Instructions for the adoption of Fair Lending Practice by NBFCs, Banks, etc.

Notification Date:
January 16, 2024
Effective Date:
January 16, 2024
Legal Framework:
Reserve Bank of India Act, 1934; Banking Regulations Act,
Government Authority:
Reserve Bank of India (RBI)
Weblink:
RBI Notification dated August 18, 2023
RBI Notification dated December 29, 2023
FAQs

LEGAL UPDATE

Target: All Non-Banking Financial Companies (NBFCs) including Housing Finance Companies

Background: The RBI in August 2023 issued instructions for the adoption of fair lending practice by NBFCs, and under the extant instructions, lending institutions may formulate a board-approved policy for the levy of penal rates of interest. The main purpose of formulating these guidelines is that many Regulated Entities (Res) were using penal rates of interest, over and above the applicable interest rates in case of defaults / non-compliance by the borrower.

As per these instructions, the quantum of penal charges shall be reasonable and proportionate to the non-compliance of the material terms and conditions of the loan contract. Further, the quantum and reason for penal charges must be clearly disclosed to the customers in the loan agreement

Extension of Timeline:

The initial effective date was January 1, 2024.

- **In case of Fresh Loans:** Extended timeline April 1, 2024
- **In case of Existing Loans:** The switchover to the new penal charges regime shall be ensured on the next review / renewal date falling after April 1, 2024, but before June 30, 2024.

FREQUENTLY ASKED QUESTIONS

In furtherance to that, RBI has now issued Frequently Asked Questions (FAQs) to provide clarifications related to the implementation of the circular.

1. Whether in case of a switchover to a new penal charges regime shall be counted only after the effective date OR even before the effective date if the accounts are subjected to review/ renewal?

Ans. In the case of existing loans as well, the instructions become effective from April 1, 2024. Hence, the switchover to the new penal charges regime shall be counted on or after April 1, 2024, but before June 30, 2024.

2. What could be material terms and conditions in case of penal charges for non-compliance of loan contracts by the borrower?

Ans. The material terms and conditions may be defined, if not already done, as per the credit policy of the bank. It may also vary from one category of loan to another, and from lender to lender based on their own assessment.

3. Whether these guidelines will also be applicable in case of default in repayment by the borrower? If yes, whether the penal charges in such cases shall be based on the default amount or outstanding amount?

Ans. If charged, it may only be levied in the form of penal charges and not penal interest. Penal charges must be reasonable and levied only on the amount under default in a non-discriminatory manner as per the board approved policy. There must be no capitalization of the penal charges i.e., no further interest computed on such charges.

4. Whether the interest charged for the default period (including in case of unpaid EMI) to be treated as penal interest or regular/overdue interest?

Ans. REs may charge interest on unpaid interest (including on unpaid EMI) at the contracted rate of interest till the date of remediation.

5. Can the penal charges be different within the same product category depending upon the amount of loan?

Ans. Yes. REs may formulate an appropriate Board approved policy and adopt a suitable structure of penal charges that is 'reasonable' and 'commensurate'.

6. If the schedule of penal charges is displayed on the website of the RE and only a reference of the said schedule is given in the sanction letter and loan agreement issued to the customer, whether it may be treated as compliance?

Ans. No. The quantum and reason for penal charges must be clearly disclosed by REs to the customers upfront in the loan agreement and Most Important Terms & Conditions (MITC) / Key Fact Statement (KFS), as applicable.

7. Is there any upper limit/cap for charging penal charges?

Ans. As such there is no prescribed upper limit/ cap for penal charges. The quantum of penal charges must be 'reasonable' and 'commensurate'. REs must keep in mind that the purpose of levying penal charges is to inculcate a sense of credit discipline and is not a revenue enhancement tool.

8. In case of invocation of Bank Guarantee (BG) /devolvement of Letter of Credit (LC), whether the provisions of the circular would apply on penal charges being imposed?

Ans. The bank may charge an appropriate rate of interest on the devolved amount considering the associated credit risk premium as per the bank's credit underwriting policy. However, penalty, if any, on that funded facility on account of non-repayment by the borrower within the due date may only be levied in under penal charges and not penal interest.

9. In case a loan account becomes Non-Performing Asset (NPA), whether penal charges be reversed and put in the bucket of unrealised income, or will continue as part of the outstanding in the account?

Ans. In respect of NPA accounts, penal charges shall be reversed for the uncollected amount for the specific purpose of non-recognition of income. It will be part of the total liability of the borrower to the lender, unless it is waived as per the bank's Board approved policy.

10. Whether RBI has specified any accounting process as well for crediting such penal charges?

Ans. Banks will disclose fees and charges, including penal charges, recovered from customers in 'Schedule 14: Other Income' as defined under Annexure II of the RBI Master Directions (Financial Statements - Presentation and Disclosures) Directions, 2021.

11. The structure of penal charges in the same category of loan/product shall be uniform or not for all borrowers, i.e. individual & non-individual: YES

12. If penal charges are not paid, whether fresh penal charges can be levied on the earlier outstanding amount of penal charges: NO

13. Instructions on penal charges are applicable:

- In case of securitisation and co-lending portfolios - YES
- In case of rupee/ foreign currency export credit and other foreign currency loans - NO

14. Are Cash Credit and Overdraft (OD) facilities exempted or not from these guidelines?

Ans. Applicable to all credit facilities except those specifically exempted in the circular.

15. GST applicability on penal charges: Since instructions related to GST are issued by the Central Board of Indirect Taxes & Customs (CBIC), instructions and clarifications, if any, CBIC may issue clarification in this regard.

Queries?

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



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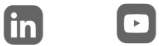
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