RBI UPDATES

1) Fair Lending Practice - Penal Charges in Loan Accounts.

On August 18, 2023, RBI vide **Notification No. RBI/2023-24/53 DoR.MCS.REC.28/01.01.001/2023-24** addressed to 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 (including HFCs) and All India Financial Institutions (EXIM Bank, NABARD, NHB, SIDBI and NaBFID) (together "**Regulated Entities**"), issued instructions with respect to levy of penal interest/charges on loans in case of defaults / non-compliance by the borrower with the terms on which credit facilities were sanctioned.

To ensure reasonableness and transparency in disclosure of penal interest, RBI has issued various guidelines. Under the extant guidelines, lending institutions have the operational autonomy to formulate Board approved policy for levy of penal rates of interest.

The intent of levying penal interest/charges is essentially to inculcate a sense of credit discipline. However, on a review of the practices followed by Regulated Entities it has been observed that Regulated Entities are charging penal interest/charges over and above the contracted rate, thereby using it as a tool of revenue enhancement. The said practices have given rise to customer grievances and disputes.

In the view of the above, RBI has issued the following instructions which shall be adopted by the regulated entities, which are briefly specified as follows:

1. Penalty on non-compliance of material terms and conditions shall be **treated as penal charges**. It shall **not be levied in the form of 'penal interest'** that is added to the rate of interest charged on the advances and there shall be **no capitalisation of penal charges**. However, this will not affect the normal procedures for compounding of interest in the loan account;
2. The Regulated Entities **shall not introduce any additional component** to the rate of interest;
3. There shall be a **Board approved Policy** on penal charges or similar charges on loan;
4. **Quantum** of penal charges shall be **commensurate** with the **non-compliance** of material terms & conditions of loan contract;
5. 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 of material terms and conditions;
6. The **Quantum** and **Reason** of penal charges shall be displayed on Regulated Entities website under Interest rates and Service Charges and also **clearly disclosed** in the **loan agreement** and most **important terms & conditions / Key Fact Statement (KFS)** as applicable;
7. The **Applicable penal charges** shall also be **communicated** to the borrower when reminder calls for non-compliance of material terms & conditions are made;

8. These instructions shall come into effect from January 1, 2024. Regulated Entities may carry out appropriate revisions in their policy framework and ensure implementation of the instructions in respect of all the fresh loans availed/ renewed from the effective date. In the case of existing loans, the switchover to new penal charges regime shall be ensured on next review or renewal date or six months from the effective date of this circular, whichever is earlier.
9. These instructions shall not apply to Credit Cards, External Commercial Borrowings, Trade Credits and Structured Obligations which are covered under product specific directions

The link for the aforesaid Notification is as follows:
https://rbidocs.rbi.org.in/rdocs/notification/PDFs/FAIRLENDINGPRACTICE1B9DBE75410B4DA881E6EF953304B6F7.PDF

2) Reset of Floating Interest Rate on Equated Monthly Instalments (EMI) based Personal Loans.

In cases of EMI based floating rate personal loans, the lenders are required to take into account the repayment capacity of borrowers to ensure that adequate headroom/ margin is available for elongation of tenor and/ or increase in EMI, in the scenario of possible increase in the external benchmark rate during the tenor of the loan.

Several consumer grievances has been related to elongation of loan tenor and/or increase in EMI amount in the wake of rising interest rates, without proper communication with and/or consent of the borrowers.

On August 18, 2023 RBI vide **Notification No. RBI/2023-24/55 DOR.MCS.REC.32/01.01.003/2023-24** addressed to All Scheduled Commercial Banks, Regional Rural Banks, Primary (Urban) Co-operative Banks State Co-operative Banks and District Central Co-operative Banks, Non-Banking Financial Companies (including Housing Finance Companies) (together "**Regulated Entities**"), issued Advisory to put in place an appropriate policy framework to address the concerns of consumer with regards elongation of loan tenor and/or increase in EMI amount, without proper communication with and/or consent of the borrowers in cases of EMI based floating rate personal loans.

The said policy framework shall meet the following requirements:

1. Regulated Entities shall clearly communicate to the borrower about the **possible impact of change** in benchmark interest rate on the loan leading to changes in EMI and/or tenor or both. and **any subsequent increase shall be communicated to the borrower immediately**;
2. At the time of reset of interest rates, Regulated Entities shall provide the **option to the borrowers to switch over** to a fixed rate as per their Board approved policy. The said policy shall also specify, inter-alia, the number of times a borrower will be allowed to switch over;

3. The borrowers shall be given the **choice to opt** for:
   (i) enhancement in EMI or elongation of tenor or for a combination of both options; and,
   (ii) to prepay, either in part or in full, at any point during the tenor of the loan subject to levy of foreclosure charges or pre-payment penalty subject to extant instructiuons;
4. All **applicable charges** for switching of loans from floating to fixed rate and any other incidental charges/costs thereto shall be **transparently disclosed** in the sanction letter and also at the time of revision of such charges/ costs by the Regulated Entities from time to time.
5. Regulated Entities shall ensure that the **elongation of tenor** in case of floating rate loan **does not result in negative amortization.**
6. Regulated Entities shall share / make accessible to the borrowers, **Quarterly statement** giving details of the principal and interest recovered till date, EMI amount, number of EMIs left and annualized rate of interest / Annual Percentage Rate (APR) for the entire tenor of the loan. The Regulated Entities shall ensure that the statements are **simple and easily understood** by the borrower.

The above instructions would also apply mutatis mutandis to all equated instalment based loans of different periodicities. In case of loans linked to an external benchmark under the External Benchmark Lending Rate (EBLR) regime, the banks should follow extant instructions and also put in place adequate information systems to monitor transmission of changes in the benchmark rate to the lending rate.

REs shall ensure that the above instructions are extended to the existing as well as new loans suitably by **December 31, 2023.**

All existing borrowers shall be sent a communication, through appropriate channels, intimating the options available to them.

The link for the aforesaid Notification is as follows:
https://rbidocs.rbi.org.in/rdocs/notification/PDFs/EMILOANCIRCULARBC3C67A8D4554B35BEDF51A6C10DF92C.PDF

3) Revised Regulatory Framework for IDF-NBFCs

Pursuant to review of guidelines applicable to Infrastructure Debt Fund-NBFCs (IDF-NBFCs), on **August 18, 2023,** RBI vide Notification No. RBI/2023-24/54 DoR.SIG.FIN.REC.31/03.10.001/2023-24, issued **a revised regulatory framework** for IDF-NBFCs, to enable them to play a greater role in the financing of the infrastructure sector and to harmonise the regulations governing financing of infrastructure sector by the NBFCs. The said notification shall come into effect from the aforementioned date.

The revised regulatory framework for IDF-NBFCs provides for the following*:*
1. Definition of IDF-NBFCs;
2. Requirement of Net owned funds (NOF) and regulatory capital by IDF-NBFCs;
3. Raising of funds;
4. Exposure Limits;

5. Risk weights;
6. Requirements of a sponsor and tripartite agreement;
7. Other regulatory norms;
7. Guidelines governing sponsorship of IDF-MFs by NBFCs.

The link for the aforesaid Notification is as follows:
https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NT546A88045446F94BF6B8E5B3CE59E8FB53.PDF

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