

# RBI proposes threshold for penal charges on loans by banks, NBFCs

Individual fine amounts cannot be higher than non-individual borrowers

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The Reserve Bank of India (RBI) has announced draft norms on penal charges levied by banks and non-banking finance companies (NBFCs) on loan accounts to bring in transparency and to ensure such charges are reasonable.

The regulator said the quantum of charges should be proportionate to default, for which threshold has to be determined by regulated entities. "The quantum of penal charges shall be proportional to defaults/non-compliance of material terms and conditions of loan contract beyond a threshold. This threshold is to be determined by the regulated entities and shall not be discriminatory within a particular loan/product category," the draft norms said.

The regulator has man-



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dated that penal charges on loans sanctioned to individual borrowers, for purposes other than business, must not be higher than the penal charges applicable to non-individual borrowers.

The RBI has said penal charges are not meant to be used as a revenue enhancement tool over and above the contracted rate of interest.

"...supervisory reviews have indicated divergent practices

amongst the regulated entities with regard to levy of penal interest/charges leading to customer grievances and disputes," the RBI said.

The RBI said it has observed that many REs 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. The regulator said default or non-compliance by the borrower should be treated as penal charges, and should not be levied in the form of "penal interest" that is added to the rate of interest charged on the advances.

"There shall be no capitalisation of penal charges, ie, no further interest computed on such charges," the draft said.

The norms will not be applicable for credit cards, which are covered under product-specific

directions. Banks and NBFCs have been allowed to change credit risk premium, if the risk profile of the borrower changes.

The regulated entities should ensure that there is a clearly laid down board-approved policy on penal or similar charges on loans, by whatever name called, the RBI said.

"Whenever reminders for payment of instalments are sent to borrowers, the applicable penal charges shall also be communicated," the draft norms said.

Feedback on the draft norms can be sent by May 15, 2023. "These instructions shall come into effect from a date to be indicated in the final circular and regulated entities may carry out appropriate revisions in their policy framework and ensure implementation from the effective date," the draft norms said.