

DRAFT CIRCULAR FOR COMMENTS

RBI/2023-24/

DoR.MCS.REC./01.01.001/2023-24

April 12, 2023

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)

Dear Sir / Madam,

Fair Lending Practice - Penal Charges in Loan Accounts

Reserve Bank has issued various guidelines to the Regulated Entities (REs) to ensure reasonableness and transparency in disclosure of penal interest. Under the extant guidelines, lending institutions have the operational autonomy to formulate Board approved policy for levy of penal rates of interest. It has been 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.

2. The intent of levying penal interest/charges is essentially to inculcate a sense of credit discipline among borrowers through negative incentives and to ensure fair compensation to the lender. Penal interest/charges are not meant to be used as a revenue enhancement tool over and above the contracted rate of interest. However, supervisory reviews have indicated divergent practices amongst the REs with regard to levy of penal interest/charges leading to customer grievances and disputes.

3. On a review of the practices followed by REs for charging penal interest/charges on loans, the following instructions are issued for adoption.

(i) Determination of interest rates on credit facilities, including conditions for reset of interest rates, will be strictly governed by the relevant regulatory instructions issued in this regard. REs shall not introduce any additional component to rate of interest.

(ii) Penalty, if charged, for default / non-compliance of material terms and conditions of loan contract by the borrower shall be treated as 'penal charges' and shall 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, i.e, no further interest computed on such charges. However, this will not affect the normal procedures for compounding of interest in the loan account.

(iii) It needs to be recognised that the rate of interest on a loan includes appropriate credit risk premium reflecting the credit risk profile of the borrower. If the credit risk profile of the borrower undergoes change, REs will be free to alter credit risk premium as per the contracted terms and conditions, in terms of extant instructions.

(iv) The quantum of penal charges shall be proportional to the defaults/ non-compliance of material terms and conditions of loan contract beyond a threshold. This threshold is to be determined by the REs and shall not be discriminatory within a particular loan / product category.

(v) 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.

(vi) Penal charges and the conditions precedent therefor, shall be clearly disclosed by REs to the customers in the loan agreement and most important terms & conditions / Key Fact Statement (KFS) as applicable, in addition to being displayed on REs website under Interest rates and Service Charges.

(vii) Whenever reminders for payment of instalments are sent to borrowers, the applicable penal charges, shall also be communicated.

(viii) The REs shall ensure that there is a clearly laid down Board approved policy on penal charges or similar charges on loans, by whatever name called.

(ix) The operationalisation of the 'penal charges' in place of 'penal interest' will be subject to appropriate review during supervisory examination by the RBI.

(x) These instructions shall come into effect from a date to be indicated in the final circular and REs may carry out appropriate revisions in their policy framework and ensure implementation from the effective date.

4. The above instructions shall not apply to Credit Cards which are covered under product specific directions.

5. Accordingly, the sections of relevant Master Directions, have been amended. The additional instructions applicable in respect of the paragraphs of the related Master Circulars are also provided in the [Annex](#).

Yours faithfully,

(Santosh Kumar Panigrahy)
Chief General Manager

Encl: As above

I. Amendments to the relevant Master Directions		
S. No.	Existing Section	Amended Section
A. Master Direction – Reserve Bank of India (Interest Rate on Advances) Directions, 2016 dated March 03, 2016		
5	Banks shall formulate a Board approved policy for charging penal interest on advances which shall be fair and transparent. The rate of penal interest shall be decided after taking into account incentive to service the debt and due regard to genuine difficulties of customers.	<i>deleted</i>
	Provided that no penal interest shall be charged on advances mentioned in the circular RPCD.Plan.BC.15/04.07.01/2001-02 dated August 17, 2001, as amended from time to time.	<i>deleted</i>
B. Master Direction – Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 dated September 1, 2016		
29	As complaints received against NBFCs generally pertain to charging of high interest / penal interest, applicable NBFCs shall mention the penal interest charged for late repayment in bold in the loan agreement.	<p>As complaints received against NBFCs generally pertain to charging of high interest / penal charges, applicable NBFCs shall mention the penalties charged for late repayment in bold in the loan agreement.</p> <p>Determination of interest rates on credit facilities, including conditions for reset of interest rates, will be strictly governed by the relevant regulatory instructions issued in this regard. REs shall not introduce any additional component to rate of interest.</p> <p>Penalty, if charged, for default/ non-compliance of material terms and conditions of loan contract by the borrower shall be treated as penal charges and shall not be levied in the form of penal interest that is</p>

		added to the rate of interest charged on the advances.
Sub - Sect ion 36(4)	(New sub-Section inserted)	<p>There shall be a clearly laid down Board approved policy on penal charges or similar charges on loans, by whatever name called.</p> <p>It needs to be recognised that the rate of interest on a loan includes appropriate credit risk premium reflecting the credit risk profile of the borrower. If the credit risk profile of the borrower undergoes change, REs will be free to alter credit risk premium as per the contracted terms and conditions, in terms of extant instructions.</p> <p>The quantum of penal charges shall be proportional to the defaults/ non-compliance of material terms and conditions of loan contract beyond a threshold. This threshold is to be determined by the REs and shall not be discriminatory within a particular loan / product category.</p> <p>There shall be no capitalisation of penal charges i.e, no further interest computed on such charges. However, this will not affect the normal procedures for compounding of interest in the loan account.</p> <p>Further, 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.</p> <p>Penal charges, and the conditions precedent therefor, shall be clearly disclosed by REs to the customers in the loan agreement and most important terms & conditions / Key Fact Statement (KFS), as applicable, in addition to being displayed on REs website under Interest rates and Service Charges. Whenever reminders for payment of instalments are sent to borrowers, the applicable penal charges, shall also be communicated.</p> <p>The operationalisation of the 'penal charges' in place of 'penal interest' will be subject to appropriate review during supervisory examination by the RBI.</p>

C. [Master Direction - Non-Banking Financial Company -Systemically Important Non-Deposit taking Company and Deposit taking Company \(Reserve Bank\) Directions, 2016 dated September 1, 2016](#)

29	As complaints received against NBFCs generally pertain to charging of high interest / penal interest, applicable NBFCs shall mention the penal interest charged for late repayment in bold in the loan agreement.	<p>As complaints received against NBFCs generally pertain to charging of high interest / penal charges, applicable NBFCs shall mention the penalties charged for late repayment in bold in the loan agreement.</p> <p>Determination of interest rates on credit facilities, including conditions for reset of interest rates will be strictly governed by the relevant regulatory instructions issued in this regard. REs shall not introduce any additional component to rate of interest.</p> <p>Penalty, if charged, for default/ non-compliance of material terms and conditions of loan contract by the borrower shall be treated as penal charges and shall not be levied in the form of penal interest that is added to the rate of interest charged on the advances.</p>
Sub - Section 36(4)	<i>(New sub-Section inserted)</i>	<p>There shall be a clearly laid down Board approved policy on penal charges or similar charges on loans, by whatever name called.</p> <p>It needs to be recognised that the rate of interest on a loan includes appropriate credit risk premium reflecting the credit risk profile of the borrower. If the credit risk profile of the borrower undergoes change, REs will be free to alter credit risk premium as per the contracted terms and conditions, in terms of extant instructions.</p> <p>The quantum of penal charges shall be proportional to the defaults/ non-compliance of material terms and conditions of loan contract beyond a threshold. This threshold is to be determined by the REs and shall not be discriminatory within a particular loan / product category.</p> <p>There shall be no capitalisation of penal charges i.e, no further interest computed on such charges.</p>

		<p>However, this will not affect the normal procedures for compounding of interest in the loan account.</p> <p>Further, 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.</p> <p>Penal charges, and the conditions precedent therefor, shall be clearly disclosed by REs to the customers in the loan agreement and most important terms & conditions / Key Fact Statement (KFS), as applicable, in addition to being displayed on REs website under Interest rates and Service Charges. Whenever reminders for payment of instalments are sent to borrowers, the applicable penal charges shall also be communicated.</p> <p>The operationalisation of the 'penal charges' in place of 'penal interest' will be subject to appropriate review during supervisory examination by the RBI.</p>
<p>D. Master Direction - Non-Banking Financial Company – Housing Finance Company (Reserve Bank) Directions, 2021 dated February 17, 2021</p>		
74.2	<p>HFCs shall transparently disclose to the borrower all information about fees/ charges payable for processing the loan application, the amount of fees refundable if loan amount is not sanctioned/ disbursed, pre-payment options and charges, if any, penal interest/ penalty for delayed repayment, if any, conversion charges for switching loan from fixed to floating rates or vice-versa, existence of any interest reset clause and any other matter which affects the interest of the borrower.</p>	<p>HFCs shall transparently disclose to the borrower all information about fees/ charges payable for processing the loan application, the amount of fees refundable if loan amount is not sanctioned/ disbursed, pre-payment options and charges, if any, penal charges for delayed repayment, if any, conversion charges for switching loan from fixed to floating rates or vice-versa, existence of any interest reset clause and any other matter which affects the interest of the borrower.</p>

75.2	HFCs shall convey in writing to the borrower in the vernacular language or a language as understood by the borrower by means of sanction letter or otherwise, the amount of loan sanctioned along with all terms and conditions including annualized rate of interest, method of application, EMI Structure, prepayment charges, penal interest (if any) and keep the written acceptance of these terms and conditions by the borrower on its record.	HFCs shall convey in writing to the borrower in the vernacular language or a language as understood by the borrower by means of sanction letter or otherwise, the amount of loan sanctioned along with all terms and conditions including annualized rate of interest, method of application, EMI Structure, prepayment charges, penal charges (if any) and keep the written acceptance of these terms and conditions by the borrower on its record.
76.2	The HFCs shall give notice to the borrower in the vernacular language or a language as understood by the borrower of any change in the terms and conditions including disbursement schedule, interest rates, penal interest (if any), service charges, prepayment charges, other applicable fee/ charges etc.	The HFCs shall give notice to the borrower in the vernacular language or a language as understood by the borrower of any change in the terms and conditions including disbursement schedule, interest rates, penal charges (if any), service charges, prepayment charges, other applicable fee/ charges etc.
80.1	The Board of the HFC shall also have clearly laid down policy for penal interest/ charges (if any).	The Board of the HFC shall also have clearly laid down policy for penal charges (if any).
80.3	The rate of interest and penal interest (if any) must be annualised rate so that the borrower is aware of the exact rates that would be charged to the account	The rate of interest must be annualised rate so that the borrower is aware of the exact rates that would be charged to the account.
81	HFCs shall lay out appropriate internal principles and procedures in determining interest	HFCs shall lay out appropriate internal principles and procedures in determining interest rates and processing and other charges (including penal charges, if any).

	rates and processing and other charges (including penal interest, if any).	
Sub - section 81.1	<i>(New Sub-section inserted)</i>	<p>There shall be a clearly laid down Board approved policy on penal charges or similar charges on loans by whatever name called.</p> <p>Determination of interest rates on credit facilities, including conditions for reset of interest rates, will be strictly governed by the relevant regulatory instructions issued in this regard. REs shall not introduce any additional component to rate of interest.</p> <p>Penalty, if charged, for default/ non-compliance of material terms and conditions of loan contract by the borrower shall be treated as penal charges and shall not be levied in the form of penal interest that is added to the rate of interest charged on the advances.</p> <p>It needs to be recognised that the rate of interest on a loan includes appropriate credit risk premium reflecting the credit risk profile of the borrower. If the credit risk profile of the borrower undergoes change, REs will be free to alter credit risk premium as per the contracted terms and conditions, in terms of extant instructions.</p> <p>The quantum of penal charges shall be proportional to the defaults/ non-compliance of material terms and conditions of loan contract beyond a threshold. This threshold is to be determined by the REs and shall not be discriminatory across a particular loan / product category.</p> <p>There shall be no capitalisation of penal charges i.e, no further interest computed on such charges. However, this will not affect the normal procedures for compounding of interest in the loan account.</p> <p>Further, the penal charges in case of loans sanctioned to individual borrowers, for purposes other than business, shall not be higher than the</p>

		<p>penal charges applicable to non-individual borrowers.</p> <p>Penal charges and the conditions precedent therefor, shall be clearly disclosed by REs to the customers in the loan agreement and most important terms & conditions / Key Fact Statement (KFS), as applicable, in addition to being displayed on REs website under Interest rates and Service Charges. Whenever reminders for payment of instalments are sent to borrowers, the applicable penal charges, shall also be communicated.</p> <p>The operationalisation of the 'penal charges' in place of 'penal interest' will be subject to appropriate review during supervisory examination.</p>
82.3	HFCs shall provide information on interest rates, common fees and charges (including penal interest, if any) through putting up notices in their branches; through telephone or help-lines; on the company's website; through designated staff/ help desk; or providing service guide/ tariff schedule.	HFCs shall provide information on interest rates, common fees and charges (including penal charges, if any) through putting up notices in their branches; through telephone or help-lines; on the company's website; through designated staff/ help desk; or providing service guide/ tariff schedule.
85.9	Display of various key aspect such as service charges, interest rates, Penal interest (if any), services offered, product information, time norms for various transactions and grievance redressal mechanism, etc. is required to promote transparency in the operations of HFCs.	Display of various key aspect such as service charges, interest rates, penal charges (if any), services offered, product information, time norms for various transactions and grievance redressal mechanism, etc. is required to promote transparency in the operations of HFCs.

II. Instructions in addition to the paragraphs of the related Master Circulars		
E. Master Circular- Management of Advances – UCBs dated July 1, 2015		
S. No.	Existing Paragraph	Additional instructions that shall apply
		<p>There shall be a clearly laid down Board approved policy on penal charges or similar charges on loans, by whatever name called.</p> <p>Determination of interest rates on credit facilities, including conditions for reset of interest rates, will be strictly governed by the relevant regulatory instructions issued in this regard. REs shall not introduce any additional component to rate of interest.</p> <p>Penalty, if charged, for default/ non-compliance of material terms and conditions of loan contract by the borrower shall be treated as penal charges and shall not be levied in the form of penal interest that is added to the rate of interest charged on the advances.</p> <p>It needs to be recognised that the rate of interest on a loan includes appropriate credit risk premium reflecting the credit risk profile of the borrower. If the credit risk profile of the borrower undergoes change, REs will be free to alter credit risk premium as per the contracted terms and conditions, in terms of extant instructions.</p> <p>The quantum of penal charges shall be proportional to the defaults / non-compliance of material terms and conditions of loan contract beyond a threshold. This threshold is to be determined by the REs and shall not be discriminatory across a particular loan / product category.</p> <p>There shall be no capitalisation of penal charges i.e, no further interest computed on such charges. However, this will not affect the normal procedures for compounding of interest in the loan account.</p> <p>Further, the penal charges in case of loans</p>

		<p>sanctioned to individual borrowers, for purposes other than business, shall not be higher than the penal charges applicable to non-individual borrowers.</p> <p>Penal charges and the conditions precedent therefor, shall be clearly disclosed by REs to the customers in the loan agreement and most important terms & conditions / Key Fact Statement (KFS), as applicable, in addition to being displayed on REs website under Interest rates and Service Charges.</p> <p>Whenever reminders for payment of instalments are sent to borrowers, the applicable penal charges, shall also be communicated.</p> <p>The operationalisation of the 'penal charges' in place of 'penal interest' will be subject to appropriate review during supervisory examination by the RBI.</p>
F. Master Circular- Customer Service in Banks dated July 1, 2015		
Paragraph 6	Levy of service charges	<p>It shall be ensured that there is a clearly laid down Board approved policy on penal charges or similar charges on loans, by whatever name called.</p> <p>Penalty, if charged, for default/ non-compliance of material terms and conditions of loan contract by the borrower shall be treated as penal charges and shall not be levied in the form of penal interest that is added to the rate of interest charged on the advances.</p> <p>It needs to be recognised that the rate of interest on a loan includes appropriate credit risk premium reflecting the credit risk profile of the borrower. If the credit risk profile of the borrower undergoes change, REs will be free to alter credit risk premium as per the contracted terms and conditions, in terms of extant instructions.</p> <p>The quantum of penal charges shall be proportional to the defaults / non-compliance of material terms and conditions of loan contract beyond a threshold. This threshold is to be determined by the REs and</p>

		<p>shall not be discriminatory across a particular loan / product category.</p> <p>There shall be no capitalisation of penal charges i.e, no further interest computed on such charges. However, this will not affect the normal procedures for compounding of interest in the loan account.</p> <p>Further, 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.</p> <p>Penal charges and the conditions precedent therefor, shall be clearly disclosed by REs to the customers in the loan agreement and most important terms & conditions/ Key Fact Statement (KFS), as applicable, in addition to being displayed on REs website under Interest rates and Service Charges.</p> <p>Whenever reminders for payment of instalments are sent to borrowers, the applicable penal charges, shall also be communicated.</p> <p>The operationalisation of the 'penal charges' in place of 'penal interest' will be subject to appropriate review during supervisory examination by the RBI.</p>
G. Master Circular - Loans and Advances - Statutory and Other Restrictions dated July 1, 2015		
Paragraph 2.5	Guidelines on Fair Practices Code for Lenders	<p>Penal charges and the conditions precedent therefor, shall be clearly disclosed by REs to the customers in the loan agreement and most important terms & conditions / Key Fact Statement (KFS), as applicable, in addition to being displayed on REs website under Interest rates and Service Charges.</p> <p>Whenever reminders for payment of instalments are sent to borrowers, the applicable penal charges, shall also be communicated.</p>