RBI takes the call on ‘penal interest: Why do borrowers feel comforted?

After a deep investigation into the banks’ lending practices, the RBI issued certain directives clearly mentioning that penal charges/interest cannot be used as additional monetary gain measures by imposing amounts atop the fixed interest rates. Taking into account the illegal practices used by banks for charging exorbitant penal rates on loan amount, a new set of rules were brought up.

Banks cannot hereafter charge any extra interest and fixing borrowing rates must follow the regulatory guidelines issued by the RBI. “Penal charges” will now replace ‘penal interest’ when a borrower defaults in terms of repayment of the loan. This is charged only once and any additional interest being charged is done away with. When considering the rate of interest for a loan profile, a proper credit risk assessment of the borrower must be done and depending on their credit scores, banks are at liberty to decide the credit risk premium. In a specific group of loans, the banks can charge multiple rates provided they follow the conditions listed in the contracts.

RBI has pinpointed that individual borrowers who have taken money for non-business purposes must be charged lesser than the rates of its corporate borrowers. All these charges under the circumstances liable must be divulged by banks with their borrowers before signing any loan agreement and every condition must be displayed on the bank’s website. Whenever payment-due notices are sent to borrowers, they must be made aware of the charges that come with them. The bank’s board must devise a strong framework for charges of loans and is required to implement it in all of its branches.

However, the RBI has also defined that these directives do not apply to credit cards as they cover multiple product specifications and are subject to further review.

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