



भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA



RBI/2023-24/53

DoR.MCS.REC.28/01.01.001/2023-24

August 18, 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)

Madam / Dear Sir,

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 and such 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) Penalty, if charged, for 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

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बैंक हिंदी में पत्राचार का स्वागत करता है

Caution: RBI never sends mails, SMSs or makes calls asking for personal information like bank account details, passwords, etc. It never keeps or offers funds to anyone. Please do not respond in any manner to such offers.

such charges. However, this will not affect the normal procedures for compounding of interest in the loan account.

(ii) The REs shall not introduce any additional component to the rate of interest and ensure compliance to these guidelines in both letter and spirit.

(iii) The REs shall formulate a Board approved policy on penal charges or similar charges on loans, by whatever name called.

(iv) The quantum of penal charges shall be reasonable and commensurate with the non-compliance of material terms and conditions of loan contract without being 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 for similar non-compliance of material terms and conditions.

(vi) The quantum and reason for penal charges 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 non-compliance of material terms and conditions of loan are sent to borrowers, the applicable penal charges shall be communicated. Further, any instance of levy of penal charges and the reason therefor shall also be communicated.

(viii) These instructions shall come into effect from January 1, 2024. REs 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.

4. The above instructions are issued under sections 21, 35A and 56 of the Banking Regulation Act, 1949, sections 45JA, 45L and 45M of the Reserve Bank of India Act, 1934, and section 30A of the National Housing Bank Act, 1987 and shall be updated in

the relevant Master Directions / Master Circulars of the applicable REs. The list of amendments to the Master Directions / Master Circulars has been provided in the [Annex](#).

5. These instructions shall, however, not apply to Credit Cards, External Commercial Borrowings, Trade Credits and Structured Obligations which are covered under product specific directions.

Yours faithfully,

(Santosh Kumar Panigrahy)
Chief General Manager

Encl: As above

I. Amendments to the relevant Master Directions		
Para No.	Existing Section	Amended Section
<u>A. Master Direction – Reserve Bank of India (Interest Rate on Advances) Directions, 2016 dated March 03, 2016</u>		
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.15/04.09. 01/2001-02 dated August 17, 2001, as amended from time to time.	<i>deleted</i>
<u>B. Master Direction – Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 dated September 1, 2016</u>		
29	Applicable NBFCs shall convey in writing to the borrower in the vernacular language as understood by the borrower by means of sanction letter or otherwise, the amount of loan sanctioned along with the terms and conditions including annualised rate of interest and method of application thereof and keep the acceptance of these terms and conditions by the borrower on its record.	Applicable NBFCs shall convey in writing to the borrower in the vernacular language as understood by the borrower by means of sanction letter or otherwise, the amount of loan sanctioned along with the terms and conditions including annualised rate of interest and method of application thereof and keep the acceptance of these terms and conditions by the borrower on its record. 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.

	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.	
	<i>(New section inserted)</i> Penal Charges in Loan Accounts	Penalty, if charged, for 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. The REs shall not introduce any additional component to the rate of interest and ensure compliance to these guidelines in both letter and spirit. The REs shall formulate a Board approved policy on penal charges or similar charges on loans, by whatever name called. The quantum of penal charges shall be reasonable and commensurate with the non-compliance of material terms and conditions of loan contract without being discriminatory within a particular loan / product category. 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. The quantum and reason for penal charges 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 non-compliance of material terms and conditions of loan are sent to borrowers, the applicable penal charges shall be communicated. Further, any instance of levy of penal charges and the reason therefor shall also be communicated. These instructions shall come into effect from January 1, 2024. REs 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 these instructions, whichever is earlier.
<u>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</u>		
29	Applicable NBFCs shall convey in writing to the borrower in the vernacular language as understood by the borrower by means of sanction letter or otherwise, the amount of loan sanctioned along with the terms and conditions including annualised rate of interest and method of application thereof and keep the acceptance of these terms and conditions by the borrower on its record. As complaints received against NBFCs generally pertain to charging of high	Applicable NBFCs shall convey in writing to the borrower in the vernacular language as understood by the borrower by means of sanction letter or otherwise, the amount of loan sanctioned along with the terms and conditions including annualised rate of interest and method of application thereof and keep the acceptance of these terms and conditions by the borrower on its record. 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.

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		Whenever reminders for non-compliance of material terms and conditions of loan are sent to borrowers, the applicable penal charges shall be communicated. Further, any instance of levy of penal charges and the reason therefor shall also be communicated. These instructions shall come into effect from January 1, 2024. REs 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 these instructions, whichever is earlier.
<u>D. Master Direction - Non-Banking Financial Company – Housing Finance Company (Reserve Bank) Directions, 2021 dated February 17, 2021</u>		
74.2	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. In other words, HFCs must disclose 'all in cost' inclusive of all	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. In other words, HFCs must disclose 'all in cost' inclusive of all charges involved in processing/ sanctioning of loan application in a transparent manner. It should also be ensured that such charges/ fees are non-discriminatory.

	charges involved in processing/ sanctioning of loan application in a transparent manner. It should also be ensured that such charges/ fees are non-discriminatory.	
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. HFCs should also ensure that changes in interest rates and charges are effected only	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. HFCs should also ensure that changes in interest rates and charges are effected only prospectively. A suitable condition in this regard should be incorporated in the loan agreement.

	prospectively. A suitable condition in this regard should be incorporated in the loan agreement.	
80.1	The Board of each HFC shall adopt an interest rate model taking into account relevant factors such as cost of funds, margin and risk premium and determine the rate of interest to be charged for loans and advances. The rate of interest and the approach for gradation of risk and rationale for charging different rate of interest to different categories of borrowers shall be disclosed to the borrower or customer in the application form and communicated explicitly in the sanction letter. The Board of the HFC shall also have clearly laid down policy for penal interest/ charges (if any).	The Board of each HFC shall adopt an interest rate model taking into account relevant factors such as cost of funds, margin and risk premium and determine the rate of interest to be charged for loans and advances. The rate of interest and the approach for gradation of risk and rationale for charging different rate of interest to different categories of borrowers shall be disclosed to the borrower or customer in the application form and communicated explicitly in the sanction letter. 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	Though interest rates are not regulated by the Bank, rates of interest beyond a certain level may be seen to be excessive and can neither be sustainable nor be conforming to normal financial practice. HFCs shall lay out appropriate	Though interest rates are not regulated by the Bank, rates of interest beyond a certain level may be seen to be excessive and can neither be sustainable nor be conforming to normal financial practice. HFCs shall lay out appropriate internal principles and procedures in determining interest rates and processing and other charges (including penal charges, if any). In this regard the directions in the Fair Practices Code about transparency in respect of

	internal principles and procedures in determining interest rates and processing and other charges (including penal interest, if any). In this regard the directions in the Fair Practices Code about transparency in respect of terms and conditions of the loans are to be kept in view. HFCs are also advised to put in place an internal mechanism to monitor the process and the operations so as to ensure adequate transparency in communications with the borrowers.	terms and conditions of the loans are to be kept in view. HFCs are also advised to put in place an internal mechanism to monitor the process and the operations so as to ensure adequate transparency in communications with the borrowers.
	<i>(New section inserted)</i> Penal Charges in Loan Accounts	Penalty, if charged, for 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. The REs shall not introduce any additional component to the rate of interest and ensure compliance to these guidelines in both letter and spirit. The REs shall formulate a Board approved policy on penal charges or similar charges on loans, by whatever name called. The quantum of penal charges shall be reasonable and commensurate with the non-compliance of material terms and conditions of loan contract

		without being discriminatory within a particular loan / product category. 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. The quantum and reason for penal charges 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 non-compliance of material terms and conditions of loan are sent to borrowers, the applicable penal charges shall be communicated. Further, any instance of levy of penal charges and the reason therefor shall also be communicated. These instructions shall come into effect from January 1, 2024. REs 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 these instructions, whichever is earlier.
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	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.

	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. HFCs shall follow the instructions on "Notice Board", "Booklets/ Brochures", "Website", "Other Modes of Display" and on "Other Issues" as per Annex XII.	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. HFCs shall follow the instructions on "Notice Board", "Booklets/ Brochures", "Website", "Other Modes of Display" and on "Other Issues" as per Annex XII.

II. Instructions in addition to the paragraphs of the related Master Circulars

[E. Master Circular- Management of Advances – UCBs dated July 25, 2023](#)

Para No.	Existing Paragraph	Additional instructions that shall apply
		Penalty, if charged, for 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. The REs shall not introduce any additional component to the rate of interest and ensure compliance to these guidelines in both letter and spirit.

		The REs shall formulate a Board approved policy on penal charges or similar charges on loans, by whatever name called. The quantum of penal charges shall be reasonable and commensurate with the non-compliance of material terms and conditions of loan contract without being discriminatory within a particular loan / product category. 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. The quantum and reason for penal charges 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 non-compliance of material terms and conditions of loan are sent to borrowers, the applicable penal charges shall be communicated. Further, any instance of levy of penal charges and the reason therefor shall also be communicated. These instructions shall come into effect from January 1, 2024. REs 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 these instructions, whichever is earlier.
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F. Master Circular - Customer Service in Banks dated July 1, 2015

Para graph 6	Levy of service charges	Penalty, if charged, for 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. The REs shall not introduce any additional component to the rate of interest and ensure compliance to these guidelines in both letter and spirit. The REs shall formulate a Board approved policy on penal charges or similar charges on loans, by whatever name called. The quantum of penal charges shall be reasonable and commensurate with the non-compliance of material terms and conditions of loan contract without being discriminatory within a particular loan / product category. 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. The quantum and reason for penal charges 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 non-compliance of material terms and conditions of loan are sent to borrowers, the applicable penal charges shall be
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			communicated. Further, any instance of levy of penal charges and the reason therefor shall also be communicated. These instructions shall come into effect from January 1, 2024. REs 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 these instructions, whichever is earlier.
<u>G. Master Circular - Loans and Advances - Statutory and Other Restrictions dated July 1, 2015</u>			
Para graph 2.5	Guidelines on Fair Practices Code for Lenders		The quantum and reason for penal charges 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 non-compliance of material terms and conditions of loan are sent to borrowers, the applicable penal charges shall be communicated. Further, any instance of levy of penal charges and the reason therefor shall also be communicated.