

FIDC

Finance Industry Development Council

(A Representative Body of NBFCs in India)

101/103, Sunflower, 1st Floor, Rajawadi Road No.2, Ghatkopar (East), Mumbai – 400 077

Tel: 022 21029898/9820035553 • E-mail: directorgeneral@fidcindia.org.in



www.fidcindia.org.in

May 13, 2023

The Chief General Manager,
Department of Regulation,
Central Office,
Reserve Bank of India,
12th Floor, Central Office Building,
Shahid Bhagat Singh Marg, Fort,
Mumbai – 400 001

Respected Sir,

SUB: “Draft Circular on Fair Lending Practice - Penal Charges in Loan Accounts”

Ref: Draft Circular RBI / 2023-24 / DoR.MCS.REC / 01.01.001 / 2023-24 dated April 12, 2023

Finance Industry Development Council (FIDC) is a Representative Body of the NBFCs registered with the Reserve Bank of India. FIDC was formed 18 years ago and is the recognized face of the NBFC sector. Almost all the leading NBFCs and a large number of small and medium sized NBFCs are our members.

RBI vide circular under reference propose to ensure reasonableness and transparency in disclosure of penal interest / Charges. The methodology outlined including accounting treatment such as non-capitalisation of penal charges are welcome as they would help curb unhealthy practices. However, the following are the challenges that the industry has to face, besides the hardship that the customer has to endure.



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1. The fundamental principle of penal interest is premised on two parameters – the time value of money and the higher risk assessment owing to a default in repayment of the loan. Since the penal interest is charged on a time basis and not for any service rendered or on any other basis, it cannot be called as a “charge” or “fee” of any nature. Its essential nature as “interest” due to higher risk premium cannot be altered. Hence, we request that the word “Charges” be suitably altered.
2. The usage of the term “Penal Charges” connotes a service/other value addition being rendered to the defaulting customer and therefore may be subject to the levy of GST. In case of default in payment of EMI by the customer, if the regulated entities are to charge “Penal Charges” then the customer who is at default will have to pay the “Penal Charges” together with applicable GST. Practically, it is highly likely that the GST levied would NOT be recovered from a customer who is already in financial distress and in default.
3. Some of the credit facilities are with a “Fixed rate of interest” and hence re-setting the rate of interest in terms of clause 3 (i) and clause 3 (ii) of the draft circular would be challenging. The option to reset the interest rate may, however, be feasible in floating rate loans only. Consequently, the customer may not be able to opt for ‘fixed rate’ loans.
4. In clause 3 (iv) of the draft circular, it is suggested that the penal charges for non-compliance of material terms shall be proportionate to the default. It is challenging to determine the materiality arising on account of default and the same would vary in the event of continuing default and varying the Penal charges periodically will result in dispute with the customer and would also be a burden to the customer. The import of the words “proportionate to the default” is uncertain and may need clarity. In any



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case, even if we call it as penal interest the amount charged is in effect “proportionate” to the period and value at default.

5. There are instances when the penal interest is waived by the NBFCs in deserving cases. However, once penal charges with GST are levied, there would be no possibility for the NBFCs to waive the penal charges.

It may therefore be observed from the above that –

- (i) The penal interest acts as a deterrent for non-compliance and default and motivates the borrower to pay the dues on time.
- (ii) Adjusting the credit risk premium can be considered when there is significant drop in risk profile and the same can be implemented post detailed review of profile on various parameters whereas penal interest can be levied from the date of default which curbs the borrower to delay unnecessarily.
- (iii) While penal interest can be waived in deserving cases, the penal charges with GST cannot be waived.

In the light of the above, we are of the view that substitution of “penal interest” by “penal charges” may rather be hurting the interests of the customer, besides causing avoidable accounting hassles to the NBFCs. It is, therefore, suggested that in order to protect the customers from excessive charges, **RBI may please**

- (I) consider substitution of the words “Penal Charges” to “Penal Interest” to avoid the GST burden to the customer**
- (II) consider a cap on the rate of Penal interest by adding that the penal interest shall be based on the entire outstanding amount of the loan**



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- (III) consider dropping the proposal to reset the interest rate arising out of default, to avoid dispute with the customer**

- (IV) clarify the materiality concept to levy the Penal interest to bring in transparency to the customer.**

We are hopeful that the suggested measures will better enhance the protection to the customers.

We also like to take this opportunity to seek a meeting with you, to give a detailed briefing regarding the rationale behind these requests. We may schedule this meeting at the date and time most convenient to you. We look forward to hearing from you.

Thanking you in anticipation

Regards

For Finance Industry Development Council

**MAHESH THAKKAR
DIRECTOR GENERAL**



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