

May 7, 2007

All Commercial Banks
(Excluding RRBs)

Dear Sir

Complaints about excessive interest charged by banks

Please refer to paragraph 168 of the Annual Policy Statement for the year 2007-08 (copy enclosed).

2. The Reserve Bank and Banking Ombudsmans' offices have been receiving several complaints regarding levying of excessive interest and charges on certain loans and advances. In this connection, a reference is invited to Reserve Bank's Master Circular DBOD. Dir.BC.5/ 13.03.00/ 2006-07 dated July 1, 2006 advising banks to have an objective and transparent policy approved by their Boards for the purpose of fixing interest rates on loans and advances. In the case of short-term advances granted to small and marginal farmers, Reserve Bank has also advised banks (vide paragraph 10.2 of master circular referred to above) to ensure that interest applied does not exceed principal amount.

3. It will be appreciated that though interest rates have been deregulated, rates of interest beyond a certain level may be seen to be usurious and can neither be sustainable nor be conforming to normal banking practice.

4. Boards of banks are, therefore, advised to lay out appropriate internal principles and procedures so that usurious interest, including processing and other charges, are not levied by them on loans and advances. In laying down such principles and procedures in respect of small value loans, particularly, personal loans and such other loans of similar nature, banks may take into account, inter-alia, the following broad guidelines:

- An appropriate prior-approval process should be prescribed for sanctioning such loans, which should take into account, among others, the cash flows of the prospective borrower.
- Interest rates charged by banks, inter-alia, should incorporate risk premium as considered reasonable and justified having regard to the internal rating of the borrower. Further, in considering the question of risk, the presence or absence of security and the value thereof should be taken into account.
- The total cost to the borrower, including interest and all other charges levied on a loan, should be justifiable having regard to the total cost incurred by the bank in extending the loan, which is sought to be defrayed and the extent of return that could be reasonably expected from the transaction.

- An appropriate ceiling may be fixed on the interest, including processing and other charges that could be levied on such loans, which may be suitably publicised.

5. Banks may confirm having put in place suitable principles and procedures in this regard within a period of three months from the date of this circular.

6. In the meantime, please acknowledge receipt.

Yours faithfully

(P. Vijaya Bhaskar)
Chief General Manager

EXTRACT**Annual Policy Statement for the Year 2007-08****Complaints about Excessive Interest Charged by Banks**

168. The Reserve Bank and the Banking Ombudsmans' offices have been receiving several complaints regarding levying of excessive interest rates and charges on certain loans and advances. Although interest rates have been deregulated, rates of interest beyond a certain level may be seen to be usurious and can neither be sustainable nor in conformity with the normal banking prudence.

- The boards of banks are, therefore, advised to lay down internal principles and procedures so that such usurious interest, including processing and other charges, are not charged.