

May 18 , 2007

The Chief Executive Officers of All  
Primary( Urban) Co-operative Banks

Dear Sir/Madam,

**Complaints about Excessive Interest Charged by Banks-UCBs**

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 our UBD.No.DS.PCB.Cir.42/13.04.00/2001-02 dated April 29, 2002 permitting UCBs to determine their lending rates taking into account their cost of funds, transaction costs etc with the approval of their Board. However, banks were advised to ensure that the interest rates charged by them are transparent and known to all customers. Banks were also required to publish the minimum and maximum interest rates charged on advances and display the information in every branch.

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:

- I. 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.
- II. 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.
- III. 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.
- IV. In the case of loans to borrowers under priority sector, no penal interest should be charged for loans up to Rs.25,000. Penal interest may be levied for reasons such as default in repayment, non-submission of financial statements, etc. However, the policy on penal interest should be governed by well-accepted principles of transparency, fairness, incentive to service the debt and due regard to genuine difficulties of customers.
- V. Banks should ensure that the total interest debited to an account should not exceed the principal amount in respect of short term advances granted to small and marginal farmers. The small and marginal farmers for the purpose shall include those with land holding of 5 acres and less.
- VI. 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 should put in place suitable principles and procedures in this regard within a period of three months from the date of this circular.

6. Please acknowledge receipt to the Regional Office concerned of the Reserve Bank.

Yours faithfully

(N.S.Vishwanathan)  
Chief General Manager –in-Charge.

## **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.