

Floating loans: RBI directs banks not to levy pre-payment fee

In a major relief to retail borrowers, the Reserve Bank of India (RBI) on Wednesday directed banks not to levy any penalty on individual borrowers for pre-paying floating rate loans.

The RBI measure is applicable only for individual borrowers, indicating that the same benefit is not applicable for corporate clients. "It is advised that banks will not be permitted to charge foreclosure charges/ pre-payment penalties on all floating rate term loans sanctioned to individual borrowers, with immediate effect," the RBI said in a notification.

In the first bi-monthly monetary policy statement for FY15 released last month, the RBI had said banks should consider allowing their borrowers the facility of pre-paying floating rate term loans without any penalty in the interest.

Some banks are charging pre-payment penalty of up to 2 per cent of the outstanding loans. Two years ago, the RBI had barred banks from levying foreclosure charges or pre-payment penalties on home loans on floating interest rate basis.

Floating rate loans are popular in auto, personal and home loan segments.

The Committee on Customer Service in Banks, headed by former Sebi chairman M Damodaran, had observed that foreclosure charges levied by banks on prepayment of home loans are resented upon by home loan borrowers across the board especially since banks were found to be hesitant in passing on the benefits of lower interest rates to the existing borrowers in a falling interest rate scenario.

As such, foreclosure charges are seen as a restrictive practice deterring

the borrowers from switching over to cheaper available source. "The removal of foreclosure charges/prepayment penalty on home loans will lead to reduction in the discrimination between existing and new borrowers and competition among banks will result in finer pricing of the floating rate home loans," the RBI said.

Though many banks have in the recent past voluntarily abolished pre-payment penalties on floating rate home loans, there is a need to ensure uniformity across the banking system, it said.

According to Damodaran panel, consumer organisations alleged that all bank charges are exorbitant and cited in particular the 'Average Quarterly Balance (AQB)' requirement and the penalties for non-maintenance of the same. Further, some of the charges levied by the banks could be deemed to be 'irrational'.

Charges levied for the reason of no transaction in a quarter, collection of loan processing charge even in a case where the loan is not sanctioned and charges levied without any prior notice to the customer are examples of this. The organisations also suggested that

the RBI should prescribe a benchmark service charge, with an operating band for each of the services.

On Tuesday, the RBI had asked banks not to levy penalty for non-maintenance of minimum balances in any inoperative account as a customer protection measure.

‘Reducing discrimination’

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(Financial Express)