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FAQs on RBI Circular: Resetting Floating Interest Rates for EMI-Based Personal Loans

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The Reserve Bank of India (RBI) had issued a circular titled “FAQs on the RBI Circular: Reset of Floating Interest Rate on Equated Monthly Instalments (EMI) Based Personal Loans” on January 10, 2025, aimed at addressing concerns related to floating interest rate resets on personal loans. This circular, originally effective from August 18, 2023, seeks to ensure transparency, enhance borrower awareness, and provide flexible options to manage interest rate changes.

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Scope and Purpose

The circular applies exclusively to personal loans repaid through equated periodic instalments (EMIs). It does not cover other loan categories like home loans or business loans. By clearly outlining communication protocols and borrower rights, the RBI aims to safeguard consumers in an era of fluctuating interest rates.

Key Takeaways from the FAQs

1. Applicability of the Circular

- **Question:** Does the circular cover all loan types?
- **Answer:** No, it is applicable only to personal loans repaid via EMIs. Other loan types, such as business or home loans, are not included.

2. Communication Requirements

- **Question:** When and how should lenders communicate with borrowers?
- **Answer:** Lenders must:
  - Disclose the annualized interest rate (APR) and potential impacts of rate changes at the time of loan sanction.Notify borrowers during the loan tenure about changes in EMI or tenure due to benchmark rate resets.
  - Provide quarterly statements detailing principal recovered, interest paid, remaining EMIs, and the annualized interest rate.

3. Options for Borrowers During Interest Rate Increases

- **Question:** What options are available for borrowers when interest rates rise?
- Answer: Borrowers can choose from:
  - Increasing the EMI amount or extending the loan tenure, or a combination of both.
  - Switching to a fixed interest rate for the remaining loan period.
  - Prepaying the loan, either partially or fully, at any time.

4. Fixed Interest Rate Requirement

- **Question:** Are lenders required to offer fixed-rate options?
- **Answer:** Yes, all lenders must provide the option for borrowers to switch from floating to fixed interest rates for personal loans.

5. Flexibility to Revert to Floating Rates

- **Question:** Can borrowers revert to floating rates after switching to a fixed rate?
- **Answer:** Yes, borrowers can switch back to floating rates, subject to the lender’s policies and applicable charges.

6. Coverage of Benchmark Types

- **Question:** Are loans linked to internal benchmarks (e.g., MCLR, Base Rate) included?
- **Answer:** Yes, the circular covers all EMI-based personal loans, regardless of whether they are linked to external or internal benchmarks.

7. Charges for Switching Loan Types

- **Question:** Can lenders charge for switching between fixed and floating rates?

- **Answer:** Yes, lenders can levy charges for such switches. However, these charges must be transparently disclosed in the loan sanction letter and any subsequent updates.

8. Loan Tenure Extension by Urban Cooperative Banks (UCBs)

- **Question:** Can UCBs extend housing loan tenure beyond the 20-year limit?
- **Answer:** Yes, UCBs can extend loan tenures as per the RBI's circular, provided they comply with existing housing finance regulations.

9. Applicability to Existing Borrowers

- **Question:** Does the circular apply to existing borrowers?
- **Answer:** Yes, the provisions of the circular are applicable to both new and existing borrowers.

Conclusion

The RBI's circular on the reset of floating interest rates aims to protect borrowers by promoting transparency and offering flexibility in loan management. By mandating clear communication and introducing options like switching to fixed rates or extending loan tenures, the RBI ensures borrowers can make informed decisions and mitigate financial stress during fluctuating interest rate cycles.

This initiative highlights the RBI's commitment to encouraging consumer-centric financial practices and bolstering trust in India's banking system.

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