



Floating Rate Loans

For Prelims: [Reserve Bank of India \(RBI\)](#), **Equated Monthly Installments (EMIs)**, **Floating Rate Loans**

For Mains: Concept of floating rate loans , Challenges in the financial institutions

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Why in News?

Recently, the [Reserve Bank of India \(RBI\)](#) will introduce a comprehensive framework to enhance transparency and establish proper rules for resetting [Equated Monthly Installments \(EMIs\)](#) for floating rate loans.

- This move aims to address **borrower concerns and ensure fair practices by financial institutions.**

What are Floating Rate Loans?

- Floating rate loans are **loans that have an interest rate that changes periodically, depending on a [benchmark rate or the base rate](#).**
 - This base rate, such as the [repo rate](#) - rate at which RBI lends money to financial institutions - is influenced by market forces.
- Floating-rate loans are also **known as variable or adjustable-rate loans**, as they can vary over the term of the loan.
- Floating rate loans are **common for credit cards, mortgages, and other consumer loans.**
- Floating rate loans **are beneficial to borrowers when interest rates are expected to drop in the future.**
 - In contrast, **a fixed interest rate loan** requires a borrower to pay set installments during the loan tenure. It offers a **greater sense of security and stability** in times of fluctuations in the economy.

FIXED RATE	FIXED RATE Vs FLOATING RATE OF INTEREST	FLOATING RATE
BENEFITS Interest Rate remains fixed irrespective of Market Conditions.  A fixed rate home loan is good for those who want a fixed monthly repayment schedule  It brings a sense of Certainty and Security.  DRAWBACKS: Usually 1 - 2.5% more than the floating rate home loan.	 What is Fixed Rate of Interest Fixed Interest Rate means repayment of home loans in Fixed Equal Instalments over the entire period of loan. What is Floating Rate of Interest Floating rate varies with the market conditions. Floating interest rate home loans are tied up to a base rate plus a floating element.	BENEFITS At least 1-2% cheaper than fixed interest rates.  Over a long period, interest rates may fall.  Floating interest rates bring savings.  DRAWBACKS: Uneven nature of monthly instalments make financial planning difficult.

What is the Need for the New Transparent Framework?

- Until recently, the RBI had been raising the **repo rates** in order to **contain inflation**. With a rise in repo rates, the floating rates too increase. This translates into higher EMIs for borrowers.
 - But it has been found that instead of asking for higher EMIs, some banks are simply **increasing the tenure of the loan without informing the borrower**.
 - This is making loan repayments **unreasonably long and without proper consent from borrowers**.
- Prevent borrowers from being harmed by **changes in the internal benchmark rate** and the spread during the term of the loan.
- Address issues faced by borrowers such as **lack of information about foreclosure charges, switching options, and key terms and conditions**.

What are the Features of the Framework Proposed by RBI?

- Lenders should **communicate clearly with borrowers** on **resetting the tenor and/or EMI**.
- RBI has asked lenders to **offer borrowers an option to switch to fixed-rate home loans** or foreclosure of loans whenever they want.
- Banks would also need to **disclose various charges incidental to the exercise of these options beforehand to borrowers** and properly communicate key information to borrowers.
 - This would result in **borrowers taking a more informed and calculated decision while repaying their home loans**.
- Lenders should **not engage in unethical or coercive loan recovery practices**, such as harassment, intimidation, or violation of privacy.

How will the Framework Benefit Borrowers and Lenders?

- Borrowers will have **more clarity, transparency, and choice regarding their floating rate loans**, and will be able to exit or switch them without any penalty or hassle.
- Borrowers will be protected from **unfair or arbitrary changes** in interest rates or EMIs by lenders and will be able to plan their finances better.
- Borrowers will be **treated with dignity and respect by lenders**, and will not face any harassment or abuse during loan recovery.
- Lenders will be **able to maintain good customer relations and trust and avoid reputational risk or legal action** due to improper lending conduct.

- Lenders will be able to improve their asset quality and risk management and ensure compliance with regulatory norms and expectations.

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