

# EARLY IMPRESSIONS

RBI Circular on Key Facts Statement for Loans and Advances

April 2024

# Foreword

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India's central bank, The Reserve Bank of India (RBI), plays a very important role in regulating and ensuring transparency in the retail credit market. Amongst other things, the RBI's objectives are to maintain stability of the financial system, which includes monitoring the growth of retail and Micro, Small & Medium Enterprises (MSME) loans.

Typically, retail / MSME segment borrowers have smaller credit requirements with limited credit information being available for evaluation as compared to large corporate borrowers. Whilst the RBI implements various measures to regulate retail / MSME credit, one of the important tenets of these measures is to promote transparency such that the retail / MSME borrower is aware of various economic and non economic features of the product. The underlying principle for this approach of the RBI is to ensure that customers are treated fairly.

In recent times with increased financial inclusion, there has been an increase in retail / MSME loans in India, which has prompted the RBI to take certain pre-emptive actions to mitigate any potential risks to financial stability. Eventually all these measures aim to protect borrowers from predatory pricing or lending practices that are unfair or opaque to an unsuspecting retail borrower.

RBI also aims to ensure that there is no buildup of excessive debt levels in the economy. RBI seeks to strike a balance between promoting financial inclusion and ensuring the overall health of the financial system by closely monitoring the retail sector and releasing appropriate regulations. Towards this end, RBI issued a

notification on 15 April 2024 laying out the Key Facts Statement (KFS) that all Regulated Entities (RE) would be required to provide to all prospective borrowers.

We sincerely hope you find the enclosed publication informative, offering insights into the recently released RBI notification, its applicability and some key considerations around transparent lending practices that RBI is promoting especially for retail / MSME borrowers. The question which the RE's will always need to ask themselves in relation to any new loan / product origination is that do their selling practices pass the test of transparency and the borrower understands the finer nuances of the product that is sold to him. It will be for the RE to implement this notification and ensure that their disclosure practices help them reach a positive response and establish trust with its borrowers.

We will be happy to participate in any discussions required to provide clarifications on our views enclosed in the attached publication. We look forward to hearing from you.

Thank you.

For Uniquus India Private Ltd.



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# Background

## 1. Foreword

RBI, through its Statement on Development and Regulatory Policies dated 8 February 2024 had mandated all RE's to provide KFS for retail and MSME term loan products. To implement this announcement, the RBI issued a notification on 15 April 2024, which overrides and repeals similar extant requirements in case of lending by Banks to individuals and digital lending.

## 2. Background

RBI's intent in issuing a formal regulation around KFS is to promote transparency and reduce information asymmetry on financial products being offered by different RE's, thereby empowering borrowers to make an informed decision. It is expected that the KFS will immensely benefit the borrower since the KFS is simple, clear and in a standardised format which will facilitate comparison of terms between various lenders. KFS avoids legal jargon to assist retail / MSME borrowers in making informed decisions whereby important details like Annual Percentage Rate (APR), all types of fees and charges, disbursement schedule, instalment details, recovery mechanisms and associated risks are required to be mentioned in an easy to understand format.

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# Scope and Applicability

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### The notification is addressed to the following entities:

- All Commercial Banks (including Small Finance Banks, Local Area Banks and Regional Rural Banks, excluding Payments Banks).
- All Primary (Urban) Co-operative Banks, State Co-operative Banks and Central Co-operative Banks.
- All Non-Banking Financial Companies (including Housing Finance Companies).

### KFS will be required to be issued mandatorily for the following types of loans:

- Retail lending by all RE whether digitally or through physical mode.
- MSME term loans by all RE whether digitally or through physical mode.
- Digital corporate lending (other than MSME) by all RE.

### The following type of lending is excluded from the scope of this notification:

- Credit Card receivables.
- Lending in physical mode to corporates (other than MSME).
- Lending (other than term loans) to MSME sector.



Whilst the RBI encourages all RE to put in place the necessary systems and processes to implement this notification at the earliest, it mandates compulsory implementation for all new retail and MSME term loans sanctioned on or after 1 October 2024, including new loans to existing customers.



# Salient Features of KFS

## 1. Foreword

As mandated by the notification, all RE's are required to provide a KFS to all prospective borrowers to help them take an informed view before executing the loan contract, as per the standardised format. The format of KFS has been prescribed in the notification. The salient features of KFS are enumerated below:

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- The KFS shall be written in a language understood by such borrowers.
- Contents of KFS shall be explained to the borrower and an acknowledgement shall be obtained that he/she has understood the same.
- Every KFS will be valid for a period of at least three working days for loans having tenor of seven days or more. Validity period for loans having tenor of less than seven days would be one working day.
- The KFS shall be provided with a unique proposal number.
- Details like disbursement schedule, loan term, details of instalments, interest rate % and type of interest rate, fees / charges / contingent charges must be clearly mentioned in the KFS.
- The KFS shall include a computation sheet of APR, and an amortization schedule of the loan over the loan tenor.
- APR will include all charges which are levied by the RE. Illustrative examples of calculation of APR and disclosure of repayment schedule for a hypothetical loan are provided in the notification for reference purposes as the RE will have to provide similar information for the relevant product / loan sold to the borrower.
- Charges recovered from the borrowers by the RE's on behalf of third-party service providers on actual basis, such as insurance charges, legal charges etc., shall also form part of the APR and shall be disclosed separately in the KFS.



# Salient Features of KFS

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- Any fees, charges, etc. which RE may wish to charge the borrower during the loan tenure and those charges / fees are not mentioned in the KFS then the RE can charge these only after obtaining the explicit consent of the borrower.
- The KFS requires the RE to disclose to the borrower if the loan is likely to be transferred to another RE or securitized now or in future. If the RE has advised that the loan will not be transferred in KFS but later decides to transfer, then express prior consent of the borrower would be needed.
- In cases of co-lending, the lead lender would be required to mention their name as originating RE and the name of the partner RE along with their funding proportions and their blended rate of interest in the KFS.
- In case of digital lending, specific disclosures around cooling off period during which the borrower shall not be charged any pre-payment penalty and the details of the loan service provider (LSP) acting as recovery agent and authorized to approach the borrower should be mentioned in the KFS.
- Phone number and email id of a nodal grievance redressal office should be mentioned in the KFS and if a generic mail id is mentioned then RE should provide a response within 1 working day.



# Potential implementation challenges

Whilst the RBI has issued elaborate guidance on implementation of this notification, there could be potential implementation challenges. Some of these are enumerated below:

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The notification mentions that the KFS shall be in a language that is understood by the borrower. In the absence of any further implementation guidance in relation to this requirement, to implement the same, the RE's may potentially rely on guidance from the RBI Fair Practice Code where it is mentioned that NBFC's shall issue a sanction letter in writing in a vernacular language that is understood by the borrower.

## 3. Scope and Applicability

The notification is silent on the responsibility of RE to issue an updated amortization schedule of the loan in instances of prepayment of the loan by the borrower.

## 4. Salient Features of KFS

As per the KFS, RE shall disclose to the borrower if the loan is likely to be transferred to another RE or securitized now or in future and if the RE has advised that the loan will not be transferred in KFS but later decides to transfer, then express prior of the borrower would be needed. Procuring such a consent may present operational challenges for the RE.

## 5. Potential implementation challenges

If in the KFS, the RE has indicated that a loan could be potentially securitized in the future, the RE will have to evaluate the accounting implication of this assertion where the accounting position has been to account for such loans on an amortized cost basis. A contrary view that the loan is for collecting the contractual cash flows as well as for sale and hence the requirement for a fair value measurement could potentially be raised.

## 6. Uniquus Point of View

RBI notification requires the RE to mention the phone number and email address of a nodal grievance redressal officer and in case a generic email address is mentioned then a response should be provided within 1 working day. It seems the intent of RBI is to make RE redress the grievance on a timely basis and hence the 1 working day timeline is mandated. This will require regular monitoring and grievance redressal by the RE.

# Uniquus Point of View

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With the issuance of this notification, RBI has mandated the long-standing need for communicating important aspects of a loan (like charges, rate of interest, other levies, equated repayments, etc) in a transparent, simple and comparable manner for retail / MSME borrowers who have limited ability to evaluate complex financial jargon. Further by prescribing a standard format of KFS, borrowers can compare loans in a manner that is devoid of any legalese.

RBI has made accountability a priority since the KFS format mandates not only mentioning a phone number and an email id of a nodal grievance redressal officer but also requires the lender to provide a response to a complaint / grievance within 1 working day. RBI has emphasized the true essence of clean jargon free lending which would be the backbone of financial inclusion and rapid credit growth in a country like India.

While RBI had announced its regulatory intent in the Statement on Development and Regulatory Policies dated 8 February 2024, this notification implements the announcement and makes KFS mandatory for retail / MSME lending from 1 October 2024. There are various changes that a RE will be required to undertake in its processes, customer journey and importantly, calculations of APR to implement this notification. Therefore, in our view it will be a

essential for the RE to test the KFS issuance processes much before the deadline. Furthermore, the RE will have to impart training to credit managers and mid office teams of credit departments to implement this RBI requirement.

Another area to evaluate for RE would be instances where if KFS has been accepted by the borrower, would it bind the RE to disburse the loan. The KFS is a summarised version of the terms of the loan. However, the grant of the loan itself may have several conditions, typically comprised in the sanction letter. According to us the binding force of the KFS during the “validity period” is only on the terms, and not on the grant of the loan itself. If the conditions precedent for availing the loan have been satisfied, the lender will be bound by the terms as contained in the KFS; however, that may not always be the case.

Overall in our view, with the issuance of this notification, RBI has taken large strides in improving retail credit lending (including digital lending) practices in India. Whilst the RE may face some initial challenges around process and system changes in implementing the notification, we expect this to be streamlined within a couple of quarters and be an inherent part of the retail lending practices.





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