

THE STATUS OF CONSUMER CREDIT IN INDIA

This paper is an attempt to present a picture on the existing status of consumer credit in India. Before proceeding into the existing conditions, it is important that one understands the different forms of credit available in the formal and the informal sector. The different types of credit options available in the formal sector are:

1. Housing Loans- Housing loans are primarily taken for the sake of financing building of new houses, purchase of new houses, purchase of old houses or for repairing an existing house.
2. Personal Loans- Personal Loans can be claimed for absolutely any purpose.
3. Consumer Durable Loans- Consumer durable loans can be claimed for the purchase of consumer durables such as televisions, music systems, refrigerators, etc.
4. Vehicle Loans- Vehicle loans, as the name suggests can be claimed for the purchase of vehicles.
5. Educational Loans- Educational loans can be claimed for the purpose of either undergraduate or postgraduate education in either India or abroad.
6. Credit cards
7. Travel Loans- Travel loans can be claimed as the name suggests for the purpose of meeting travel expenditures.

The different types of credit facilities available in the informal sector can be broadly classified into the following:

1. Hourly vatti¹ – where interest is charged by the hour (normally for extreme emergency loans irrespective of loan amount).
2. Daily vatti² – where interest is charged by the day (also for extreme emergency loans)
3. Kandhu vatti³ – where the loan is for a longer period of time, but interest repayment is periodic. Default in repayment will result in the interest amount due being added to the principal amount, and therefore interest on interest will be charged.
4. Meter vatti⁴ – where the loan is similar to the kandhu vatti loan, but interest is charged and repayment is required on a daily basis. (It is called ‘meter vatti’ after the infamous autorickshaw meters in Tamil Nadu that are known for their rapidly increasing fares).
5. Thandal 1 & 2⁵ – where the loan is generally smaller and is advanced either for one day (Thandal 1) or for a fixed period of time (Thandal 2), and repayments are daily. However, further interest is generally not charged for default in payment and borrowers’ can repay lump sums at regular intervals.
6. Money lender⁶ – Means a person whose main or subsidiary occupation is the business of advancing and realising loans, but excludes a bank or a cooperative society.
7. Pawn Broker⁷ – Means a person who carries on the business of taking goods and chattels in pawn for a loan. Pawner⁸ means a person delivering an article for pawn to a pawnbroker

¹ See The Tamil Nadu Prohibition of Exorbitant Interest Ordinance, 2003 (*hereinafter* T.N.P.E.I.O.), section 2 (4).

² See T.N.P.E.I.O., section 2 (1).

³ See T.N.P.E.I.O., section 2 (5).

⁴ See T.N.P.E.I.O., section 2 (7).

⁵ See T.N.P.E.I.O., section 2 (8).

⁶ See The Tamil Nadu Money Lenders Act, 1957, Section 2 (8).

A more detailed discussion on the provisions with respect to the above mentioned forms of credit in both the formal and the informal sector will be discussed in further detail in the course of the paper.

Credit from the formal sector is essentially available to one and all, provided the eligibility criteria are fulfilled. As far as the informal sector is concerned, the eligibility criteria is primarily based on the repayment capacity of the borrower. The eligibility criteria in the formal sector also depends largely on the repayment of the borrower, however the method of calculating the repayment capacity or rather the eligibility criteria is fixed. The repayment capacity for all loans barring vehicle loans, education loans and credit cards is calculated as a proportion of 5 or 10 times the gross annual income for businessmen and traders and as a proportion of 10 months gross income for salaried persons. As far as vehicle loans are concerned, the demanded loan amount is broken into monthly repayment installments and if monthly installments are less than 50% of applicants net monthly take-home salary, the applicant is technically eligible to claim the loan. Education loans depend on the ability of the guardian who represents the student to repay the amount sanctioned (in case of default by student) and the potential of the student to repay the loan amount after the completion of the course. The eligibility criteria for application for credit cards is that the applicant must be earning annual salary of above Rs. 60,000/-.

The maximum period that is available for the repayment of the amount borrowed differs from one form of credit to another. The period of time permitted for the repayment of housing loans is a maximum of 15 years by the public sector and 25 years by the private sector. A maximum period of 1-5 years is allowed for the repayment of consumer durable loans and personal loans. The repayment period allowed by travel loan providers ranges from 1 to 3 years.

In the case of an education loan, the student receives a repayment holiday until the completion of his or her course plus the time till he or she secures employment or a period of one year, or whichever is earlier. Once the repayment period commences, it extends up to 5 years. In the case of credit cards the repayment period stretches from 48 to 52 days.

The period for repayment of loans borrowed through the informal sector is very flexible. The repayment period for vatti usually stretches from a period of 1 to 5 years and in rare cases may extend upto 10 years. Pawning, on the other hand indebts a person for a period of 1 to 5 months. However thandals are daily repayment loans, while meter vatti indebts the borrower for a period upto one month. However, largely repayment period in the informal sector is calculated on the basis of the repayment capacity of the borrower and can be modified at any time during the repayment schedule. Consumer rating in the informal sector is based on factors such as goodwill, assets of the borrower, purpose behind claiming loan, etc.

LAWS GOVERNING CONSUMER CREDIT TRANSACTIONS

There are various laws that govern different forms of consumer credit transactions. The Banking Regulation Act governs certain activities of the Reserve Bank of India (*hereinafter* R.B.I.).

⁷ See The Tamil Nadu Pawn Brokers Act (*hereinafter* T.N.P.B.A.), 1943, Section 2 (6).

⁸ See T.N.P.B.A., section 2 (7).

Section 21 of the Banking Regulation Act read with section 35A places an obligation on the R.B.I. to regulate interest rates. The R.B.I. is also the competent authority to regulate rates of interest on loans and advances.⁹ While giving directions on interest rates there should not be any discrimination against any class of depositors or loanees or banks. Art 14 of the Indian Constitution embodies the principle of equality and ensures that no discrimination is to be made between the citizens of India. However, the doctrine of reasonable classification is an exception to Article 14. Under this doctrine people can be treated differentially provided there exists a reasonable classification. To fulfil the needs for reasonable classification there are two broad conditions-

- a. There must exist an intelligible differentia which distinguishes persons or things that are grouped together from others left out of the group and
- b. There should be a rational nexus between the intelligible differentia and the legislative or the executive action.¹⁰

In *Harjit Singh v Union of India*¹¹, the Supreme Court held in the context of reduction of rate of interest on bank loans to riot victims that the concession should be extended to loanees from financial institutions also as there was no basis for discrimination between loanees from banks and loanees from financial institutions.

The Usurious Loans Act, 1918 prohibits lending at exorbitant rates. This law has been passed so as to protect the weaker borrowers from the powerful moneylenders. The Act protects weaker borrowers' such as agriculturists from unscrupulous lenders by remitting debts or giving other concessions. Although the lending rates of banks are regulated by the R.B.I., borrowers' often used to resort to these laws for remitting loans or reducing rates of interest in respect of loans taken by them from banks. This was coming in the way of the monetary policy decided by the Central Bank. Accordingly section 21A was inserted in the Banking Regulation Act to make the rates of interest charged by banking companies beyond the scrutiny of courts. A transaction between a banking company and its debtor cannot be reopened by any court on the ground that the rate of interest charged is excessive.¹² This provision is given overriding effect over the provision of the Usurious Loans Act, 1918 or any other law relating to indebtedness in force any State. Section 21A was held to be *intra vires* the Constitution in the case of Corporation Bank v. D.S. Gowda.¹³

Under the Tamil Nadu Pawnbrokers Act, no pawnbroker shall charge interest in respect of a loan on a pledge at a rate exceeding such rate as the State government may, by notification, fix from time to time.¹⁴ Every pawn broker shall on taking a pledge in pawn give to the pawner a pawn ticket in the prescribed form [which shall be in English and in such language of the locality as

⁹ See Banking Regulation Act, section 21 (2) (e).

¹⁰ See Hanif v. State of Bihar, AIR 1958 SC 731.

¹¹ See AIR 1994 SC 1433.

¹² See The Banking Regulation Act, section 21A.

¹³ See (1994) 5 SCC 213.

¹⁴ See T.N.P.B.A., section 6 (1). It must however be noted that the rate of interest to be fixed by the State Government under this sub section shall not exceed five per cent more than the current bank rate of lending as may be fixed by the Reserve Bank of India, from time to time.

may be prescribed] and shall not take a pledge in pawn unless the pawner takes the pawn-ticket.¹⁵

Any pawnbroker who actually advances an amount less than that shown in the pawn-ticket or in his accounts or registers or who takes or receives interest or any other charge at a rate higher than that shown in the pawn-ticket or in his accounts or registers shall be punished with imprisonment for a term not exceeding six months but not less than three months.¹⁶

The Tamil Nadu Money Lenders Act specifically deals with the following-

- License to money lenders
- Interest and charge allowed to moneylenders
- Power to deposit in court, the money due on loan
- To keep books, give receipts etc.

Provisions regarding rates of interest, punishment, etc. are similar to that of the Tamil Nadu Pawnbrokers Act. The Negotiable Instruments Act, 1881 mentions the penalties in case of dishonour of certain cheques due to insufficiency of funds in the account. Section 138 provides that

“where any cheque drawn by a person on an account maintained by him with a banker for payment of any amount of money to another person from out of that account for the discharge in whole or in part of any debt or other liability is returned by the bank unpaid either because of the amount of money standing to the credit of that account is insufficient to honour the cheque or that it exceeds the amount arranged to be paid from that account by an agreement made with that bank such person shall be deemed to have committed an offence and shall without prejudice to any other provisions of this Act be punished with imprisonment for (a term which may be extended to 2 years) or with fine which may extend to twice the amount of the cheque or with both:

Provided that nothing contained in this section shall apply unless-

The cheque has been presented to the bank within a period of 6 months from the date on which it is drawn or within the period of its validity whichever is earlier

The payee or the holder in due course of the cheque as the case may be makes a demand for the payment of the said amount of money by giving a notice in writing in writing to the drawer of the cheque (within 30 days) of the receipt of information by him from the bank regarding the return of the cheque as unpaid and

The drawer of such cheque fails to make the payment of the said amount of money to the payee or as the case may be to the holder in due course of the cheque within fifteen days of the receipt of the said notice.

For the purposes of this section, “debt or other liability” means a legally enforced debt or other liability.”

The question that arises after an analysis of the some of the laws governing consumer credit transactions is whether these laws are adequate. The answer to this question would be NO.

¹⁵ See T.N.P.B.A., section 7.

¹⁶ See T.N.P.B.A, section 15 (1).

The main fallacy existing in these laws is the fact that they are often contradicting and do not provide the consistency that they must. What is needed in India is a uniform consumer credit law that would bring within its ambit all forms of credit transactions in both the formal and the informal sector. The consumer credit laws in India need to go through a thorough revision. A model legislation that can probably be made use of is the United States Truth in Lending Act (*hereinafter* T.L.A.). Several amendments have been made to this act, notably by the Truth in Lending Simplification Act in 1980. The Act has been in force since 1969 and is expected to remain in force for the foreseeable future.¹⁷

The TLA has served as a template for all the consumer credit statutes that have followed. The basic features of TLA are:

- Application to virtually all forms of borrowing for consumer purposes, including sale and loan credit.
- Detailed disclosure obligations upon lenders.
- A standardized method for calculating and disclosing the finance charge as a percentage rate per annum (the “APR”).
- Specific penalties against lenders, recoverable by consumers, for breaches of the legislation by lenders.¹⁸

Countries such as Canada, New Zealand and Australia have replaced and modified their consumer credit regime. It is suggested that in the long run, India also needs to pass legislation similar to that of TLA, bringing within its ambit all the different forms of credit availabilities in both the formal and the informal sector.

It is relevant in this context to discuss the Banking Ombudsman Scheme, 2002. The scheme has been introduced with the object of:

1. enabling resolution of complaints relating to provision of banking services and to facilitate the satisfaction or settlement of such complaints.
2. resolving disputes between a bank and its constituent as well as between one bank and another bank through a process of conciliation, mediation and arbitration.

Chapter III of the Scheme provides for the jurisdiction, powers and duties of the Banking Ombudsman. Section 10 provides that:

The banking Ombudsman shall have the following powers and duties:

- a) to receive complaints relating to provision of banking services.
- b) to consider such complaint and facilitate their satisfaction or settlement by agreement through conciliation and mediation between the bank and the aggrieved parties or by passing an Award in accordance with the Scheme; and
- c) to resolve by way of arbitration such disputes between banks or between a bank and its constituent as may be agreed upon by the contesting parties in accordance with the provisions of the Scheme and the Arbitration and Conciliation Act, 1996.

¹⁷ See Rohner, *Whither Truth in Lending*, (1966) 50 Consumer Finance Quarterly Law Report 114.

¹⁸ See Nick McBride, *Consumer Credit Regulation*, Asian Conference on Consumer Protection, Competition Policy and Law, 28 February- 1 March 2003, Kuala Lumpur, Malaysia.

There are several problems faced by consumers in India with regard to credit transactions. The most notable of the problems would be the understanding of the contractual terms of the credit agreement. Consumers complain that the contracts are very voluminous and technical and that they do not have the legal expertise to understand the finer details of the contract. Consumers also complain that they do not receive copies of the standard form contract. Lenders however say that the copies of the contract are made available on the request of the consumers, however consumers suggest otherwise.

It may be noted that the consumers face a fair amount of problems regarding non-disclosure of information, by the financial corporations. The main problem that occurs normally in this respect is that the consumers are promised, for instance, no foreclosure fee would be charged, when the standard form contract actually mentions that a nominal fee would be charged for foreclosure. Therefore, customers with the belief that no foreclosure fee would be charged, foreclose their loans and are then charged for the same. This is a practice that needs to be checked immediately. Another major problem faced by consumers regarding similar issues is that of credit cards. Often when credit cards are stolen and misused by the miscreant, the credit card company charges the customer for the usage of the card by the miscreant in spite of the customer having reported the loss of the credit card. This is corrected only after several deliberations by the customer with the organization. There are several other problems faced by the consumers with regard to consumer credit transactions. It is however beyond the scope of this paper to discuss all these problems.

Contrary to consumers' belief, eligibility to apply doesn't mean that they are guaranteed the sanction of the loan. Consumers are not told or do not know how the decision to give or not give credit is made. Loans are sometimes given to persons who do not meet 'eligibility to apply' requirements and at times loans are denied to persons who supposedly have the right financial qualifications. These are problems that need to be checked immediately. Another major problem faced by the consumers is that of over aggressive advertisements. Consumers complain of overenthusiastic agents and tiring tele-marketing. Marketing of credit is sometimes done through agencies. The agent / sales person, in his or her desire to earn 'sales points', often do not have all / adequate information and end up making offers to consumers that the credit provider refuses to stand by. Misleading advertisements also cause a lot of trouble to the consumers, often portraying outrageously low rates of interests and thereby luring the consumers to claim credit from their company. The R.B.I. does not set any guidelines with regard to credit marketing. It is suggested that the R.B.I. must impose certain guidelines to prevent sales persons from going overboard and to provide a check on misleading advertisements.

SUGGESTIONS TO IMPROVE THE EXISTING CONSUMER CREDIT SITUATION IN INDIA

As far as the formal sector goes it is suggested that

1. There should exist a single law governing all credit forms in the formal sector.
2. There must be an effort to make the borrowers understand all terms and conditions of the loan agreement.
3. There must be no inconsistencies in so far as what the contract reads and what the borrower is informed through word of mouth

As far as the informal sector is concerned it is suggested that

1. There should be a direct link between the informal credit providers and the R.B.I.
2. There should be an indirect control of the business of the informal sector by the RBI mediated through commercial banks.
3. The RBI should lay down guidelines for Commercial Banks for their dealings with the Informal sector.