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RBI's Loan Pricing Draft Still Leaves Hard Questions Over Fairness

India's retail loan pricing needs more than transparency. Usury, business strategy premiums and risk-based pricing raise deeper questions about fairness and access to affordable credit.

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Today, a citizen seeking a personal loan from a bank or NBFC, with no credible assets to show, can expect to pay between 14% and 30% a year. Is that comfortably low enough, given her circumstances? Is it fair?

The price of a formal loan is built by stacking well-established costs: the lender's cost of borrowing, the operating cost of originating and servicing the loan, and a credit risk premium that the lender can rightly demand for the chance that the borrower defaults. Lenders have considerable room to add other costs and to play with these components, so the Reserve Bank of India has stepped in at various points to govern how they are set. The latest step is a draft circular released in August 2026, with compliance to begin from 1 April 2027 for banks, NBFCs and certain other entities. It asks for greater transparency on the internal or external benchmarks lenders use, through public disclosure of the benchmark, its methodology and the spread over it, for different categories of loan.

Bank lending has been moving towards external benchmarks for years, most substantially after the 2017 Internal Study Group review of the marginal cost of funds based lending rate system, which required floating retail and MSME loans to be linked to one. The draft stays silent on corporate loans, which remain outside that paradigm despite the Study Group's specific call to include them.

A policy objective runs through the draft: a borrower should not be left worse off by an event beyond her control. Let us unpack this through three aspects.

The first is **usury**. No specific interest rate and no pure unlawfulness of the contract makes a loan usurious. It is established case by case, by concluding that the interest is excessive and the transaction substantially unfair. The Usurious Loans Act 1918, though inapplicable to banks and most NBFCs, supplies the legal foundation for what counts as excessive: interest beyond what is reasonable given the risk the creditor ran at the time of lending. It directs attention to pricing, security and returns, but also to the borrower's financial condition, her earlier dealings with the creditor and the relationship between the two, including the borrower's necessity. The draft uses the word "usury" only in connection with an Annual Percentage Rate (APR) cap on microfinance and small-value loans. It remains to be seen whether the RBI's suitability rules under its responsible business conduct regulations, in force

from 1 January 2026, will keep lenders from exploiting the non-price drivers of usury.

Strategy Premium

The second aspect is the portion of the spread that the RBI calls the "**business strategy premium**", which the draft says may reflect competition, liquidity, expected returns and other commercial considerations. This is an honest acknowledgement that pricing is not a pure costing exercise and that commercial discretion is legitimate. A lender may even price below its true economic cost, within regulator-prescribed limits, as is common in corporate loans. But can overpricing be driven entirely by this component?

Is it right for a borrower with an impeccable 15-year microfinance repayment record to be charged microfinance rates on a gold loan simply because she is used to such APRs? Is it right for a lender expanding aggressively into a new market or product to fund that push by loading a business strategy premium onto a seasoned, good borrower? The RBI would do well to direct how this component is governed, because the question goes beyond risk to fairness within profit-seeking.

Risk Ordinality

The third aspect is **risk ordinality**, the objective that pricing should preserve the correct ranking of risk across borrowers. The RBI's 2014 committee on financial services for small businesses and low-income households wanted affordable rates to be "ordinal by risk level in the long-run after adjusting for reasonable transactions charges". When that ordering breaks, riskier borrowers get cheaper loans than safer ones, credit flows to the wrong people, and crowds out productive, lower-risk investment. Overcharged safe borrowers may leave the market, leaving mostly high-risk borrowers behind, a case of adverse selection that weakens the whole lending system.

The RBI is well placed to gather fresh evidence on whether mispricing of credit risk is being discovered and removed efficiently or is accumulating at various levels. If it is accumulating, the remedy will not be easy. The difficulty lies in allocating capital against expected and unexpected credit losses. The former depends on credit bureau and ratings data, which need robust statistical risk models. The latter depends on how advanced lenders' internal ratings-based methods are, and on whether risk-adjusted performance management takes

hold across India's lenders. Such measures bring more stable returns for shareholders and do not work against profit-making.

Disclosure of benchmarks and spreads is a sound first step, but transparency alone cannot establish fairness. That depends on what lenders are permitted to build into the spread, how consistently risk is reflected in the final price, and whether borrowers' circumstances constrain the exercise of commercial discretion.

The RBI's challenge, therefore, is not simply to make loan pricing more transparent, but to ensure that the freedom to price credit does not become the freedom to charge borrowers more than their circumstances and risk justify.