July 2025

Reserve Bank of India's 2025 Directions on pre-payment charges: enhancing borrower protection and transparency

In order to ensure fair practices and enhance transparency regarding the levy of pre-payment charges on loans extended by Regulated Entities ("**REs**") to individuals and Micro and Small Enterprises ("**MSEs**"), the Reserve Bank of India ("**RBI**"), on July 2, 2025, has issued the RBI (Pre-payment Charges on Loans) Directions, 2025 ("**Prepayment Directions**").

Key provisions and changes

1. **Scope and Applicability**: The Prepayment Directions will be applicable to all commercial banks (excluding payments banks), co-operative banks, Non-banking Financial Companies ("**NBFCs**"), and All India Financial Institutions, for all loans sanctioned or renewed by them on or after January 1, 2026.

2. **Exemption for non-business loans**: The Prepayment Directions prohibit levy of any pre-payment charges on floating rate non-business loans extended to individuals, whether with or without co-obligants.

3. **Exemption for business loans**: The Prepayment Directions prohibit levy of any pre-payment charges on the following floating rate business loans extended to individuals and MSEs, whether with or without co-obligants:

    a) business loans extended by commercial banks (excluding small finance banks, regional rural banks and local area banks), Tier 4 urban co-operative banks, upper layer NBFCs, and All India Financial Institutions; and

    b) business loans extended by small finance banks, regional rural banks, Tier 3 urban co-operative banks, State and Central co-operative banks, and middle layer NBFCs, for an amount up to INR 50,00,000 (Indian Rupees fifty lakh only).

4. **No lock-in period**: The above exemptions will be applicable irrespective of:

    a) the source of funds used by the applicable borrower for making the pre-payment;

    b) whether the prepayment is made in part or full; and

    c) any minimum lock-in period imposed by REs.

5. **Dual/special rate loans**: For loans with a combination of fixed and floating rates, the Prepayment Directions will be applicable if the said loan is on a floating rate at the time of pre-payment.

Key differences

Aspect	Earlier regulations	Prepayment Directions
Pre-payment charges	Levied by many REs, often with lock-in periods	Prohibited for most floating rate loans to individuals and MSEs
Uniformity	Varied across REs	Standardised across all REs
Type of loan covered	Not clearly defined	Clearly distinguishes between business and non-business loans
Applicability	Discretionary	Mandatory from January 1, 2026
Dual rate loans	Ambiguous treatment	Clarified based on rate at time of pre-payment

Conclusion

Once the Prepayment Directions are effective, individuals and MSEs will enjoy a greater degree of flexibility, as they will have an option to repay loans from their own sources or out of refinancing facility from other REs, thereby saving on prepayment charges. Further, REs will be also required to revise their loan agreements, internal policies, and IT systems prior to January 1, 2026, to be in compliance with the Prepayment Directions.

From a regulatory perspective, given that the Prepayment Directions are a directive and not merely an advisory issued by the RBI, there will be enhanced transparency for borrowers, and is therefore likely to reduce their grievances regarding charging of pre-payment penalty by REs.

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