REFORM MEASURE TO ENHANCE CREDIT FLEXIBILITY AND REDUCE BORROWING COSTS FOR BUSINESSES

Rationalisation of Pre-payment Charges on Loans and Advances

The Reserve Bank of India (Commercial Banks – Responsible Business Conduct) Directions, 2025 and similar Directions for other categories of RBI regulated entities (REs) have significantly liberalised the framework governing pre-payment charges on loans and advances. Effective January 1, 2026, the new provisions remove major barriers that previously discouraged borrowers from refinancing, restructuring, or repaying debt ahead of schedule.

The reform is particularly beneficial for individual business borrowers, Micro and Small Enterprises (MSEs), and entrepreneurs, as it enhances credit market flexibility, promotes competition among lenders, lowers the effective borrowing cost, and improves access to affordable finance.

As per *E. Pre-payment Charges on Loans (Chapter VIII – Commercial Banks-Responsible Lending Conduct and similar Directions for other categories of REs):*

- ***Elimination of Pre-payment Charges for Individual and MSE Borrowers on Floating Rate Business Loans:*** Commercial Banks (excluding Small Finance Banks [SFBs], Regional Rural Banks [RRBs], and Local Area Banks [LABs]), Tier 4 Primary (Urban) Co-operative Banks, NBFCs in Upper Layer (NBFC-UL), and All India Financial Institutions can no longer levy pre-payment charges on floating rate loans granted for business purposes to individuals and MSEs, irrespective of the loan amount. Similarly, SFBs, RRBs, LABs, Tier 3 Primary (Urban) Co-operative Banks, State Co-operative Banks, Central Co-operative Banks, and NBFCs in Middle Layer (NBFC-ML) cannot levy pre-payment charges on such loans with sanctioned amount / limit up to ₹50 lakh. The exemption applies irrespective of whether the loan is prepaid partially or in full and regardless of the source of funds used for repayment, including refinancing through another lender. No minimum lock-in period can be imposed before availing of this benefit.
- ***Transparency in Lending Practices*:** REs of RBI are required to clearly disclose the applicability or otherwise of pre-payment charges in the sanction letter and loan agreement. Where a Key Facts Statement (KFS) is mandated, details of pre-payment charges must also be included in the KFS. REs are prohibited from imposing charges that were not disclosed to the borrowers upfront.
- ***Protection Against Retrospective and Arbitrary Charges*:** REs cannot retrospectively impose any charges / fees at the time of pre-payment if such charges had previously been waived. No charges may be levied when the pre-payment is undertaken at the instance of the RE.
- ***Rationalised Treatment for Other Loan Categories*:** For loan categories where pre-payment charges may continue to be levied, REs must follow an approved policy. In term loans, charges must be linked only to the amount being prepaid rather than the entire sanctioned loan amount. In case of closure of cash credit or overdraft facilities before the due date for renewal, pre-payment charges, if any, can be levied on an amount not exceeding the sanctioned limit.