
FROM RESTRICTIONS TO GOVERNANCE: RBI'S OVERHAUL OF RELATED PARTY LENDING FOR NBFCs AND SFBS

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ABSTRACT

This article examines the Reserve Bank of India's January 2026 overhaul of the related party lending framework for Non-Banking Financial Companies and Small Finance Banks. It analyses the shift from fragmented restrictions to a governance-driven, board-centric regime and assesses its implications for institutional behaviour, credit discipline, and regulatory oversight.

Introduction

Related party lending has long been a sensitive fault line in financial regulation. Although lending money to individuals and organizations that are related to each other is not inherently illegal, it is associated with the inherent risk of conflict of interests, favouritism, misappropriation of funds, and the loss of credit discipline. With the growth in the size and sophistication of the Indian financial system, especially in the non-banking financial company ("NBFCs") and the Small Finance Banks ("SFCs") segments of the industry, the Reserve Bank of India ("RBI") has paid growing attention to governance failures due to related lending.

It is against this context that the RBI on January 05, 2026, in its notifications has implemented far-reaching modifications to the *Credit Risk Management Directions* which pertains to NBFCs ([here](#)) and to SFBs ([here](#)). These amendments do not simply improve on restrictions that exist. They restore the regulation regime that covers related party lending and overturn the fragmented prohibitions into a board-based regime of governance. The fact that the changes were similar in NBFCs and SFBs is an indication of the RBI trying to harmonise the supervisory expectations among the regulated parties.

A Unified Regulatory Framework Across NBFCs and SFBs

The notable aspect of the changes of January 2026 is that the RBI has assumed the similarity of regulatory philosophy of NBFCs and SFBs. Regardless of the institutional structure and

statutory treatment, the RBI has shifted to a template in terms of governance in mitigating the risks that are linked to related party transaction.

In both regimes, the RBI focused on an improvement in the definitional clarity, accountability of the board, materiality-based controls and tough enforcement aided by audit and anti-circumvention measures. This convergence is indicative of a transition to entity-neutral micro-regulation to principles-based and governance-focused supervisory model, in which the responsibility has been entrenched on the board level.

Fragmented Restrictions to an Integrated Framework.

Before these amendments, related party lending was subject to regulation that was spread over various provisions and overlays of entity-specific exception and technical carve outs. For NBFCs, the RBI has removed the previous framework in paragraphs 9 to 13 and instead inserted one broad regime in paragraphs 13A to 13Q deposing the previous regime clearly named as Lending to related parties. On the same note, in the case of SFBs, some whole line items in Chapter V have been deleted and replaced by new Section B.1 that relates to paragraphs 42A to 42T.

This re-organization is not superficial. Having all the requirements in a single location has helped to bring a clear understanding of regulatory expectations and minimized the interpretational level of ambiguity. More so, it represents a desire to consider related party lending as a matter of governance and not just as a matter of technicality.

Expanded and Aligned Definitions

The core of the new framework is massive increase and rationalisation of definitions. The related party, related person, control, promoter, key managerial personnel, lending, and specified employee are also related with the Companies Act, 2013, the Banking Regulation Act, 1949, and the Insolvency and bankruptcy code, 2016. In the case of SFBs, the RBI has also made provision to a person who is linked in a reciprocally related manner to avoid circumventions of a kind caused by inter-bank or group association.

The meaning of lending has been expanded to cover not only funded and non-funded credit facilities but also investment in debt instruments but not in equities. This difference is a regulatory issue on credit exposure but not ownership. It has also been noted that state-owned

bodies are not subject to the related party framework purely on the basis of the common government ownership or control and due to the fact that public sector structures are unique.

Board-Centric Governance as the Base.

The most impactful change made under the revised Directions is re-focusing of the responsibility on the Board of Directors. In the case of NBFCs as well as with SFBs, the Board is now expressly mandated with the responsibility of making sure that there are strong mechanisms in place to carry out the policies regarding related party lending. The credit risk management policy should particularly target lending to close ones and targeted employees, include extra protection, and offer whistle-blower solutions to communicate unethical or abnormal transactions without being afraid of penalty.

Controlled persons are also expected to give aggregate exposure limits and sub-limits on individual and group-related exposures to parties, with the prudential norms of the RBI strictly followed. This is better than blanket prohibitions and the boards have to exercise discretion wherein policy discipline and internal controls support such discretion.

Materiality Thresholds and Approval Architecture

The other major characteristic of the new framework is that it introduces materiality thresholds at transaction level, to decide who has the approval authorities. In the case of NBFCs, these thresholds are connected with regulatory layers Base, Middle and Upper or Top layers. Thresholds are associated with asset size in case of SFBs. Any transactions that are beyond the prescribed limit have to be sanctioned by the Board or a specific committee of the Board and transactions that are limited to the threshold can be sanctioned by delegated authority.

The mechanism guarantees increased scrutiny of the large exposures which are more risky, and operational flexibility on regular transaction and wasteful centralisation.

Conflict Management, Monitoring, and Anti-Circumvention

The RBI has strengthened governance reforms by having strict conflict-management provisions. The directors, all the close people in managerial positions, and certain employees must not be present when deliberating and making decisions that touch on lending to themselves or their respective persons. This is also to later activities like restructuring, waivers,

write-offs, settlements or enforcement.

Audit requirements and monitoring have also been enhanced. Regulated entities should have the updated records of related persons, related parties, and the corresponding exposures, report loans to specified employees to the Board on annual basis, and subject compliance with the framework to quarterly internal audit review. Any such variation of approved policy should be reported to the Audit Committee or the Board as may be the case.

Another anti-circumvention rule that has been introduced by the RBI is also maintained. Any product, structure, or arrangement that will circumvent the Directions such as reciprocal lending or quid pro quo transaction will be considered related party lending despite the nature of such transaction.

Prohibitions, Enforcement, and Transition

Although the general structure is based on governance, the RBI has stipulated and in certain instances reinforced substantive prohibitions, especially on SFBs. These are absolute limitations of exposures on promoters, key shareholders and organizations under their control or where they hold substantial influence, with exceptions of limited institutions.

The enforcement policy of RBI is clear. Failure to comply or evasion can invite financial fines, complete provisioning, forensic examination and audits, employee liability measures and company prohibitions. Simultaneously, the RBI has taken a cautious approach towards transition by permitting the current non-conformity exposures to lapse to maturity, but no renewal or upgrading of such exposures without being in the new framework is allowed.

Industry Impact and Regulatory Direction

It is probable that the amendments are going to modify incentives among regulated entities more than it is something that changes the formal permissibility of related party lending. Integrating decision-making into board practices, audit trails, and materiality levels has made the RBI make the failure of governance a more expensive affair and not just a higher exposure limit. This replaces institutional attention on the technicity of a transaction with the technicity of a transaction that is defensible on supervisory scrutiny. Consequently, boards might become more conservative in terms of connected lending, including in the context of transactions that are within the stipulated limits.

On an industry-wide level, the practice can slowly decrease the dependency on promoter-related or management-linked credit as a growth factor, especially in the NBFCs with a concentrated ownership structure. It puts more emphasis upon internal controls, independence of audit and effectiveness of boards of directors, thus making the institutions stand out based on the quality of governance and not the size of the balance sheet in itself. Although this can enhance market discipline in the long run, it also creates greater compliance drag on institutions that have less effective governance structures and this limits the amount of credit that can be deployed until the capacity to do so internally gets upgraded.

Conclusion

The January 2026 amendments mark a decisive shift in the RBI's regulatory strategy on related party lending. By replacing fragmented restrictions with a unified and board-driven governance framework, the RBI has sought to address the root causes of connected-lending risks rather than merely their symptoms. The parallel treatment of NBFCs and SFBs underscores RBI's intent to standardise governance expectations across the financial sector while retaining proportionate differentiation where necessary.

These changes reflect a broader supervisory philosophy. Sustainable financial growth depends not only on capital adequacy and prudential norms, but also on institutional governance, transparency, and accountability. How effectively boards internalise and implement this framework will determine whether the RBI's governance reset achieves its intended objective.