



BANKING AND FINANCE

From Co-Lending to Governance Reform: RBI's Expanding Prudential Framework

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Introduction

The Reserve Bank of India (RBI) has released the Draft Reserve Bank of India (Lending to Related Parties) Directions, 2025, inviting public comments until **October 31, 2025**. This marks a significant step towards establishing a unified, principle-based framework for transactions between regulated entities and their related parties, a long-standing area of concern for governance and prudential oversight in the Indian financial sector.

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Background and Rationale

At present, restrictions on lending to related parties are scattered across multiple regulatory frameworks. For example, Section 20 of the Banking Regulation Act, 1949 restricts banks from granting loans to their directors or firms in which they are interested. Similar provisions exist for Non-Banking Financial Companies (NBFCs) and co-operative banks, but with differing thresholds, exceptions, and disclosure obligations.

This fragmented approach has often led to regulatory arbitrage and ambiguity in defining “related parties.” With the financial ecosystem increasingly characterized by group structures, inter-connected entities, and complex ownership patterns, the RBI has sought to harmonize the approach under a single, principle-based framework.

The new draft directions are thus intended to simplify governance standards, improve transparency in related-party exposures, and enhance market discipline by aligning the obligations of all regulated entities (REs).

Key Provisions of the Draft Directions

(a) Applicability and Scope

The draft directions apply to all entities regulated by the Reserve Bank of India, including scheduled commercial banks (excluding regional rural banks), all categories of Non-Banking Financial Companies (NBFCs) such as housing finance companies, co-operative banks, and all-India financial institutions. The framework extends to every form of lending and credit exposure, encompassing loans, advances, guarantees, investments, or any other financial assistance granted where a related-party relationship exists.

(b) Definition of “Related Parties”

The draft directions adopt a broad, principle-based definition of “related parties,” consistent with Indian Accounting Standards (Ind AS 24) and established company law concepts. Under this framework, related parties include directors and key managerial personnel, significant shareholders and their relatives, as well as entities that are controlled or materially influenced by any of these individuals. Additionally, subsidiaries, joint ventures, and associates within the same group are considered related parties. Importantly, the draft proposes excluding independent directors of other banks or financial institutions from this definition to prevent unnecessary compliance burdens and avoid duplication in regulatory oversight. This approach ensures clarity in identifying related-party relationships while maintaining a practical balance for regulated entities.

(c) Materiality and Board Oversight

The draft directions introduce the concept of materiality-based thresholds to determine which related-party transactions require prior Board or committee approval. Under this framework, transactions exceeding the specified materiality threshold must obtain explicit approval from the Board or a designated committee. Such approvals would need to be accompanied by comprehensive documentation demonstrating that the transaction is conducted at arm's length, ensuring that lending decisions are based on commercial prudence rather than insider influence. Conversely, smaller or routine exposures, which fall below the prescribed thresholds, may be carried out under pre-approved internal policies, provided they are subject to appropriate monitoring and disclosure mechanisms. This tiered approach is designed to balance strong prudential oversight with operational flexibility, allowing financial institutions to efficiently manage day-to-day lending while maintaining strong governance and risk control for material related-party transactions.

(d) Exemptions under Section 20 of the Banking Regulation Act

The draft directions introduce a principle-based exemption to Section 20(1)(b) of the Banking Regulation Act, 1949, allowing certain categories of lending to related parties to be conducted without breaching statutory restrictions, provided that adequate safeguards and transparency measures are implemented. This exemption reflects the RBI's effort to modernize the regulatory framework in light of evolving and increasingly complex group structures within the financial sector. By providing a carefully calibrated exemption, the RBI aims to enable legitimate intra-group lending while continuing to mitigate risks arising from potential conflicts of interest.

(e) Reporting and Disclosure

To further enhance transparency and governance, the draft directions impose comprehensive reporting and disclosure obligations on regulated entities. Under the proposed framework, institutions would be required to:

- Report all material related-party transactions to the RBI under a structured supervisory reporting framework;
- Disclose the aggregate exposure to related parties in their annual financial statements, providing stakeholders with visibility into intra-group lending; and
- Ensure internal audit systems periodically review compliance with these norms, strengthening internal controls and accountability.

These measures are designed to align India's regulatory practices with international best practices on disclosure of related-party transactions and intra-group exposures, thereby promoting prudent risk management, stronger governance, and increased market confidence in the financial sector.

Governance and Compliance Implications

The proposed framework highlights the RBI's focus on ethical governance and management of conflicts of interest in lending to related parties. By mandating Board or designated committee oversight and clear disclosure requirements, the draft directions aim to ensure that all lending decisions are made at arm's length, grounded in the borrower's creditworthiness rather than personal relationships, influence, or proximity to decision-makers.

To comply effectively, financial institutions will need to:

- Revisit and update internal lending policies to align with the principles outlined in the draft directions;
- Identify and map related parties accurately, using both legal and beneficial ownership data to avoid gaps in compliance;
- Incorporate Board or committee approvals into credit workflows for transactions exceeding materiality thresholds; and
- Strengthen internal audit and compliance systems to continuously monitor, report, and review related-party transactions.

Once these directions are finalized, non-compliance could lead to regulatory action, supervisory penalties, or reputational consequences, making it critical for institutions to embed strong governance and risk management practices in their lending processes.

Strategic Significance and Stakeholder Consultation

The draft directions on lending to related parties are part of the RBI's broader policy reforms aimed at tightening prudential regulation and promoting uniformity across all regulated entities. This initiative follows the recent issuance of the Final Co-Lending Framework, effective January 1, 2026, which expanded the co-lending model beyond priority sector loans and

introduced enhanced risk-sharing and transparency norms. Together, these regulatory measures reflect a strategic effort to reduce regulatory arbitrage between banks and NBFCs, promote sound corporate governance, and strengthen market confidence in India's financial system.

As part of the consultative process, the RBI has invited comments and suggestions on the draft framework from stakeholders by October 31, 2025. Submissions can be made through the Connect2Regulate portal or via email/post to the Department of Regulation, RBI, Mumbai. Following a review of stakeholder feedback, the RBI is expected to issue the final directions, which will supersede existing circulars and set the definitive regulatory framework for lending to related parties. This process underscores the RBI's commitment to transparency and stakeholder engagement while finalizing measures that carry significant governance and compliance implications for financial institutions.

Conclusion

The Draft Lending to Related Parties Directions, 2025 represent a critical regulatory milestone in India's ongoing effort to promote integrity, transparency, and uniform governance in financial intermediation. For banks, NBFCs, and cooperative banks, the framework is both a compliance challenge and an opportunity to strengthen internal risk culture.

By embedding accountability at the Board level and insisting on transparent disclosures, the RBI's proposal aims to strike a balance between operational flexibility and prudential discipline, a step that could significantly improve the resilience and credibility of India's financial system.

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