



REGULATORY

Recalibrating MSME Credit: Why RBI's 2026 Move Matters for Small Businesses

AUTHOR Aditi Rana, Riya Rajbhar

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For years, one of the biggest struggles for small businesses in India has not been lack of ideas or effort. It has been accessing credit. A small manufacturer, a home-based food unit, a repair workshop, or a first-time entrepreneur often walks into a bank with a viable business plan, only to hear one question first: “What security can you give?”

In February 2026, the Reserve Bank of India attempted to change that equation. Acting under its powers under the Banking Regulation Act, 1949, the RBI issued the Lending to Micro, Small and Medium Enterprises (MSME) Sector (Amendment) Directions, 2026. While it may sound technical, the core idea is simple: small businesses should not be denied loans merely because they do not own property.

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The End of Mandatory Collateral up to ₹20 Lakh

The most significant reform is clear and direct. Banks are now prohibited from taking collateral security for loans up to ₹20 lakh granted to Micro and Small Enterprises.

This is not advisory guidance. It is a binding rule.

Earlier, banks often relied heavily on asset-backed lending. Even promising businesses were expected to provide property documents, land, or valuable assets as security. The amendment forces a shift in mindset. Credit appraisal must now focus on business viability, projected income, and repayment capacity rather than asset ownership.

In effect, the RBI is saying that entrepreneurship should not be limited to those who already possess wealth.

Protection for Government-Supported Entrepreneurs

The reform also strengthens support for businesses financed under the Prime Minister Employment Generation Programme, administered by the Khadi and Village Industries Commission.

Entrepreneurs covered under this scheme must receive collateral-free loans up to ₹20 lakh. This ensures that self-employment initiatives backed by public policy are not quietly defeated by collateral demands at the bank counter. It aligns regulatory banking norms with national employment and grassroots development goals.

A Step Further: Flexibility up to ₹25 Lakh

The amendment also introduces practical flexibility. Banks may extend collateral-free loans up to ₹25 lakh for borrowers with strong financial standing and good repayment history, subject to their internal credit policies.

This provision rewards disciplined businesses. It recognizes that trust in credit markets must be built through conduct. A small enterprise that demonstrates financial responsibility may be treated differently from a first-time borrower.

Balancing Inclusion with Stability

Naturally, banks operate within risk frameworks. Removing collaterals could raise concerns about exposure. The RBI addresses this by allowing banks to avail themselves credit guarantee coverage to cover existing schemes for MSE financing.

In simple terms, if a borrower defaults, part of the loss may be covered under a guaranteed mechanism. This design ensures that inclusion does not come at the cost of systemic stability.

The Clarification on Voluntary Collateral

An important nuance in the amendment relates to voluntary security. If a borrower chooses to pledge gold or silver for a loan within the collateral-free limit, that does not violate the rule.

The distinction is crucial. Banks cannot compel security. But borrowers remain free to offer it voluntarily, especially if it results in better interest rates or faster processing. The reform protects borrower autonomy while preventing coercion.

Regulatory Simplification and Transition

The amendment also removes an earlier provision from the Master Direction, indicating regulatory streamlining. Further, the new norms apply prospectively to loans sanctioned or renewed on or after 1 April 2026. Existing loans remain unaffected unless renewed, preserving legal certainty and orderly transition.

A Structural Shift in MSME Lending

At its heart, the 2026 amendment reflects a deeper philosophical shift. It reorients MSME lending from asset-based gatekeeping to performance-based evaluation. For countless micro and small enterprises that operate without property or large capital reserves, this change could redefine their relationship with formal banking institutions.

Whether the reform fully transforms ground-level banking practice will depend on implementation. Yet, as a matter of regulatory policy, the message is unmistakable: access to credit should depend on enterprise and ability, not inherited assets.

For India's small business ecosystem, that is no small development.

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