

## GENERAL STUDIES III

# RBI's PSL Reforms: Who Benefits from Priority Sector Credit?

**Faculty/Author:** Faculty Editorial Board**Date:** 21 October 2026**Platform:** Civil Service Gurukul Research Wing**Reading Time:** 5 Mins

*Decode RBI Priority Sector Lending norms for UPSC 2026 Prelims and Mains: targets, revised eligibility, financial inclusion, and policy challenges. The principal overhaul was issued on March 24, 2025, effective April 1, 2025, followed by amendments in 2026. RBI's consolidated directions reviewed here are updated through September 11, 2026. This should not be described as an entirely new "PSL Scheme 2026."*

## RBI Priority Sector Lending Norms: UPSC 2026 Explained

**Priority Sector Lending** directs a prescribed share of bank credit towards eligible activities and underserved borrowers. For UPSC, it connects **GS Paper III** banking, agriculture, MSMEs and inclusive growth with **GS Paper II** policy implementation. Priority Sector Lending also provides important Prelims distinctions between targets, eligibility and subsidies. RBI's reforms raise a wider Mains question: how can credit allocation support development without weakening prudent lending? These notes explain the revised framework, relevant 2026 developments, benefits, implementation risks and reforms needed for meaningful financial inclusion.

### 1. Introduction: What Has RBI Changed?

#### Get the Timeline Right

RBI issued its revised PSL Master Directions on **March 24, 2025**, effective **April 1, 2025**. Further amendments followed in 2026. The consolidated version examined here is updated through September 11, 2026. Therefore, distinguish the original overhaul from subsequent amendments instead of calling everything a new 2026 scheme.

#### Purpose of PSL

Some economically useful borrowers face high transaction costs, limited information or weak access to formal finance. PSL seeks to improve credit flows to eligible segments. It does not eliminate credit

appraisal, guarantee loan approval or convert bank lending into government expenditure.

## 2. Background: Why Directed Credit Matters

### Market Access and Development

Banks may find larger, established borrowers easier to assess than dispersed small enterprises or farmers. Yet smaller borrowers can generate employment and productive investment. Directed-credit obligations attempt to address this mismatch. Their effectiveness depends on whether finance reaches viable, underserved activities rather than merely satisfying accounting requirements.

### Credit Is Only One Input

Affordable finance cannot compensate fully for unreliable infrastructure, delayed customer payments or weak market access. PSL works best alongside extension services, business support, risk management and functioning supply chains. This distinction helps avoid treating higher lending volumes as proof of higher borrower welfare.

## 3. Categories and Bank-Specific Targets

### Eligible Categories

- **Production:** Agriculture and MSMEs.
- **Human development:** Education and housing.
- **Infrastructure:** Social infrastructure and renewable energy.
- **Additional categories:** Eligible export credit and specified other activities.

### Do Not Apply One Percentage to Every Bank

Overall targets include **40%** for domestic commercial banks excluding RRBs and SFBs, **75%** for RRBs, and **60%** for SFBs and UCBs. The applicable base is ANBC or the credit equivalent of off-balance-sheet exposures, whichever is higher. Category-specific conditions and sub-targets remain important.

### Small Finance Bank Revision

RBI's June 20, 2025 review reduced the overall SFB target from 75% to 60%, effective from financial year 2025-26. This separate change must be read with the consolidated directions. More lending flexibility creates a policy trade-off between diversification and maintaining attention to underserved customers.

## 4. Important Revised Features and 2026 Updates

### Eligibility Limits and Regional Incentives

Education loans, including vocational courses, qualify up to **₹25 lakh**. Housing eligibility varies by centre population and requires compliance with both loan and dwelling-cost ceilings. District-based weights reward eligible incremental lending in identified low-credit areas. These features should not be mistaken for universal loan entitlements.

### Cooperative Finance and Small-Loan Charges

The January 2026 amendment added conditional PSL treatment for eligible bank lending through NCDC to cooperative societies. It also clarified that specified loan-related charges, including guarantee fees, must not be levied on PSL loans up to ₹50,000. Institutional exclusions and underlying-use conditions still apply.

### Changes to the Calculation Base

Later 2026 amendments address specified ANBC exclusions connected with qualifying FCNR(B) and NRE deposit-funded advances. These are conditional denominator adjustments, not a general reduction in the headline PSL percentage. Always identify the applicable amendment and qualifying conditions.

## 5. Significance for India

### Productive Inclusion

Appropriate credit can finance equipment, working capital, education and livelihood improvements. Smaller firms may become more productive when finance arrives at the right time. Borrowers benefit when repayment schedules reflect actual cash flows instead of relying on unrealistic assumptions.

### Regional Balance and Green Investment

Location-sensitive incentives can encourage banks to develop underserved markets. Eligible clean-energy and social-infrastructure projects can combine commercial lending with wider development benefits. However, classification alone cannot establish project quality, environmental performance or equitable access.

## 6. Challenges and Criticism

### Compliance versus Additional Lending

Expanded eligibility may improve measured achievement without creating equivalent new access for excluded borrowers. Evaluation should separate newly originated credit from reclassification and examine borrower distribution. Larger eligible loans can also absorb attention unless smaller

borrowers receive effective institutional support.

### Risk, Documentation and Borrower Protection

Weak records, seasonal income and market shocks complicate appraisal. Targets should not encourage unsuitable debt. Equally, rigid documentation can exclude viable borrowers. Better information, proportionate processes and transparent communication are preferable to either indiscriminate approval or blanket rejection.

### Intermediary Accountability

On-lending can extend reach but adds monitoring layers. Institutions must establish where funds ultimately go and avoid duplicate recognition. Distribution networks should improve borrower service rather than simply move compliance responsibilities between organisations.

## 7. Way Forward and Mains Value Addition

- **Measure outcomes:** Track first-time borrowers, enterprise survival and repayment quality.
- **Improve appraisal:** Combine cash-flow assessment with proportionate documentation.
- **Build local capacity:** Strengthen staff knowledge of agricultural and small-business cycles.
- **Protect customers:** Explain costs, repayment obligations and grievance channels.
- **Coordinate support:** Connect lending with skills, infrastructure and market access.

**Mains frame work:** Assess access, additionality, affordability, asset quality and accountability. A balanced argument recognises market failures while protecting banking stability. The goal is viable economic participation, not simply larger loan books or favourable classification ratios.

## 8. Prelims Pointers

ANBC means Adjusted Net Bank Credit. PSL targets are not percentages of customer deposits. Eligibility does not guarantee concessional interest, collateral exemption or sanction. Weaker sections constitute an overlapping classification. A loan may contribute to relevant sub-targets only when all applicable conditions are satisfied.

## 9. UPSC PYQs and Practice Questions

**PYQ linkage:** Connect PSL with agricultural credit, financial inclusion, MSMEs and banking regulation. The following are original practice questions, not UPSC PYQs.

### Prelims Question 1

Which statement about PSL is correct?

- **A:** Every eligible applicant must receive a loan.

- **B:** All bank categories have identical targets.
- **C:** Classification does not remove credit appraisal.
- **D:** Targets are calculated only on deposits.

**Answer: C.** Regulatory eligibility does not establish repayment capacity or guarantee approval.

### Prelims Question 2

The revised overall SFB target from FY 2025–26 is:

- **A:** 40%.
- **B:** 50%.
- **C:** 60%.
- **D:** 75%.

**Answer: C.** Use the prescribed ANBC or off-balance-sheet credit-equivalent base, whichever is higher.

### Mains Question

How can priority sector lending promote inclusion without weakening credit discipline? Suggest implementation reforms. **(Answer in 150 words.)**

## 10. Conclusion

PSL should connect underserved borrowers with suitable, sustainable finance. Its success depends on genuine access, responsible appraisal and productive outcomes alongside compliance with targets.

### Key Takeaways for Revision

- The principal directions took effect on April 1, 2025.
- Read subsequent 2026 amendments separately.
- PSL targets differ across bank categories.
- SFBs have a 60% overall target from FY 2025–26.
- Classification is not an automatic subsidy or entitlement.
- Assess inclusion together with repayment quality.

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