Banks get 4 years to spread provisions for ECL norms

RBI proposes lower risk weightings for loans to MSMEs, residential housing

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Mumbai, 1 October

The Reserve Bank of India (RBI) has decided to give a glide path of four years starting 1 April, 2027, to banks to spread higher provisioning requirements while transitioning to the expected credit loss (ECL) framework from the current incurred loss framework. The RBI also proposed tweaking risk weightings for loan to micro, small & medium enterprises (MSMEs) and residential housing loans, which will release capital for banks.

This new framework of provisioning with prudential floors is proposed to be made applicable to all Scheduled Commercial Banks with effect from 1st April 2027. ECL norms will not be applicable for Small Finance Banks (SFBs), Payment Banks (PBs), Regional Rural Banks (RRBs) and All India Financial Institutions (AIFIs).

"They will be given a glide path (till March 31, 2031) to smoothen the one-time impact of higher provisioning, if any, on their existing books," RBI Governor Sanjay Malhotra said while announcing the review of the monetary policy on Wednesday. Rating agency ICRA had projected a 300-400 basis point reduction in core capital ratio of banks for the expected credit loss (ECL) effect.

"As against our earlier estimate of implementation from April 1, 2025, the proposed implementation from April 1, 2027 onwards will moderate the impact, given the consistent improvement in asset quality in recent years," ICRA said adding the phased rollout through FY2031, provides banks with greater flexibility to manage the associated provisioning requirements.

RBI said the ECL norms are expected to enhance credit risk management practices, promote better comparability of reported financials across institutions, and the framework is designed to be implemented in a non-disruptive manner.

Malhotra said it is proposed that the revised Basel III capital adequacy norms effective for commercial banks (excluding SFBs, PBs and RRBs) will come into effect from April 1, 2027.

RBI will issue a draft of the standardised approach for credit risk proposing lower risk weights on certain segments which are expected to reduce the overall capital requirements, particularly for MSMEs and residential real estate, including home loans. The capital requirements for operational risk have already been finalised (in 2023) whereas the capital requirements for market risk are under finalisation.

"These measures will help align our guidelines with global standards adapted to our national conditions and priorities, and strengthen the capital adequacy framework for banks and AIFIs," RBI said, adding the revised framework aims to improve the robustness, granularity and risk sensitivity of the standardized approach for calculating the capital charge for credit risk.

New norms at a glance

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- ECL norms are expected to enhance credit risk management practices and promote better comparability of reported financials
- RBI will issue a draft of the standardised approach for credit risk proposing lower risk weights on certain segments
- Icra had projected a 300–400-bp reduction in core capital ratio of banks for the expected credit loss effect