ICRA

# Indian Banking Industry

## RBI’s Draft Framework on Capital Charge for Credit Risk Hints at Relief for Banks

OCTOBER 2025

# Highlights

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*The draft circular proposes to reduce the risk weights applicable to some of the rating categories. This would enable the banks to reduce the capital allocated to such exposures, leading to an improvement in the capitalisation profile of the banks.*

*Capital release from risk weight changes would also help the banks partially negate the impact of proposed expected credit loss (ECL) framework.*

- The Reserve Bank of India (RBI) released a draft circular - Reserve Bank of India (Scheduled Commercial Banks - Capital Charge for Credit Risk – Standardised Approach) - on October 7, 2025.
- Key changes include lowering of risk weights for entities rated in the AA, BBB and BB ratings categories and for A1 rating on the short-term scale. However, as per the short-term rating mapping with long-term ratings, the variation across rating categories has increased. For instance, A3 rating maps with BBB rating category, though the risk weights on both these categories are different.
- In addition, risk weights have been specified separately for project financing exposures, which will be bifurcated to pre-operational and operational phases with further distinction in operational projects (high quality projects vs non-high quality). Fully operational projects will attract lower risk weights and projects classified as high quality will attract even lower risk weights.
- Besides, some of the individual loans like transactors in credit card loans will now attract lower risk weights. Moreover, the changes proposed in the risk weights applicable to lower rated MSMEs, unrated MSMEs meeting the regulatory retail criteria, and unrated MSMEs not meeting the regulatory retail criteria but having consolidated group turnover less than Rs. 500 crore will attract lower risk weights. Thus, it may lead to the release of capital and, hence, increased lending by banks across these MSMEs. Home loans and loan against property (LAP) have also got risk weight reductions and other operational changes, which would result in capital release for banks, thereby increasing their competitive edge in the segment.
- The RBI has also introduced a concept of differentiation in risk weights applicable to ratings assigned by different rating agencies. The ratings assigned by rating agencies, which have high reported 1-year probability of default (PD) than the reference PD, will attract higher risk weights. Accordingly, the banks will prefer to ask their borrowers to get rated from rating agencies having lower PDs.

# Key changes - Capital charge for credit risk

## Proposed risk weight reduction in certain categories to benefit capital ratios

- Under the standardised approach (SA), credit exposures shall be risk weighted either as per the risk weights prescribed for specific categories of exposures or as per the ratings assigned by eligible credit rating agencies (ECRA). Risk weighted assets are calculated as the product of the standardised risk weights and the exposure amount.

- The draft circular proposes to reduce the risk weights applicable to some of the rating categories. This would enable the banks to reduce the capital allocated to such exposures, leading to an improvement in the capitalisation profile of the banks.

- Banks are now also required to conduct a thorough due diligence to ensure that external credit ratings accurately and conservatively reflect the creditworthiness of counterparties. If a bank's internal analysis indicates that an exposure carries higher risk characteristics than those suggested by the external rating category, the bank may apply a risk weight that is at least one notch higher than the base risk weight assigned by the external rating agency. However, they are not allowed to lower the risk weight, if their internal assessment is favourable.
- In addition, ratings by different ECRAs could attract different risk weights based on their respective reported one-year probability of default (PD) statistics. Ratings by ECRAs with high PDs than specified would attract higher risk weights.

# Corporates to see reduced risk weights across rating categories

<table>
<tr><th>Exposures</th><th>Current regulations</th><th>Draft directions</th><th>ICRA’s comments</th></tr>
<tr>
<td>**Corporates including NBFCs – Long-term exposures**</td>
<td>Base risk weights, as per external rating category of counterparty
<table>
<tr><th>AAA</th><th>AA</th><th>A</th><th>BBB</th><th>Below BBB</th><th>Unrated</th></tr>
<tr><td>20%</td><td>30%</td><td>50%</td><td>100%</td><td>150%</td><td>100%</td></tr>
</table>
</td>
<td>Base risk weights, as per external rating category of counterparty
<table>
<tr><th>AAA and AA</th><th>A</th><th>BBB</th><th>BB</th><th>Below BB</th><th>Unrated</th></tr>
<tr><td>20%</td><td>50%</td><td>75%</td><td>100%</td><td>150%</td><td>100%</td></tr>
</table>
</td>
<td>▪ *Lowering of risk weights for entities rated in AA, BBB and BB rating categories will lead to lower capital being set aside for these exposures.*</td>
</tr>
<tr>
<td>**Corporates including NBFCs – Short-term exposures**</td>
<td>Base risk weights,as per external rating category of counterparty
<table>
<tr><th>A1+</th><th>A1</th><th>A2</th><th>A3</th><th>A4 & D</th><th>Unrated</th></tr>
<tr><td>20%</td><td>30%</td><td>50%</td><td>100%</td><td>150%</td><td>100%</td></tr>
</table>
</td>
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<tr><th>A1+</th><th>A1</th><th>A2</th><th>A3</th><th>A4 & D</th><th>Unrated</th></tr>
<tr><td>20%</td><td>20%</td><td>50%</td><td>100%</td><td>150%</td><td>100%</td></tr>
</table>
</td>
<td>▪ *On a short-term scale, the change is only for A1 rating wherein the risk weight has been reduced. However, as per the short-term rating mapping with long-term ratings, the variation across the rating categories has increased. For instance, A3 rating maps with BBB rating category; however, the risk weights on both these categories are different.*</td>
</tr>
</table>

# Specialised lending exposures to get specific risk weights

<table>
<tr><th>Exposures</th><th>Current regulations</th><th>Draft directions</th><th>ICRA's comments</th></tr>
<tr>
<td><b>Specialised lending exposures (SLE)</b></td>
<td>No specific regulation</td>
<td>Corporate exposures classified as specialised lending (not related to real estate) and where issue-specific external credit rating is not available shall attract following risk weights
<table>
<tr><th rowspan="3">Objects and commodities finance</th><th colspan="3">Project finance</th></tr>
<tr><th rowspan="2">Pre operational Phase</th><th colspan="2">Operational phase</th></tr>
<tr><th>High quality projects^</th><th>Others</th></tr>
<tr><td>100%</td><td>130%</td><td>80%</td><td>100%</td></tr>
</table>
</td>
<td>▪ <i>Project financing* exposure to be bifurcated to pre-operational and operational phases with further distinction in operational projects (high quality projects vs non-high quality). Resultantly, fully operational projects will attract lower risk weights and projects, which are able to meet their financial commitments in a timely manner across cycles will further be classified as high quality, leading to further lowering of the risk weights.</i></td>
</tr>
</table>

[*] *Includes refinancing of* an existing installation, with or without improvements

^^A project that can meet its financial commitments in a timely manner and its ability to do so is assessed to be robust against adverse changes in the economic cycle and business conditions will be classified as a high-quality project. Some of the conditions, such as at least one year of satisfactory operational track record of an infrastructure project, having sufficient reserve funds to cover contingency, assurance of revenues from a strong counterparty and so on need to be met to qualify as a high-quality project.

# MSMEs to get benefit of reduced risk weights; scope of retail expanded

| Exposures | Current regulations | Draft directions | ICRA's comments |
|---|---|---|---|
| **Regulatory retail exposures** | 75% risk weight<br>Small business having average annual turnover less than Rs. 50 crore were included in the regulatory retail | 75% risk weights<br>The regulatory retail now also includes education loans meeting the criteria, credit cards and overdraft receivables, which qualify as transactors*<br>For MSMEs to be included in regulatory retail, the criteria stands revised to the consolidated group turnover being less than Rs. 500 crore compared to the earlier criteria of a standalone turnover of Rs. 50 crore | ▪ *Risk-weights retained at 75% for all retail categories (exposures <Rs 7.5 crores extended to individuals, Hindu undivided family (HUF) and MSMEs) excluding personal loans, credit card receivables (other than transactors) credit market exposures, real estate exposures, loans/advances to staff covered by superannuation benefits. The addition of transactors in retail would reduce the risk weight applicable to them (currently 100%).* |
| **MSME exposures** | No specific regulation and were risk weighted akin to corporate exposures | If the MSME is part of a group with reported annual sales for the consolidated group greater than Rs. 500 crore for the most recent financial year, it shall attract the risk weight as applicable on corporate exposures.<br>▪ Rated exposures to MSMEs will be risk weighted akin to corporate exposures<br>▪ Exposure to MSMEs that meet regulatory retail exposure criteria to be risk weighted at 75%<br>▪ Unrated MSME not meeting regulatory retail criteria exposures shall be risk weighted at 85%<br>▪ Exposures to MSME secured by real estate shall be risk weighted akin to real estate asset class | ▪ *Given a majority of MSMEs were rated BBB and below, the risk weight for MSMEs was largely at 100% or 150% under current regulations. Given the lowering of risk weights for MSMEs meeting regulatory retail criteria as well as for BBB and below rated entities, it may lead to release of capital and hence increased lending by banks across these MSMEs. Similarly, unrated MSMEs not meeting regulatory retail criteria but having consolidated turnover less than Rs. 500 crore would also benefit.* |

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*[*] Refers to obligors in relation to facilities such as credit cards where the balance has been repaid in full at each scheduled repayment date for the previous 12 months and for overdrafts where there has not been any drawdown in the past 12 months*

# Housing loans - Proposed risk weight reduction across segment

<table>
<tr><th>Exposures</th><th>Current regulations</th><th>Draft directions</th><th>ICRA’s comments</th></tr>
<tr>
<td><b>Housing loans</b></td>
<td>
Base risk weights, as per ticket size (for one loan)
<table>
<tr><th>Up to Rs 30 lakh</th><th>Above Rs 30 lakh and <=75 lakh</th><th>Above Rs 75 lakh</th></tr>
<tr><td><b>35% (LTV<80%) 50% (LTV between 80 and 90%)</b></td><td><b>35%</b></td><td><b>50%</b></td></tr>
</table>
</td>
<td>
Base risk weights as per LTV (up to to two loans)
<table>
<tr><th colspan="4">Up to two loans</th></tr>
<tr><th><=50%</th><th>>50% to <=60%</th><th>>60% to <=80%</th><th>>80% to <=90%</th></tr>
<tr><td><b>20%</b></td><td><b>25%</b></td><td><b>30%</b></td><td><b>40%</b></td></tr>
</table>
<table>
<tr><th colspan="4">Third loan onwards</th></tr>
<tr><th><=50%</th><th>>50% to <=60%</th><th>>60% to <=80%</th><th>>80% to <=90%</th></tr>
<tr><td><b>30%</b></td><td><b>35%</b></td><td><b>45%</b></td><td><b>60%</b></td></tr>
</table>
In both the above cases, an additional five percentage points of risk weight would be applicable if loan amount is of Rs. 3 crore or above
</td>
<td>
<ul>
<li><i>Risk-weights are based on LTV compared to current regulations where risk weights were largely determined by ticket sizes.</i></li>
<li><i>Additionally, the base risk weights are now applicable for up to two loans instead of one loan earlier. The risk weights increase from third loan onwards.</i></li>
<li><i>The overall ticket size stands increased to Rs. 3 crore from Rs. 30-75 lakh under current regulations for applicability of the new risk weights. For loans above Rs. 3 crore, the loans will attract 5% additional risk weight.</i></li>
<li><i>On an overall, there have been risk weight reductions across the segment, which may lead to capital release, further increasing the competitive edge of the banks.</i></li>
</ul>
</td>
</tr>
</table>

# Risk weights increased for CRE segment; banks' builder portfolio to be impacted

<table>
<tr><th>Exposures</th><th>Current regulations</th><th>Draft directions</th><th>ICRA's comments</th></tr>
<tr>
<td><b>Commercial real estate (CRE) exposures</b></td>
<td>
<table>
<tr><th>Category</th><th>CRE – Residential Housing</th><th>Other CRE</th></tr>
<tr><td>Risk weight (%)</td><td>75%</td><td>100%</td></tr>
</table>
</td>
<td>
<table>
<tr><th>Category</th><th>CRE – Residential housing (ADC)*</th><th>Other CRE (ADC)</th></tr>
<tr><td>Risk weight (%)</td><td>100%</td><td>150%</td></tr>
</table>
</td>
<td>
<ul>
<li><i>In the case of commercial real estate (CRE) exposures for acquisition, development and construction – CRE (ADC), repayment is dependent on the underlying property such as renting/leading/selling units (in part or complete).</i></li>
<li><i>Overall risk weight in CRE segment has gone up which will lead to higher capital requirement for builder portfolio.</i></li>
<li><i>The banks having high exposures in the CRE/builder loans are expected to be impacted the most.</i></li>
</ul>
</td>
</tr>
</table>

**Projects should be RERA compliant and the borrower has invested 33% of the total cost or at least 50% of the approved has been sold/leased through pre-sale or pre-lease contracts, which are legally binding and where the purchaser/renter has paid at least 10% of the agreement value (forfeitable) and the borrower has invested at least 15% of the project cost as equity*

# Other real estate backed exposures – Higher risk weights for loans without underlying economic activity

<table>
<tr><th></th><th>Current regulations</th><th>Draft directions</th><th>ICRA's comments</th></tr>
<tr>
<td><b>Other claims secured by real estate (not covered in housing loans or CRE)</b></td>
<td>No separate regulation</td>
<td>
<table>
<tr><th colspan="5">Claims secured by residential properties – Repayment from economic activity</th></tr>
<tr><th>LTV</th><th><=50%</th><th>>50% to <=60%</th><th>>60% to <=80%</th><th>>80% to <=90%</th></tr>
<tr><td><b>Risk weight</b></td><td><b>20%</b></td><td><b>25%</b></td><td><b>30%</b></td><td><b>40%</b></td></tr>
</table>
<table>
<tr><th colspan="6">Claims secured by residential properties – Repayment from underlying property</th></tr>
<tr><th>LTV</th><th><=50%</th><th>>50% to <=60%</th><th>>60% to <=80%</th><th>>80% to <=90%</th><th>>90% to <=100%</th></tr>
<tr><td><b>RW</b></td><td><b>30%</b></td><td><b>35%</b></td><td><b>45%</b></td><td><b>60%</b></td><td><b>75%</b></td></tr>
</table>
</td>
<td>▪ <i>Risk weights are determined by type of usage of property and driven by repayment done either through economic activity or underlying property.</i><br>▪ <i>For cases where the repayment is done from the cash flows arising from the property only and not from the underlying economic activity, the risk weights applied are higher.</i><br>▪ <i>Banks having loans against property (LAP) with repayments from the underlying business will get more benefit and this would incentivise them to undertake income assessment while sanctioning the LAP. Many MSMEs also avail business loans against security of property and, hence, will get the advantage of lower risk weights.</i></td>
</tr>
</table>

# Other real estate backed exposures – Higher risk weights for loans without underlying economic activity (continued)

<table>
<tr><th></th><th>Current regulations</th><th>Draft directions</th><th>ICRA's comments</th></tr>
<tr>
<td>**Other claims secured by real estate (not covered in housing loans or CRE)**</td>
<td>No separate regulation</td>
<td>
<table>
<tr><th colspan="3">Claims secured by commercial properties –<br>Repayment from economic activity</th></tr>
<tr><th>LTV</th><th><=50%</th><th>>60%</th></tr>
<tr><td>Risk weight (RW)</td><td>Lower of 60% or RW of counterparty</td><td>RW of counterparty</td></tr>
</table>
<table>
<tr><th colspan="4">Claims secured by commercial properties –<br>Repayment primarily from underlying property</th></tr>
<tr><th>LTV</th><th><=60%</th><th>>60% to <=80%</th><th>>80% to <=100%</th></tr>
<tr><td>Risk weight</td><td>70%</td><td>90%</td><td>110%</td></tr>
</table>
<table>
<tr><th colspan="3">Claims secured by other real estate–<br>Repayment from economic activity</th></tr>
<tr><th>Counterparty type*</th><th>Individuals</th><th>MSME</th></tr>
<tr><td>Risk weight</td><td>75%</td><td>85%</td></tr>
</table>
</td>
<td>
■ *Risk weights are determined by type of usage of property and driven by repayment done either through economic activity or underlying property.*<br>■ *For cases where the repayment is done from the cash flows arising from the property only and not from the underlying economic activity, the risk weights applied are higher.*
</td>
</tr>
</table>

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**For Counterparty type other than Individuals and MSME, risk weight is applicable as per corresponding counterparty*

# Specified categories witness some modifications

| | Current regulations | Draft directions | ICRA's comments |
|---|---|---|---|
| **Specified categories** | ▪ Personal loans (excluding housing loans, education loans, vehicle loans and loans secured against gold) attract a risk weight of 125%<br>▪ MFI loans attract risk weight of 100%<br>▪ Credit card receivables have risk weight of 150%<br>▪ For gold and gold jewellery, risk weight of 125% for exposure after risk mitigation | ▪ Personal loans (excluding housing loans, education loans, vehicle loans and credit card receivables other than transactors) attract a risk weight of 125%<br>▪ MFI loans will continue to attract risk weight of 100%<br>▪ For gold and gold jewellery, risk weight of 125% for exposure after risk mitigation | ▪ *The risk weight is proposed to be retained at the existing levels, barring credit card receivables for transactors, which will attract risk weight of 75% compared to existing risk weight of 150%.*<br>▪ *Haircut of 20% on gold loans to be applied instead of 15% as per current regulations.* |

# RBI introduces higher risk weights for CRAs having higher probability of default

<table>
<tr><th></th><th>Current regulations</th><th>Draft directions</th><th>ICRA’s comments</th></tr>
<tr>
<td><strong>Differentiation in ratings assigned by different CRAs based on PD</strong></td>
<td>No specific regulation</td>
<td><em>Reference PD range for rating categories, which shall be used to compare individual rating agencies’ reported PDs</em>
<table>
<tr><th>AAA and AA</th><th>A</th><th>BBB</th><th>BB</th><th>B and Below</th></tr>
<tr><td><=0.10%</td><td>>0.10% and <=0.20%</td><td>>0.20% and <=0.40%</td><td>>0.40% and <=1.%</td><td>>1.0%</td></tr>
<tr><td></td><td></td><td></td><td></td><td></td></tr>
<tr><th colspan="5">Base  risk weight</th></tr>
<tr><td>20%</td><td>50%</td><td>75%</td><td>100%</td><td>150%</td></tr>
</table>
</td>
<td><ul>
<li><em>If the one-year PD* of a credit rating agency is less than the specified range, a base risk weight is provided. However, if the reported PD for a rating category is above the range, risk weight of one bucket higher will be applied.</em></li>
<li><em>With the introduction of this, there will be differentiation in the risk weights applicable to ratings assigned by different rating agencies.</em></li>
<li><em>The ratings assigned by rating agencies, which have higher reported PD than the reference PD, will attract higher risk weights. Accordingly, the banks will prefer to ask their borrowers to get rated from rating agencies having lower PDs.</em></li>
</ul></td>
</tr>
</table>

*Clarity will be needed on if the PD is the long-term 1-year PD or short-term 1-year PD*

# Annexure I: Recent research reports published in the banking sector

- GST rate cuts to support consumption, which along with surplus liquidity would drive bank's credit growth (September 2025)
- Margins to be under pressure given repo rate cuts; asset quality remains monitorable (June 2025)
- Final guidelines on liquidity coverage ratio to support credit growth (April 2025)
- Regulatory easing to support credit growth in FY2026; though asset quality remains monitorable (March 2025)
- Increase in deposit insurance limit to impact banks' profitability but may aid their liquidity coverage (March 2025)

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# Thank You!