

Indian Banking Industry

Impact of RBI's proposed ECL framework on banks' capitalisation profile likely to be moderate

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The proposed expected credit loss (ECL) framework would shift banks from the traditional 'incurred loss' approach to a predictive framework.

Given the slightly higher floors than the current norms, the overall provisioning requirement is set to increase from the current level.

Nevertheless, the improvement in asset quality in the recent past would lessen the impact compared to the impact had the norms been implemented a few years ago.



- The Reserve Bank of India (RBI) released a draft circular - [Reserve Bank of India \(Scheduled Commercial Banks - Asset Classification, Provisioning and Income Recognition\) Directions, 2025](#) - on October 7, 2025. Principally, the overdue ageing-based classification* will get replaced with a forward-looking, risk-based model (Stage 1: Low risk, Stage 2: Significant increase in credit risk (SICR), and Stage 3: Credit-impaired).
- The proposed expected credit loss (ECL) framework would shift banks from the traditional 'incurred loss' approach to a predictive framework and is a step in direction towards Ind-AS implementation. Banks must now estimate losses based on probability of default (PD), loss given default (LGD), and exposure at default (EAD). This allows for early recognition of credit deterioration, improving the risk visibility and enabling proactive portfolio management.
- One of the important changes would be the inclusion of loans, which are 30-90 days past due (dpd), in the Stage 2 classification. This approach would be in line with that being followed by non-banking financial companies (NBFCs). However, this is different from the earlier discussion paper, as per which only 60-90 dpd accounts were likely to be included in the Stage 2 category.
- The proposed ECL floors are marginally higher than the current Income Recognition and Asset Classification and Provisioning (IRAC) norms. Accordingly, the overall provision requirements are set to increase for majority of the product segments. The significant improvement in asset quality in the recent past would lessen the impact compared to the impact had the norms been implemented a few years ago. Overall, as per ICRA's initial estimates, the impact of the proposed ECL norms on reported core capital ratios of the banks as on transition date would be below 150 basis points.
- In ICRA's view, banks, particularly those operating with thinner capital cushions and with higher overdue books, high sanctioned but undisbursed limits and high non-fund-based exposures are likely to see more transitioning pain and would need to raise capital and/or avail the transition period till FY2031 to phase out the impact on CET-1. Those banks, which will avail such forbearance, are not likely to be viewed favourably by investors, making it even more difficult for them to raise capital in such a situation.

*<90 days past due (dpd) classified as standard; thereafter classification changes to non-performing advances (NPA) and eventually reaching upto loss assets



RBI's proposed implementation of ECL approach is expected to increase the provisioning requirement for banks



- Lending institutions, including banks, are required to maintain sufficient provisions on loan assets, investments and other assets to account for any diminution in the value of such assets. It is the responsibility of the management to maintain sufficient provisions. However, the provisions are subject to meeting the minimum thresholds prescribed by the regulator.



- The existing approach defines fixed rates to make provisions for different loans/investments/assets and the same depend on the type of asset and the overdue ageing status of the same. The rate of provision to be made is directly proportional to the overdue ageing of the asset.



- Under the draft circular, the RBI has proposed to implement the ECL framework for making provisions starting April 1, 2027. The banks will be required to calculate the additional provision required, if any, on the existing portfolio at the time of transition and thereafter the ECL norms are to be followed on yearly basis.
- A bank shall recognise lifetime ECL for all financial instruments evidencing SICR since initial recognition. For this purpose, a bank shall adopt a 'three-stage' approach, based on the credit quality of the financial instrument at the time of initial recognition, or on any subsequent reporting date. The approach is akin (with suitable changes) to what NBFCs currently follow under Ind-AS. Thus, it may be considered a precursor to banks to eventually shifting to Ind-AS, going forward.

Asset classification; 3-stage approach to replace overdue ageing-based classification

Parameters	Existing provision	Revised provision	ICRA's comments
Guiding principle	<p>Under the current norms, the asset classification is done basis the overdue ageing with 90 days overdue getting tagged as non-performing advances (NPA) with further overdue status leading to further downgrade of status.</p>	<p>Banks to follow a 3-stage classification basis the level of credit risk. Banks are required to make an assessment, at each reporting date, if the credit risk on a financial instrument has increased significantly since the initial recognition. If so, the bank is required to make a loss allowance, estimated based on lifetime expected credit losses.</p>	<ul style="list-style-type: none"> Asset classification is set to become more forward looking. The ECL model shifts from the traditional 'incurred loss' approach to a predictive framework. Banks must now estimate losses based on PD, LGD, and EAD. This allows for early recognition of credit deterioration, improving the risk visibility and enabling proactive portfolio management. ECL would bring Indian banks in line with international standards, facilitating better integration with global financial systems and improving investor confidence. The mandated disclosures in financial statements would bring in more transparency and, thus, enhance comparability among banks.
Classification	<p>The standard assets comprise all the borrower's accounts, which have been regular in servicing and not regarded as NPA. Accounts under special-mention status (1-90 days overdue) or restructured are also considered standard unless the same slip to 90 days' overdue and get classified as NPA. Accounts are classified as NPA on overdue status exceeding 90 days for any of the loan account held by the borrower. NPA accounts are further downgraded, depending on overdue ageing finally being classified as loss asset (refer Exhibit 3). Provisioning norms vary, depending on the asset classification in the above categories.</p>	<p>All the assets with low credit risk and no significant increase therein since their initial recognition to be classified as Stage-1. For assets which have had a SICR since the initial recognition but are not credit impaired to be classified as Stage-2. While the SMA and restructured assets are not specifically required to be categorised here, these may be included herein. A financial instrument is said to be under Stage 3, when it is considered to be 'credit impaired' at the reporting date. Though there could be other means to identify/classify financial instruments as Stage-3, one of the important parameters would be overdue status and the accounts 90 days' overdue (NPAs) would come under this category. For such instruments, lifetime ECL shall be recognised.</p>	

- The ECL model primarily calculates the expected loss from an asset/financial instrument, which is based on PD, LGD and EAD. Thus, the ECL is a product of PD, LGD and EAD.
- ECL provisioning will be based on bank's own historical data (at least five years) on PD and LGD. Nevertheless, the RBI has specified the floors (refer Exhibits 2 and 4) and the ECL provisioning cannot go below the same.
- A bank's board and senior management would be responsible for credit risk practices and adequacy of the ECL framework.
- The Stage-2 classification would be including loans which are 30-90 dpd, which is in line with the approach being followed by NBFCs. This is different from the earlier draft norms as per which only 60-90 dpd accounts were likely to be included in Stage-2 category.
- ECL provisioning will be extended to off-balance sheet items and sanctioned but undisbursed limits as well.
- The banks would be permitted a glide path from FY2027 to FY2031 to smoothen the impact of the additional required provision on capitalisation profile.
- Banks would be required to provide detailed credit risk disclosures, which will increase the transparency.

ECL floors for – Stage-1 and Stage-2 assets to increase provisioning requirement

Exhibit 1: Existing provisions under IRAC

Loan product	IRAC provisions
Corporate loans	0.40%
Secured retail loans	0.40%
Small and micro-enterprises	0.25%
Medium enterprises	0.40%
Home loan/LAP	0.25%
Unsecured retail loans	0.40%
Loan against FD	0.40%
Gold loan	0.40%
Credit equivalents for off-BS exposures	0.40%
Farm loans	0.25%
Others	0.40%
Commercial real estate	1.00%
Commercial real estate- Residential	0.75%
Other project	0.40%

Source: RBI

Exhibit 2: Proposed ECL floors under draft ECL guidelines

Loan product	Stage-1 floor	Stage-2 floor		
Corporate loans	0.40%	5.00%		
Secured retail loans	0.40%	5.00%		
Small and micro-enterprises	0.25%	5.00%		
Medium enterprises	0.40%	5.00%		
Home loan/LAP	0.40%	1.50%		
Unsecured retail loans	1.00%	5.00%		
Loan against FD	0.40%	0.40%		
Gold loan	0.40%	1.50%		
Credit equivalents for off-BS exposures	0.40%	5.00%		
Farm loans	0.25%	5.00%		
Others	0.40%	5.00%		
Project loans	Construction	Operational	Construction	Operational
Commercial real estate	1.25%	1.00%		
Commercial real estate- Residential	1.00%	0.75%	^Additional 0.375%/0.5625%	
Other project	1.00%	0.40%		

Source: RBI

- The proposed minimum provisioning requirements are largely similar for Stage-1 but higher for Stage-2 as per the present IRAC norms. The major impact will be on the Stage-2 assets as most of these currently form part of the standard asset and, hence, attract lower provisioning requirement than the proposed floors. However, some of the loan products like unsecured retail and commercial real estate would carry higher ECL floors in Stage-1 as well compared to the current norms. Project loans and loans and exposure to foreign counterparty shall attract additional requirements, as per the respective guidelines on infrastructure financing and country risk premium.
- Thus, overall provisions for Stage-1 and Stage-2 are likely to increase from the current standard asset provisions. Nevertheless, the floors specified does not seem to be very high, as usually NBFCs carry higher provisions given that the typical borrower profile of banks tend to be better than NBFCs.

^For accounts which have availed DCCO deferment and are classified as 'standard', lenders shall maintain additional specific provisions of 0.375% for infrastructure project loans and 0.5625% for non-infrastructure project loans (including CRE and CRE-RH), for each quarter of deferment

Stage-3 assets – Higher floor, except for specified loans

Exhibit 3: Existing provisions under IRAC

NPA ageing	IRAC provisions	
	Secured	Unsecured
0-1 Year	15% ^{&}	25%
1-2 year	25%	100%
2-3 year	40%	100%
3-4 year	40%	100%
>4 years	100%	100%
Loss Asset	100%	100%

Source: RBI, ICRA Research. [&]25% for lease assets

Exhibit 4: Proposed ECL floors under draft ECL guidelines

Stage-3 ageing	ECL floors			
	Secured	Unsecured-other than retail	Retail-Unsecured	Secured portion of specified loans*
0-1 Year	25%	40%	25%	10%
1-2 year	40%	100%	100%	20%
2-3 year	55%	100%	100%	30%
3-4 year	75%	100%	100%	40%
>4 years	100%	100%	100%	100%
Loss Asset	100%	100%	100%	100%

Source: RBI, ICRA Research. *Loans against house property (HL/LAP), gold, FD, LIC policy, KVP; for residual unsecured portion, floors specified for unsecured portion would apply

- Exemptions to the ECL provisions for all stages and thus the floors mentioned above are as follows:
 - SLR investments, loans or direct claims on GoI
 - GoI guaranteed portion of loan, including any guarantee by ECGC/CGTMSE etc.
- Stage-3 asset provisioning requirements are set to increase for majority of the products, while there is partial comfort on Stage-3 assets secured against the safer assets which would have lower proportion ECL than the general category. Given that the banks currently have provision cover of ~78%, the additional provisioning requirement for Stage-3 assets is expected to be limited.
- The addition of the step-levels for the intermittent years of Stage-3 assets would require banks to provide on Stage-3 assets more consistently in its transition to loss asset status.

Transitional provisions up to FY2031 to provide relief for banks

Exhibit 5: Glidepath transition up to FY2031 allowed for the transitional difference as on April 1, 2027

Financial Year	Maximum transitional adjustment allowed to CET-1 capital	Illustration for CET-I capital with transitional arrangement	Illustration for CET-I % with transitional arrangement	Illustration for CET-I capital without transitional arrangement	Illustration for CET-I% without transitional arrangement
FY2028	4/5	Rs. 9,600 crore	9.6%	Rs. 8,000 crore	8.0%
FY2029	3/5	Rs. 9,200 crore	9.2%	Rs. 8,000 crore	8.0%
FY2030	2/5	Rs. 8,800 crore	8.8%	Rs. 8,000 crore	8.0%
FY2031	1/5	Rs. 8,400 crore	8.4%	Rs. 8,000 crore	8.0%
FY2032	nil	Rs. 8,000 crore	8.0%	Rs. 8,000 crore	8.0%

Assumptions for the Illustration: one-time transitional hit to be Rs. 2,000 crore on a CET-1 capital base of Rs. 10,000 crore and RWA of Rs. 1.0 lakh crore resulting in base CET-1 of 10.0%. The above calculation excludes the impact of incremental profits/capital raise and yearly provisions.

Source: RBI ICRA research

- The guidelines shall be in effect from April 1, 2027 (FY2028). For the additional ECL provision on the existing exposures (above the existing provisions), the bank may choose to phase out the effect of the same on CET-1 over the transition period until March 31, 2031.
- Going ahead, the bank must create provisions as per the ECL methodology on existing as well as new exposures, irrespective of the initial incremental provisions being adjusted till FY2031.
- Additional disclosures for the banks in the financial statements, shall include,
 - Whether transitional arrangements have been applied; and,
 - Its impact on the bank's regulatory capital and leverage ratios had these transitional arrangement not being availed.

Impact of ECL framework on CET to be manageable

- **Stage 1** – As most of the products carry ECL floors similar to current IRAC norms, the additional requirement is expected to be limited.
- **Stage 2** – Most of the impact will be visible in this segment as currently these are classified as standard assets and carry lower provision than the specified ECL floors. ICRA estimates the impact of this to be in the range of 10 bps to 20 bps on reported CET-1 ratio for the sector.

Exhibit 6: Expected reduction in CET-1% at different levels of SMA and ECL

		Special Mention Accounts (SMA) as % of Loan Book		
		2.0%	2.5%	3.0%
ECL	5.00%	0.11%	0.14%	0.16%
	7.50%	0.16%	0.20%	0.24%
	10.00%	0.22%	0.27%	0.33%

- **Stage 3** – Given the improvement in asset quality in the recent past and the high provision coverage ratio of ~78% of banks as on March 31, 2025, the incremental provisioning requirement is expected to be limited.
- **Sanctioned but undisbursed exposures** would also lead to additional provisioning requirement. Assuming the same to be 10-20% of the fund-based exposures of the banks and assuming the range of applicable ECL on the same, the impact could lie in the range of 5-20 bps on reported CET-1 ratio.
- In addition, provisioning for **off-balance sheet items** like non-fund-based limits and derivatives etc. would also have some impact on the capital ratios; however, it is difficult to quantify the same at this stage.

Overall, ICRA's initial estimate of impact of the proposed ECL norms on reported core capital ratios stands at below 150 bps

Annexure I: Recent research reports published in the banking sector

- [RBI's Draft Framework on Capital Charge for Credit Risk Hints at Relief for Banks](#) (October 2025)
- [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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Analytical Contact Details

Name	Designation	Email	Contact Number
Karthik Srinivasan	Senior Vice-President and Group Head	karthiks@icraindia.com	022 – 6114 3444
Anil Gupta	Senior Vice-President and Co-Group Head	anilg@icraindia.com	0124 – 4545 314
Sachin Sachdeva	Vice-President and Sector Head	sachin.sachdeva@icraindia.com	0124 – 4545 307
Varun Dhapade	Analyst	varun.dhapade@icraindia.com	022 – 6114 3463





ICRA

Business Development/Media Contact Details

Name	Designation	Email	Contact Number
L Shivakumar	Chief Business Officer	shivakumar@icraindia.com	022-61693304
Sai Krishna	Head - Research Sales and Investor Connect	sai.krishna1@icraindia.com	9840774883
Rohit Gupta	Head Business Development – Infrastructure Sector	rohitg@icraindia.com	0124-4545340
Vivek Bhalla	Head Business Development – Financial Sector	vivek.bhalla@icraindia.com	022-61693372
Vinita Baid	Head Business Development – East	vinita.baid@icraindia.com	033-65216801
Shivam Bhatia	Head Business Development – Corporate Sector – North & South	shivam.bhatia@icraindia.com	0124-4545803
Sanket Kulkarni	Head Business Development – Corporate Sector – West	sanket.kulkarni@icraindia.com	022-6169 3365
Naznin Prodhani	Head - Group Corporate Communications & Media Relations	communications@icraindia.com	0124-4545860





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