



Expected Credit Loss (ECL)

RBI's Draft Directions on Asset Classification, Provisioning and Income Recognition, 2025



November 2025

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1. Introduction

On 7 October 2025, the Reserve Bank of India (RBI) proposed a transformative shift in the provisioning requirements by issuing a draft Directions on Asset Classification, Provisioning and Income Recognition¹. In this, RBI has proposed a comprehensive overhaul of the existing IRACP (Income Recognition, Asset Classification and Provisioning) norms by introducing a forward-looking Expected Credit Loss (ECL) framework governing Scheduled Commercial Banks (SCBs) (excluding Regional Rural Banks (RRBs), Small Finance Banks (SFBs), and Payments Banks) and All India Financial Institutions (AIFIs). This addresses the limitations of the current incurred Loss model under IRACP norms which recognises credit losses only after a default event, often resulting in delayed provisioning and underestimation of credit risk. These directions shall come into effect from 1 April 2027.

The proposed framework aims to enhance the accuracy, transparency, and timeliness of expected credit loss recognition, thereby improving the resilience of the Indian banking system. It introduces a structured staging mechanism for asset classification, updates income recognition norms, and mandates robust governance and disclosure standards. These changes are expected

to drive consistency across institutions, improve risk management practices, and support better-informed decision-making by stakeholders. This will also ensure align provisioning requirements with other regions across globe where banks are already computing ECL basis IFRS9/ASC 326 CECL requirement.

A forward-looking approach to provisioning has been introduced which is applicable to loans, debt securities (excluding those measured at FVTPL), trade and lease receivables, loan commitments, off-balance sheet exposures and any other financial assets having contractual right to receive cash.

The ECL framework mandates banks to compute probability-weighted Expected Credit Loss across multiple macroeconomic scenarios, ensuring forward-looking provisioning with product based prudential floors prescribed for Stage 1 and Stage 2. Additionally, for Stage 3 accounts, provisioning floors are based on product type and duration of default.

The framework mandates robust governance, data quality, and model validation processes, aiming to enhance transparency, consistency, and resilience in credit risk management across banks.

1. "Reserve Bank of India (Scheduled Commercial Banks - Asset Classification, Provisioning and Income Recognition) Directions, 2025 – Draft for Comments issued by the Reserve Bank of India in October 2025

2. Key aspects of proposed framework

Default / NPA classification

The draft guidelines mandate borrower-level NPA classification, meaning if any facility is in default, all exposures to that borrower are treated as NPAs. Some of the aspects to consider classifying an asset as NPA/credit impaired as mentioned in guideline are overdue for more than 90 days (which is to be determined basis day-end batch process run), out-of-order in overdraft accounts, or if there's cross-default or signs of financial distress of borrower. REs may need to enhance credit assessment framework to identify signs of distress and accordingly classify borrower as default.

Upgradation to standard status requires full clearance of all overdue amounts across facilities. NPA will continue to get categorised into sub-standard, doubtful, and loss assets based on duration and recoverability with special provisions being applied to agricultural loans (based on crop duration), government-guaranteed exposures, co-lending, consortium lending, and export finance. Additionally, assets acquired at deep discounts due to

credit impairment must be classified as Purchased or Originated Credit-Impaired (POCI).

We believe that though the NPA guidelines are mostly similar as issued before by RBI, but now banks have to consider above default/NPA criteria while determining pool of customers for PD and LGD computation. Additionally, banks will need to have mechanism to assess likely financial distress and accordingly classify all account of borrower as default and subsequently consider them for PD and LGD computation

Transition arrangements

A transitional adjustment mechanism has been introduced to ease the capital impact of adopting the ECL framework. This allows banks to phase in the difference between ECL-based provisions and existing IRACP provisions over four years from 2027 to 2031 whereby up to 80 per cent to 20 per cent of the transitional adjustment may be added back to CET 1 capital. This phased approach aims to support a smooth transition while maintaining regulatory capital adequacy.

The RBI Draft Directions, 2025 for Scheduled Commercial Banks on Asset Classification, Provisioning and Income Recognition propose a comprehensive revision of the existing norms. Here are the key requirements and highlights

ECL modelling requirements

- **Homogenous segmentation**
- **Forward looking** PD, LGD & EAD
- Historical data for **minimum 5 years**.
- **Regulatory PD floor of 0.05 per cent**
- **Regulatory LGD of 45 per cent, 65 per cent or 70 per cent** if sufficient data is unavailable.



Prudential floors

- **Minimum provisioning for ECL estimates** computed for Stage 1 and 2 at a product level as regulatory backstop
- **Provisioning floor** for Stage 3 accounts basis NPA vintage
- Additional provisioning as per ECGC classification



SICR Criteria

- **Indicative triggers** as part of regulations
- **Forwarding looking** indicators to be used
- **Cool-off period** of 6 months from stage 3 to stage 1
- **Rebuttable** for 30 days DPD



Default / NPA classification

- **Day-end processes** for borrower accounts overdue
- **Cross default** across products including derivatives
- Same borrower level classification across REs in case of **co-lending**
- **Crop cycle-based classification** for agricultural loans



Governance

- **Board level oversight** in guidelines
- **Subcommittee / approved committee** of CFO & CRO with roles and responsibilities
- **Control framework** for ECL



Model risk management

- **Three tier MRM framework**; Front line operations, Risk management and compliance, Internal audit
- Requirement of **model inventory, tiering, document, validation, calibration and performance assessment**



Disclosures

- **Mandatory disclosures** in financial statements of credit risk management, ECL estimation approach
- **Specific submissions** to RBI of **approach, macroeconomic assumptions, adjustments**



Transition arrangements

- **Transitional adjustment for ECL impact** on regulatory capital
- 80 per cent to 20 per cent adjustment added back to CET 1



KEY PARAMETERS

Significant increase in credit risk (SICR)


Banks are required to assess SICR at each reporting date using documented criteria such as days past due, credit rating downgrades, increased loan pricing, or macroeconomic deterioration and other forward-looking

factors. Draft guidelines state a rebuttable presumption for classifying more than 30 days past due in Stage 2. The draft regulations also require “cool-off” period to be followed when transitioning assets back to Stage 1 from Stage 3 with minimum period of six months in Stage 2 when all irregularities are rectified.


Key focus areas for banks



We have observed that banks normally only use DPD criteria for SICR assessment but moving forward that will not suffice and banks need to perform additional assessments.



To be able to comply with cool-off requirement, banks must have consistency in data (such as unique identifier) as well as overdue status for in different months for stage 3 accounts.



As SICR have significant impact on ECL provisions (12-month ECL for stage 1 versus lifetime for stage 2), banks must have framework to validate SICR criteria.



Banks need to closely monitor the slippages as they will have material impact on provision and capital of the bank for considerable time period even after account has been cured due to cool-off requirement.

Prudential floors for ECL

Though the draft guideline requires use of internal models for computation of external credit loss, it provides product wise prudential floors too to ensure adequate provisions are kept by banks. The floors provided range from 0.25 per cent (small and micro, farm loans, etc.) to 1.25 per cent for CRE under construction phase for Stage 1 loans. Similarly, floor for Stage 2 range from 1.50 per cent to 5.00 per cent depending upon portfolio type and floors for Stage 3 accounts are based upon NPA vintage as well as secured and unsecured exposure. Additionally, banks are required to make provisions on net funded country exposures, based on ECGC classification, ranging from 0.25 per cent to 100 per cent according to the risk categories.

As mentioned earlier, proposed floors are conservative and will have higher impact on capital of the bank. Thus, it is imperative for the bank to efficiently manage portfolio as well as have robust collection mechanism to minimise the impact.



Modelling requirements for ECL components

Segmentation of credit risk exposures is one of the main building blocks in the computation of Expected Credit Loss (ECL). Banks are expected to group exposures based on shared credit risk characteristics to enable a more accurate assessment of changes in credit risk and their impact on ECL estimates.

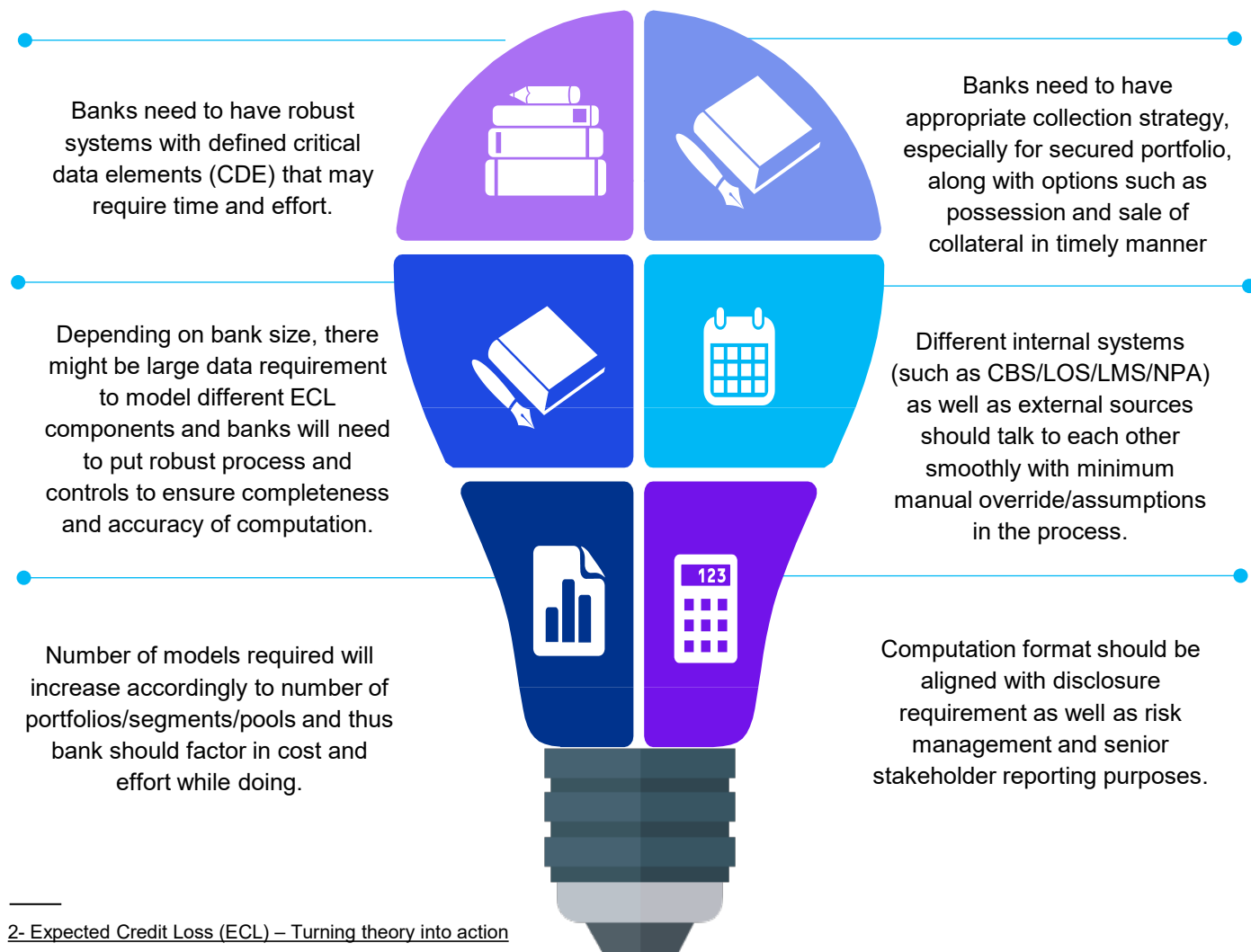
ECL will be based on three key components—Segmentation, Probability of Default (PD), Loss Given Default (LGD), and Exposure at Default (EAD)—and must incorporate forward-looking macroeconomic scenarios.²

- Homogenous segments within portfolio must be created depending on portfolio vintage and availability of data.
- PD must be estimated using both Through-the-Cycle (TTC) and Point-in-Time (PiT) approaches, with PiT reflecting macroeconomic forecasts.

- LGD should be reflective of realistic recovery expectations, be forward-looking, and include regular collateral valuation, especially for Stage 3 exposures.
- EAD must cover both funded and off-balance sheet exposures wherein Banks are required to estimate based on past the future macroeconomic projections. Additionally regulatory Credit Conversion Factors (CCFs) can be used in line with the existing Basel norms for capital.

To support model robustness, banks are required to maintain at least five years of historical loss data to account for business cycle variations and outliers. The guidelines also provide regulatory benchmarks: a minimum PD floor of 0.05 per cent, and LGD backstops of 45 per cent (Basel-eligible collateral), 65 per cent (other secured), and 70 per cent (unsecured), which banks may adopt where internal estimates are not available or reliable.

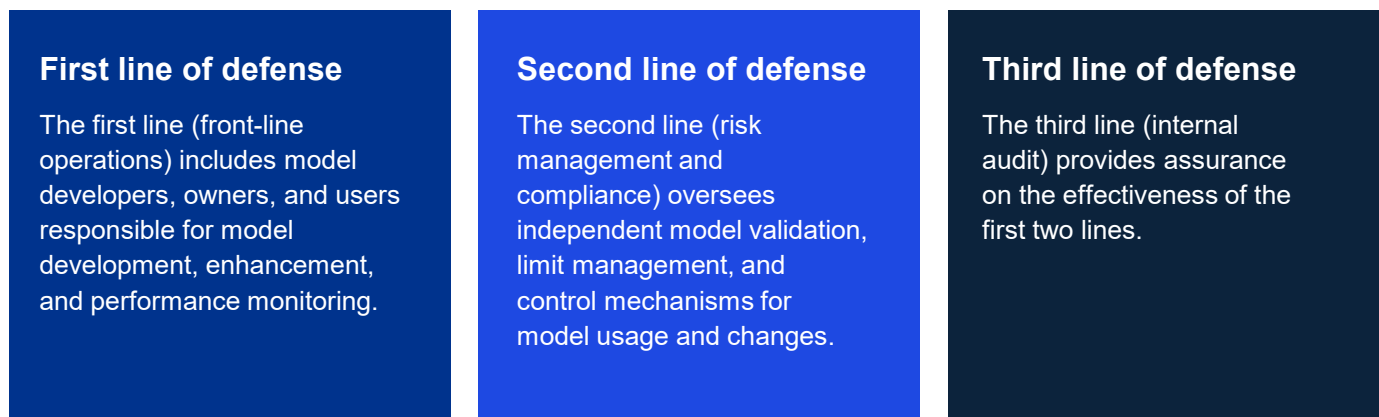
Key focus areas



²- Expected Credit Loss (ECL) – Turning theory into action

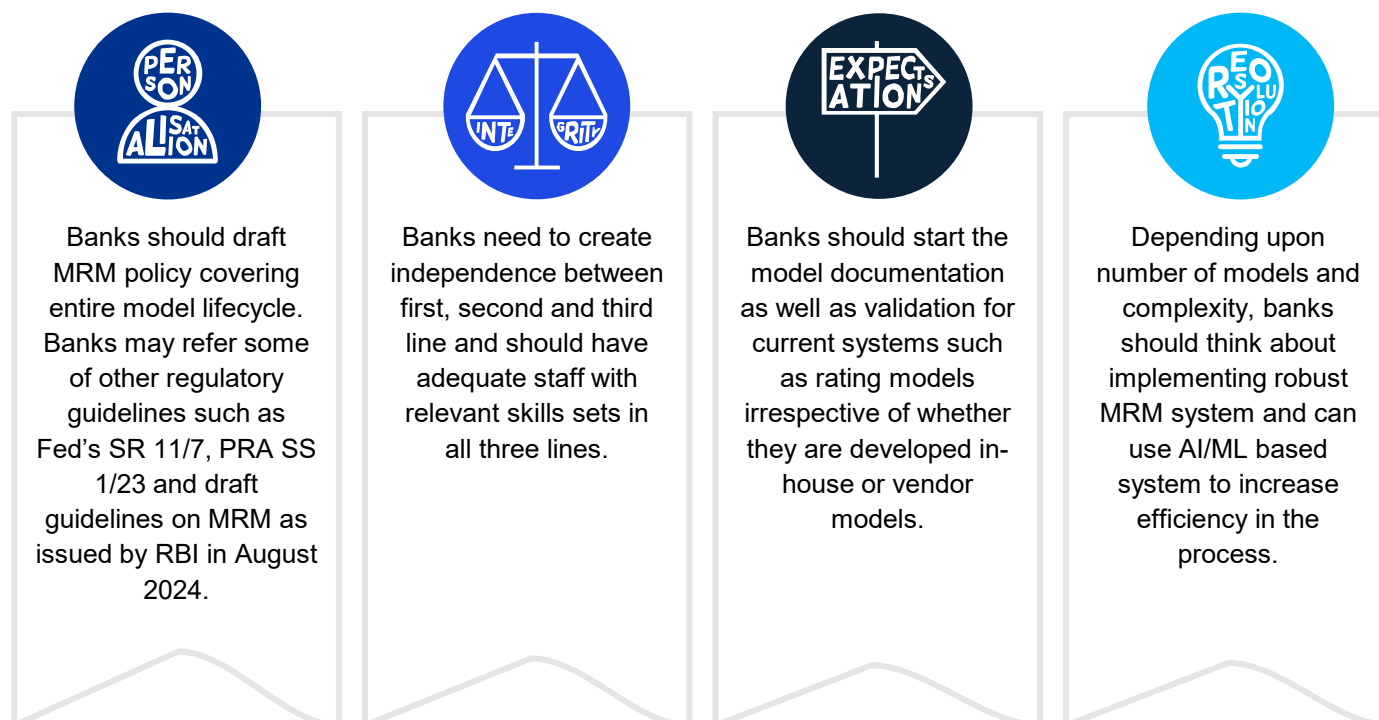
Model risk management (MRM)

A robust Model risk management (MRM) framework under the draft guidelines is structured around a three-line-of-defense model wherein,



The draft guideline mandates requirement for all three lines to operate independently. ECL models are critical in nature and thus the identification and management of risks emanating from such models also becomes imperative. To mitigate this risk, capturing key components of the MRM such as maintaining a comprehensive model inventory, implementing risk-based model tiering and ensuring detailed model documentation is important. These measures aim to enhance reliability, accountability, and regulatory compliance in ECL estimation,³

Key focus areas for banks



³- Model risk management - Key considerations in effective management of models

Governance and control

Draft guidelines introduce a structured approach to governance in Expected Credit Loss (ECL) computation and reporting. They require active oversight from the Board of Directors, supported by a designated subcommittee or board-approved committee. Approved committee should include the CFO, CRO, and other relevant members. Banks must establish clear controls across data management, override mechanisms, and process integrity, including provisions for post-model adjustments. The framework also calls for consistency in systems, tools, and data used for ECL and other credit risk functions such as loan origination and monitoring—encouraging alignment across risk processes. To ensure reliability, banks are expected to maintain systems that produce unbiased ECL outcomes, subject to regular review and challenge. These measures reflect a broader regulatory intent: to embed governance and discipline into the core of credit risk management.

In our view, in the initial years, till the process is stabilised, senior management as well as board has to invest lot of time and effort and accordingly should plan the implementation accordingly.

Disclosures and reporting

The draft guidelines place strong emphasis on disclosure requirements to support transparency and comparability in ECL-based provisioning. Banks are expected to provide both quantitative and qualitative disclosures in financial statements and regulatory reports. Additionally, RBI has asked for certain disclosure to be submitted to them only.

These disclosures must cover key elements such as the determination of Significant Increase in Credit Risk (SICR), segmentation of exposures, definitions of impairment, and the macroeconomic assumptions used in ECL models. The intent is to ensure that stakeholders—including regulators, investors, and auditors—have a clear view of the methodologies and judgments underlying ECL estimates.

By standardising disclosure practices, the guidelines aim to strengthen regulatory oversight and promote consistency in ECL implementation across the banking sector.

Banks need to ensure consistent data, assumptions, forecast and system are used across credit lifecycle. Any over or under estimation of forecast/assumptions or having entirely different methodology from industry might entail clarification from RBI.



3. Potential implementation challenges

Below are the key challenges, grouped into different categories, that we have noticed while assisting different FIs globally in their journey of ECL implementation and subsequent validation:



Data availability and quality

Basis our experience, data is the biggest challenge for ECL computation. Some of the data challenges we noticed are in terms of historical data availability, data quality, data integration across various systems, data volume, and lack of availability of critical data in digital format in the system. Due to such issues, many FIs go for regulatory backstop for different components which might result in conservative ECL estimation.



Methodology

Many FIs do not select model methodology basis availability of volume and quality of data, or considering process, IT, and people capability. Using appropriate methodology is critical in having robust ECL framework and thus it is selected after due considerations on various aspects. Also, to avoid undue volatility in provisions, model methodology selected should be robust and should not require frequent changes.



Process

ECL computation requires coordination among different departments and thus having robust process for entire ECL computations i.e., data extractions, model running, computation and reporting is critical. Additionally, as the numbers are reported in financial statements, any delay or break in the process might result in inaccurate or delay in statements which might impact reputation of the FI.



People

Having adequate resources in different departments with relevant knowledge and experience is critical both during development of framework and as part of BAU. Many a times we find that FIs have key man risk in critical departments. FIs can take help of consultants as and when required for this purpose.



IT systems

Many FIs still rely on spreadsheets for ECL computation which might not be optimum given the volume of data that needs to be processed for both - computation of different components and final ECL estimates at each reporting date. In our view, FIs should invest in either strategic or tactical system depending on volume of data that is expected to be handled.



Governance and control

Defining appropriate governance with clear roles and responsibilities for all the stakeholders is critical and requires deliberations with different teams. Also, appropriate Turnaround Time (TAT) and escalation matrix should also be defined so that there is no delay in financial reporting. Additionally, as the numbers are reported in the financial statements, designing, and implementing effective controls for the entire ECL framework process became paramount.

4. Way forward

To successfully implement the RBI's ECL framework, banks must prioritize strengthening their data infrastructure, ensuring availability, quality, and integration across systems. Building robust internal models for PD, LGD, and EAD with forward-looking macroeconomic inputs is essential, supported by a strong governance framework involving Board-level oversight and a dedicated subcommittee. System alignment across credit lifecycle processes and ECL computation must be ensured for consistency. Banks should also prepare for capital impact through transitional adjustments and optimize regulatory capital treatment. In our experience, ECL implementation will not only impact complete credit lifecycle but also other functions and departments and thus it is imperative that different stakeholders understand the requirements and enhance process accordingly. Finally, readiness testing, dry runs, and proactive engagement with RBI will be key to ensuring a smooth transition by April 2027.

Glossary

Abbreviation	Full Form
RBI	Reserve Bank of India
IRACP	Income Recognition, Asset Classification and Provisioning
ECL	Expected Credit Loss
SCB	Scheduled Commercial Bank
RRB	Regional Rural Bank
SFB	Small Finance Bank
AIFI	All India Financial Institution
FVTPL	Fair Value Through Profit and Loss
NPA	Non Performing Assets
RE	Regulated Entities
POCI	Purchased or Originated Credit-Impaired
SICR	Significant Increase in Credit Risk
PD	Probability of Default
LGD	Loss Given Default
EAD	Exposure At Default
TTC	Through The Cycle
PiT	Point In Time
CCF	Credit Conversion Factor
MRM	Model Risk Management
CRE	Commercial Real Estate
ECGC	Export Credit Guarantee Corporation
BAU	Business As Usual
EIR	Effective Interest Rate
MEV	Macroeconomic variable
PMA	Post Model Adjustments
NBFC	Non-Banking Financial Company
SME	Small and Medium Enterprise

Acknowledgements

We are sincerely grateful to the following people from the ecosystem who have helped in the preparation of this point of view.

KPMG in India research team

- Nilanjana Banerjee (Manager - Financial Risk Management)
- Vaibhav Khanolkar (Manager - Financial Risk Management)
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