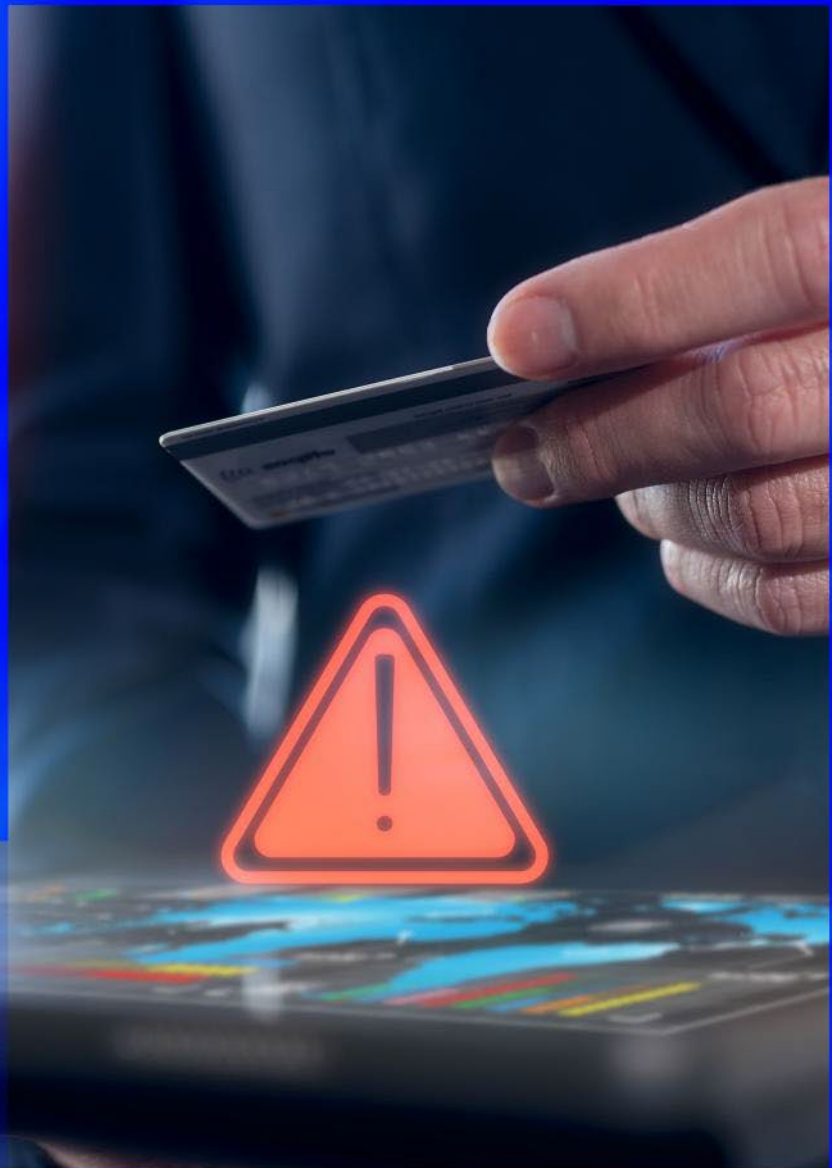




Basel III standardised approach

Reserve Bank of India (Commercial Banks - Capital Charge for Credit Risk – Standardised Approach) Directions, 2026



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RBI has issued the 'Commercial Banks – Capital Charge for Credit Risk – Standardised Approach Directions 2026', to take effect from 1 April 2027 for the banking book of commercial banks (excluding Small Finance Banks (SFBs), Payments Banks and Local Area Banks). These directions replace the earlier standardised credit risk rules and operationalize the Basel III 'final reforms' for banks in India. The directions introduces more granular risk-sensitive risk-weights, increase in capital requirements for riskier segments, differentiation

within the CRE & RRE segments, unhedged FX borrowers, while preserving preferential treatment for priority areas such as MSME, retail and low LTV housing loans. While RBI has released final Basel III requirements for credit risk effective from 1 April 2027, requirements for market risk are still to be released. The capital requirements under Standardised Approach (SA) for operational risk were released by RBI on 26 June 2023 but are still not effective.

The key requirements in Reserve Bank of India (Commercial Banks - Capital Charge for Credit Risk – Standardised Approach) Directions, 2026, are given below:

Key requirements under CR SA

Due diligence requirements

- Banks are required to establish a due diligence framework that ensures that the bank has adequate understanding of the risk profile and characteristics of each borrower at origination and at least annually thereafter in line with the board approved due diligence policy
- Risk weights assigned to the borrowers are required to be aligned to banks internal assessment processes. Banks are also required to factor in climate risk as part of the requirements.

Exposure to banks

- Introduction of external credit rating based differential risk weights for banks as compared to existing CET1 + CCB ladder-based approach
- Lower RW for short-term interbank and trade-related inter bank exposures across national borders
- Sovereign floor for unrated bank exposures to reflect transfer and convertibility risk.

Exposure to corporates

- Introduction of differential risk weights for new MSMEs sub-asset class and for Specialized Lending (SL) exposures (project finance/object finance) where issue specific rating is unavailable
- Higher RW for unrated non-SL exposures with total banking exposure of more than INR500 crore.

Retail exposures

- Application of a more granular treatment for different retail exposures
- Segregation between revolvers and transactors with lower RW for transactors.

Exposures secured by Commercial Real Estate (CRE)

- Introduction of more risk-sensitive methods for RW for exposures secured by commercial real estate
- Different risk weights based on whether repayment dependent on cashflows from economic activity or repayment from underlying property.

Exposures secured by Residential Real Estate (RRE)

- Increased risk sensitivity by aligning category of RW based on LTVs, number of live loans and outstanding loan amount
- Differential risk weights for certain class of RRE with repayment from economic activities and repayment from underlying property.

Observed default rate (ODR) based adjustment

- Introduction of ODR based overlay on the RBI prescribed base risk weight mapping of long-term domestic ratings of chosen domestic ECRA's
- Comparison of each ECRA's ODR with RBI reference ODR ranges to evaluate increase in RW.

Equity investments in funds, UFCE and other exposures

- Look-through, mandate based and fallback approaches with leverage adjustments for funds
- Incremental capital requirements for Unhedged Foreign Currency Exposures (UFCE) based on potential loss
- Made more risk sensitive by modifying the Credit Conversion Factor (CCF), removal of maturity based CCF for other commitments and introduction of glide path based 10% for UCCs.

Key implementation challenges



Implementation of the revised credit risk standardised approach will not only require banks to update their computation methodology, but will also require banks to update their governance, policies, data and systems. The directions clearly set out how exposures are classified and risk weights are assigned with computation of final risk weighted assets under revised credit risk standardised approach. Implementation of requirements will require a coordinated change management effort across people, processes, data and technology. Basis our experience working with different banks in India and globally, we noted some key challenges that are faced during implementation which banks should consider in implementation process:

Data



Data availability, quality and accuracy is the primary challenge for implementation of revised methodologies under various exposure classes as mentioned in the direction. Banks will need to capture additional data fields at customer and exposure level such as LTV, MSME status, transactor status, count of housing loans, and repayment from economic activity flag. Additionally, some banks might not have such data in system for existing book.

Methodology



Reviewing and updating existing policy interpretations with respect to asset classification and other areas of the direction will require decision points based on data availability and potential impact. Banks will have to update clear policies and procedures to ensure that selected approaches are consistently followed.

Impact



New requirements may materially change RWA at segment level especially for large corporates, specialized lending, real estate exposures and exposures to equity investment in funds. Banks would be required to quantify the portfolio level capital impact and assess the change to be done in risk appetite, limit framework and other risk indicators setup by the bank.

People



Having adequate resources in different departments with relevant functional knowledge and experience of implementation of RWA computation requirements 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.

System

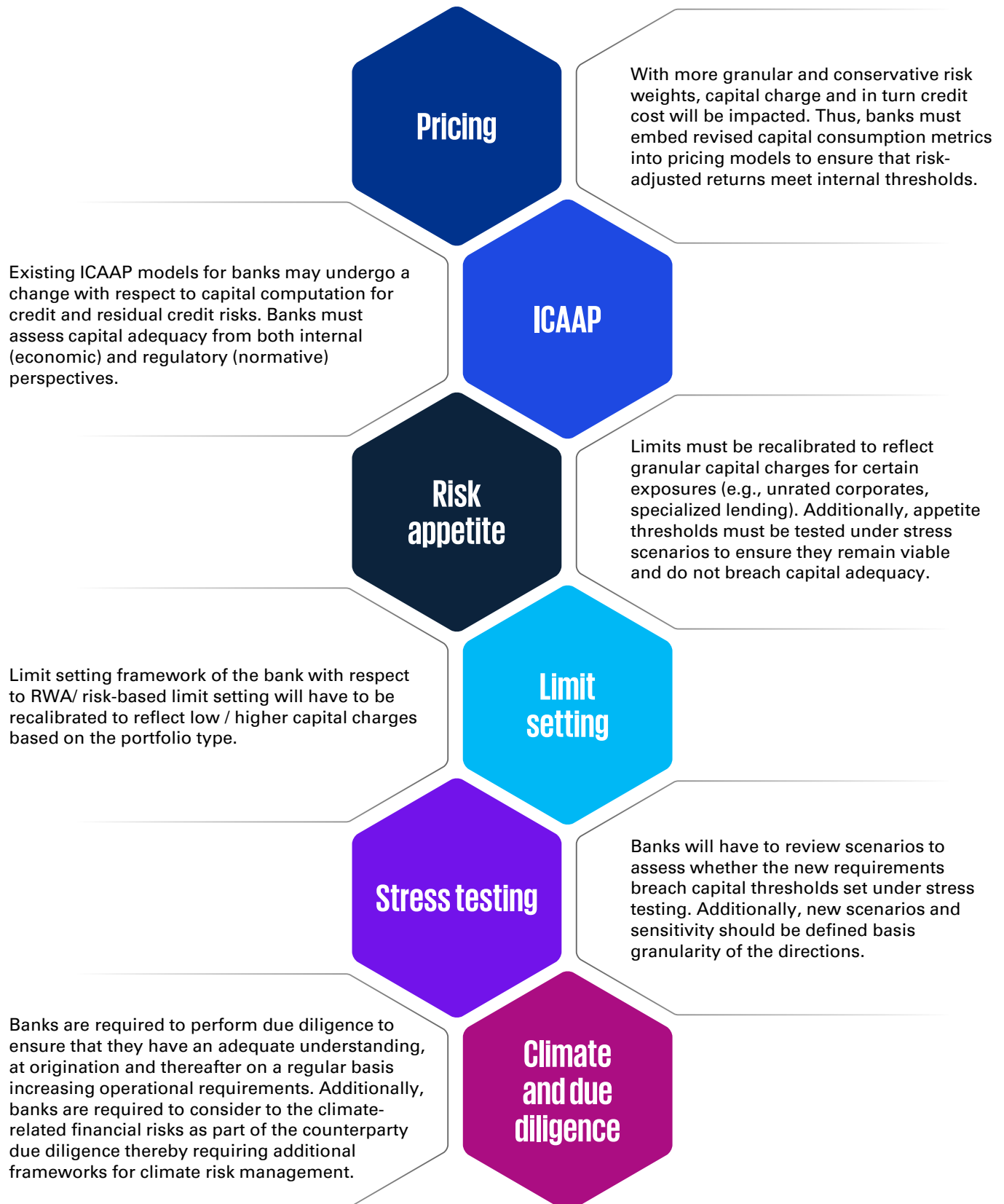


Revised requirements under standardised approach adds to the system and data implementation complexities. Core banking, credit administration, collateral management, rating and treasury and RWA systems will need changes to capture new data attributes and the revised computational requirements. Additionally reporting systems will also have to be updated to reflect the change in computation at granular level and RWA computation in line with direction.

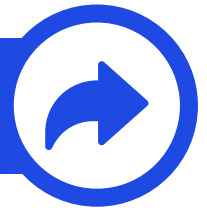
Expected impact beyond capital computation



In our experience, implementation of requirements under the directions will not just have impact on capital and the processes but will also impact other functions and departments. Key areas that will be impacted are:



Way forward



To successfully implement the RBI's 'Commercial Banks - Capital Charge for Credit Risk - Standardised Approach Directions 2026', banks must follow a structured approach from ensuring that the right data points are available for implementing the requirements as part of their systems, policies and procedures. Banks should consider the following imperatives as part of their transition to the new requirements,

- Assessment of impact across different asset classes
- Cost-benefit analysis of non availability of data points and consequent impact of increased RW
- Impact across different systems in terms of changes to data and computational requirements
- Impact of policies and framework beyond capital computation
- Implementation of methodologies across different asset classes
- Readiness testing and dry runs to ensure smooth transition by April 2027.



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Our service offerings



Impact assessment

- Carry out qualitative and quantitative impact analysis of the new requirements as compared to existing regulations
- Develop a transformation roadmap for the implementation of the new guideline.



Ongoing support

- Conduct knowledge transfer and training based on leading practices
- Review Basel capital computation on an ongoing basis
- Assist the bank in ongoing computation and reporting under Basel.



Third party system implementation

Assist in migration to new requirements from development of user requirements, functional/technical design, system selection and implementation, project management and user acceptance testing for any third-party solutions.



Functional implementation

- Policy interpretations and development of methodologies/decision points
- Development of adaptation programs to new standard methods along with policy, process, governance and controls
- Develop be-spoke calculators for Basel III capital computation and reporting.



Implementation review

- Review bank's implementation of the new Basel requirements in line with the regulatory and market practices
- Provide recommendations on improvement areas and assist in required enhancements.



KPMG in India in house tool

Implementation of our proprietary inhouse python based customisable solution for implementing the RBI requirements under standardised approach for credit risk and operational risk.

Our team and expertise

Experience of successfully delivering **Basel implementation projects across credit, market, operational and Pillar II risks** across local and global banks including DSIBs and AIFIs.

400+ multidisciplinary team comprising of Chartered Accountant (CA), MBA, FRM, CFA, CQF, Statisticians, Econometricians, Actuaries, Ex-bankers and Risk specialists.

Multiple awards such as 'Best Credit Modelling Team of the Year' and 'Central Banking Award' for risk management services. In-house solution is ranked 37 by Chartis globally in providing risk technology solution.



Top talent covering kaleidoscope of professionals from leading professional services firms, top management institutes and premier colleges.

Extensive knowledge base regarding regulatory expectations on account of working experience in different geographies with relevant stakeholders.

KPMG in India has experience working with **multiple central banks and MDBs** across geographies.

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