

ECL Framework for Banks

Key Highlights

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Staging criteria for asset classification

- Stage 1, Stage 2 (significant increase in credit risk) and Stage 3 (defaulted) assets largely as per Ind AS; however, significant levels of “regulatory floor” for provisioning, ranging from the vintage of Stage tag.
- Stage 3 classification applies to all facilities to a borrower - that is, once the borrower attains Stage 3, all exposures to the borrower tagged as Stage 3 (aligned with present NPA treatment). However, Stage 2 classification shall be at the facility level.
- Restructured accounts shall be straightway upgraded from Stage 3 to Stage 1 after the rectification of all the irregularities which led to Stage 3 classification cease to exist, including absence of any evidence indicating SICR. If there is evidence of SICR, the financial instrument may be moved to Stage 2.



ECL Computation

- Stage 2, currently not treated as NPA, attracts 5% minimum ECL, whereas in case of Stage 3 (currently NPA as per IRACP norms), attracts 25% to 100% over a period of 4 years for secured and for unsecured 100% after one year.
- Fraud facilities require 100% provision, wilful defaulters to attract additional provision of 5%. Currently, additional 5% provisioning is required in case the director's name appears more than once in the LWD.
- 12-month PD for any instrument shall not be less than 0.05%. If the bank is unable to correctly estimate LGD, LGD will be taken as 65% for the secured portion and 70% for the unsecured portion.



Income Recognition and Inclusion as Regulatory Capital

- On Stage 3 assets, interest income recognition shall be done only on cash (receipt) basis. [That it so say, the present position that income recognition ceases on NPAs continues]
- Stage 2 and Stage 3 provisions hit P/L of the bank, and not be reckoned as a part of regulatory capital.
- To ensure that ECL provisions do not result into capital deficiency, provisions ensure a phased “add back” to Common Equity Tier 1, that is, the additional ECL provision eating regulatory capital will get partial relief over 4 years from 2027-28 (the first year when the ECL framework applies)



Collateral and Governance Norms (1/2)

- Compulsory valuation of collateral for Stage 3 assets for exposure beyond ₹7.5 crore, once upon classification, and thereafter, every 2 years. Annual valuation in case the collateral is stock.
- Implementation and functioning of ECL is board responsibility [para 42]; a Board Committee or Committee approved by the board shall oversee the implementation of ECL.
- Banks to implement a three-stage model risk management framework: Frontline operations being handled by model owners, risk management team to identify risk and internal audit to provide objective assurance on the effectiveness of the first two stages. The same shall be reported to the board and audit committee.

Collateral and Governance Norms (2/2)

- Banks to ensure the following policy documentation:
 - ECL assessment approach for each exposure or portfolio, justifying the suitability of chosen methods
 - Parameters for the determination of SICR
 - The basis of segmentation for computing ECL on a collective basis for a particular portfolio segment.
 - Model validation framework



Board Room Responsibilities

- The Board shall be responsible for oversight of the implementation and on-going functioning of the ECL Framework [para 56];
- A sub-committee of the Board including the CFO and CRO shall help the Board oversee the ECL implementation including, *inter-alia*, challenging the ECL strategy, checking whether ECL assumptions are consistent with risk management etc. [para 57].
- The Board shall approve a policy governing exceptions to system-driven asset classification with defined approval hierarchy, audit trails and periodic reporting to the audit committee/audit head. [Annex 3(3)(3)]
- Board shall oversee incorporation of any additional risk considerations for foreign exposures/credit facilities extended to overseas subsidiaries of Indian corporates [para 125-129].
- Board/Committee of the Board shall approve a policy for rebuttal of SICR presumption, specifying criteria, methodology and applicable exposures [para 35]