5. Expected Credit Loss- Economy

Banks seek more talks on ECL norms for crop loans The transition from an "Incurred Loss" model to the Expected Credit Loss (ECL) framework marks a fundamental shift in Indian banking regulation. By requiring banks to recognize potential losses upfront, the RBI aims to strengthen the financial system, though the move has sparked significant concern regarding its impact on agricultural lending.

1. Understanding the ECL Framework

The ECL model is a forward-looking approach to credit risk management, shifting away from the traditional practice of provisioning only after a default has occurred.

Forward Loss Recognition- Banks must estimate potential loan losses in advance based on historical data, current conditions, and future economic forecasts.

The "Cash Flow Gap" Concept- Credit loss is defined as the difference between the contractual cash flows a bank is entitled to and the cash flows it actually expects to receive, discounted at the original interest rate.

Risk-Based Estimation Metrics-

Probability of Default (PD)- The likelihood that a borrower will fail to repay over a specific timeframe.

Loss Given Default (LGD)- The share of an asset that is lost if a borrower defaults.

Exposure at Default (EAD)- The total value a bank is exposed to at the time of a borrower's default.

2. The Three-Stage Classification Model

Assets move through different stages based on the evolution of credit risk since the initial recognition of the loan.

Stage	Credit Quality	Provisioning Requirement	Overdue Period (Proposed)
Stage 1	Performing; no significant increase in risk.	12-month Expected Credit Loss.	0–30 days.
Stage 2	Significant increase in credit risk.	Lifetime Expected Credit Loss.	30–90 days.
Stage 3	Credit Impaired (NPA).	Lifetime Expected Credit Loss.	> 90 days (or specific crop seasons).

3. Regulatory Scope and Implementation

Applicability- Applies to Scheduled Commercial Banks (SCBs) and All India Financial Institutions (AIFIs).

Exclusions- Currently, Small Finance Banks (SFBs), Payment Banks, and Regional Rural Banks (RRBs) are exempt to prevent excessive administrative burden on smaller entities.

Timeline- Effective from April 1, 2027, with a "glide path" (transition period) lasting until March 31, 2031, allowing banks to spread the impact on their capital.

4. Banks are Raising Concerns

Lenders, particularly those with deep footprints in rural India, are worried about the "sudden death" impact on their balance sheets.

A. The Agricultural Mismatch

Seasonal vs. Monthly Cycles- Crop loans follow harvest cycles. A farmer might be technically "overdue" by 40 days simply because the market yard (mandi) opened late, triggering a Stage 2 classification and a sharp jump in provisioning despite zero actual risk of default.

Routine Rollovers- Frequent "forward and backward" rollovers during a single crop season can artificially inflate the number of "overdue days," misrepresenting the borrower's creditworthiness.

NPA Triggers for Crops- For short-duration crops, being overdue for two seasons leads to Stage 3; for long-duration crops, it is one season. Banks argue this is too rigid for the volatile nature of Indian farming.

B. Financial and Capital Impact

Provisioning Jump- Under the current Special Mention Account (SMA) norms, banks provide roughly 0.4%. Under Stage 2 ECL, they face a minimum regulatory floor of 5% plus lifetime loss recognition. This represents a massive increase in capital locked away.

Capital Erosion- Lenders with high exposure to priority sector lending (PSL) may see their capital adequacy ratios (CAR) drop significantly, limiting their ability to lend further.

5. Way Forward and Proposed Solutions

To ensure the ECL transition doesn't stifle credit flow to the rural economy, several modifications have been suggested-

Crop-Sensitive Norms- Aligning ECL triggers with the Kisan Credit Card (KCC) model, where classification is linked to the specific crop cycle rather than a standardized 30/90-day clock.

Gradual Transition (Glide Path)- Mimicking the Basel III implementation, where the capital hit is absorbed over a decade rather than a four-year window.

Data Strengthening- Utilizing PMFBY (Crop Insurance) and digital farm credit databases to differentiate between "cyclical stress" (bad monsoon) and "structural risk" (wilful default).

Risk Differentiation- Applying a lower "provisioning floor" for agricultural assets compared to unsecured personal or corporate loans.

6. Conclusion

While the ECL framework is a vital step toward a more resilient and transparent banking system, its application to the agricultural sector requires a nuanced, "India-specific" lens. A rigid 90-day rule applied to a 180-day crop cycle risks punishing both the farmer and the lender for the inherent biological delays of agriculture.

Source- https-//economictimes.indiatimes.com/news/economy/agriculture/banks-seek-more-talks-on-ecl-norms-for-crop-loans/articleshow/127494233.cms

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