We find our report 'Prayas (Energy Group). (2022, May). Expected Loss Ratings Scale: Unexpected outcomes. ' relevant to below discussion questions mentioned in the 'Discussion Paper on Introduction of Expected Credit Loss Framework for Provisioning by Banks'. We are attaching a PDF copy of the same as part of this email. The report is also accessible on our website, https://energy.prayaspune.org/our-work/research-report/expected-loss-ratings-scale.

Discussion Question 10. Do you agree with the above proposal to permit the banks to develop customised approaches for expected credit losses subject to principles / expectations laid out by the RBI? Are the mitigants proposed to reduce the consequent inevitable variability between the entities, adequate?

Discussion Question 18. Are there any aspects that would be germane to the proposed transition that have not been discussed in this discussion paper? If so, please comment on the same and provide your views or preferences on such aspects which, in your opinion, should be part of the regulatory instructions that the RBI will issue regarding the proposed provisioning regime.

We believe that in perusing the aforementioned report, RBI may find some clarity on the inadequacies, pitfalls and some policy recommendations towards permitting self determination for measurement of expected credit loss for banks taking from the experience of Credit Rating Agencies' (CRAs) self determination of Expected Loss for the infrastructure sector.

Brief overview of the report:

The Securities and Exchange Board of India (SEBI) introduced the Expected Loss (EL) Rating Scale meant specifically for the infrastructure sector in July 2021. As part of this, Credit Rating Agencies (CRAs) have been empowered to assign EL ratings based on their assessment of the Probability of Default of a loan facility seen together with scenario-based recoverability of the underlying project's economic value post such debt servicing default. Public money funded financing entities such as Life Insurance Corporation of India (LIC) have reduced their external credit rating based investment threshold for the infrastructure sector by factoring in the EL based ratings scale. This move has profound implications on the participation of such large public money funded financiers in the evolving Indian Renewable Energy (RE) story with its vast need for finance. Our report 'Expected Loss Ratings Scale: Unexpected outcomes' has attempted to discuss the nuances of the same.

Based on our perusal of the various EL rating methodology documents publicly available on various CRA websites, it is evident that there is material divergence as well as a lack of transparency in the approach to EL computation by each CRA. Each CRA has their own computation formula albeit operating within similar risk contours. Our report contains a detailed case study on inconsistent assignment of ratings for the same borrower by two different CRAs and its implications on timely flagging of credit quality impairment.

The report carries policy design level recommendations to bring in transparency, standardisation, regulatory backstops and discipline in assignment of EL ratings by CRAs.