



KAMARAJ IAS ACADEMY
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RBI Master Directions on Bad Loans (NPAs)

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The Reserve Bank of India has issued updated Master Directions on bad loans (Non-Performing Assets – NPAs) to strengthen credit risk management and align India’s banking system with global standards. These guidelines aim to improve transparency, early detection of stress, and effective resolution of bad loans.?

Key Changes in NPA Classification:

A major reform introduced is borrower-level NPA classification. If a borrower has multiple loans and defaults on even one, all loans of that borrower will now be classified as NPAs. However, the core rule remains unchanged: a loan is classified as NPA if interest or principal remains overdue for more than 90 days.

Stricter Upgradation Norms:

The RBI has tightened rules for upgrading a bad loan back to a standard asset. A borrower must now repay all outstanding dues across all loan accounts, not just the defaulted loan, before the account can be upgraded.

This ensures stricter discipline and prevents partial repayments from masking overall financial stress.

Mandatory Automated Identification

Banks are now required to adopt automated systems for identifying NPAs.

Manual classification will be phased out to:

Improve accuracy

Reduce human intervention

Ensure timely recognition of stressed assets

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Plot A P.127, AF block, 6 th street, 11th Main Rd, Shanthi Colony, Anna Nagar, Chennai, Tamil Nadu 600040

Phone: **044 4353 9988 / 98403 94477 / Whatsapp : 09710729833**

Shift to Expected Credit Loss (ECL) Framework

One of the most important changes is the transition from the incurred loss model to the Expected Credit Loss (ECL) framework.

Banks must now anticipate potential losses in advance rather than waiting for default

Provisioning will be based on risk levels in three stages:

Low risk

Significant increase in credit risk

Credit impairment

This aligns India with international standards such as IFRS.

Use of Effective Interest Rate (EIR):

The RBI has mandated the use of the Effective Interest Rate (EIR) instead of contractual rates for calculating expected losses. This improves the accuracy of financial reporting and risk assessment.

Objective of the Guidelines

The new directions aim to:

Strengthen credit discipline

Improve early warning systems

Enhance financial stability

Align India's banking practices with global best practices

NPA (Non-Performing Asset):

A loan where interest/principal is overdue for more than 90 days

Types of NPAs:

Substandard assets

Doubtful assets

Loss assets

Gross vs Net NPA:

Gross NPA: Total bad loans

Net NPA: After provisioning

Related Mechanisms:

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Insolvency and Bankruptcy Code (IBC), 2016

Asset Reconstruction Companies (ARCs)

SARFAESI Act, 2002

Role of RBI:

Regulates banks and NBFCs

Ensures financial stability and risk management

Global Context:

ECL model is recommended under IFRS 9 accounting standards