ESAF
ESAF SMALL FINANCE BANK

# Pillar 3 Disclosures as of 30th June 2022

Pillar 3 disclosures of ESAF Small Finance Bank Limited, on the Capital Structure, Capital adequacy and Risk Management framework is provided below.

## The shareholding pattern of the Bank

| Description | Share Holding (%) |
|---|---|
| Promoter Holding Company | 62.46 |
| Insurance Companies | 10.02 |
| Resident Individuals | 7.44 |
| Bodies corporate | 1.98 |
| FIIs, FPI, NRIs, other Foreign Nationals | 18.10 |
| **TOTAL** | **100.00** |

## 1. Capital Adequacy

### 1.1 Norms

The Bank is subject to the capital adequacy framework as per the Operating Guidelines for Small Finance Banks, issued by RBI. Accordingly, the Bank is required to maintain a minimum Capital to Risk Weighted Assets Ratio (CRAR) of 15%, with a minimum Tier I capital of 7.5%.

As per RBI guidelines DBR.NBD. No.4502/16.13.218/2017-2018 dated 08th November 2017, SFBs are not required to create separate capital charge for market risk and operational risk. As such, the Bank has considered capital charge for credit risk only, for arriving at capital adequacy. For credit risk, RBI has prescribed that SFBs shall follow Basel II Standardized Approach and permitted the use of external rating-based risk weights for rated exposure and regulatory retail approach for small loans.

### 1.2 Structure –Table 1 (₹ in Crores)

Breakup of capital funds is as follows:

| Particulars (30th June 2022) | ₹ in Crores |
|---|---|
| **Tier I capital –(I)** | |
| Paid Up Capital | 449.47 |
| Reserves | 1,037.09 |
| Perpetual Debt Instrument | 48.00 |
| Total | **1,534.56** |
| **Deductions – (II)** | |
| Intangible Assets | 0.00 |
| Any Other Deductions | 13.05 |
| Total Deductions | **13.05** |
| **Total Tier I Capital Total (I-II) A** | **1,521.51** |
| **Tier II Capital – (III)** | |
| General provisions on Standard Assets | 106.08 |
| Investment Fluctuation Reserve | 26.20 |

| Particulars (30th June 2022) | ₹ in Crores |
|---|---|
| Sub Ordinated term Debt | 70.00 |
| Total | **202.28** |
| **Deductions – (IV)** | |
| Total Deductions for Tier II | 0.00 |
| **Total Tier II Capital (III-IV) B** | **202.28** |
| **Total Capital (A+B)** | **1,723.79** |
| **Bank's CRAR as on 30-06-2022** | **20.31%** |

### 1.3 Disclosures

*A summary discussion of the Bank's approach to assess the adequacy of its capital to support its current and future activities:*

Capital requirements for current business levels and estimated future business levels are assessed on a periodic basis.

As per RBI guidelines for SFBs, minimum capital required to be maintained by the Bank is 15% of the Risk Weighted Assets. The Bank's CRAR as on 30-06-2022 is above the regulatory minimum level.

**Quantitative Disclosures Table 2 (₹ in Crores)**

| S. No. | Particulars As on 30-06-2022 | ₹ in Crores |
|---|---|---|
| A | **Capital Requirements for Credit Risk** | 1,273.02 |
| **A.1** | For Portfolio Subject to Standardized approach | 1,273.02 |
| **A.2** | For Off Balance Sheet Credit Portfolio | 0 |
| **A3** | For Off Balance Sheet Corporate Guarantee | 0 |
| B | Capital Requirements for Market Risk | 0 |
| **B.1** | For Interest Rate Risk | 0 |
| **B.2** | For Equity Risk | 0 |
| **B.3** | For Forex Risk (including gold) | 0 |
| **B.4** | For Commodities Risk | 0 |
| **B.5** | For Options risk | 0 |
| **C** | Capital Requirements for Operational Risk | 0 |
| **D** | **Total Capital Requirement ( A+B+C)** | **1,273.02** |
| **E** | **Total Risk Weighted Assets (RWA for all types of assets)** | **8,486.82** |
| **F** | **Total Capital Funds (Tier I + Tier II)** | 1,723.79 |
| | **CRAR (%)** | |
| **A** | Tier -1 Capital Adequacy Ratio (%) | 17.93% |
| **B** | Tier -2 Capital Adequacy Ratio (%) | 2.38% |
| **A+B** | **Overall CRAR (%)** | **20.31%** |

## 2. Internal Capital Adequacy Assessment Process (ICAAP)

The Bank has put in place a Board approved policy for Internal Capital Adequacy Assessment Process (ICAAP). The Risk Management Department (RMD) assesses all the risks faced by the Bank and identifies the risks that are material to the Bank. A comprehensive annual assessment of Capital Adequacy is made through the annual ICAAP report and this assessment is reviewed on a quarterly basis through the quarterly ICAAP reviews.

ICAAP aims at identification, measurement, aggregation and monitoring of risks; holding capital commensurate with these risks; and developing systems to continuously monitor capital adequacy. It is the central component of the Bank's strategy for managing risks.

## 3. Leverage Ratio

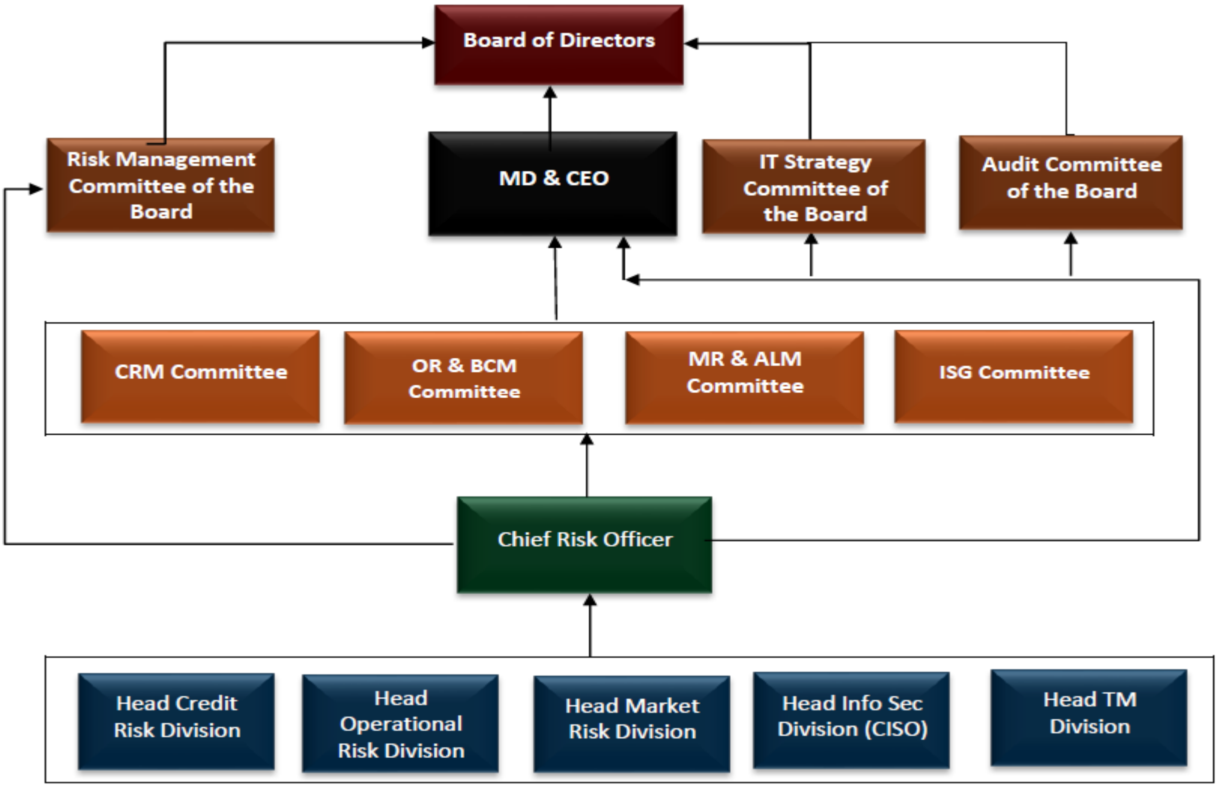
The Bank Computes Leverage Ratio as per Basel III framework. Leverage Ratio is a non-risk-based measure of exposure over capital. The leverage ratio is calibrated to act as a credible supplementary measure to the risk-based capital requirements.

***Leverage Ratio = Capital Measure (Tier I Capital)/ Exposure Measure (Total Exposure)***

### Leverage Ratio as on 30-06-2022 – Table 3 (₹ in Crores)

| S.No | Particulars | ₹ In Crs |
|---|---|---|
| | On Balance Sheet Exposure | |
| **1** | On-balance sheet items (excluding derivatives and Securities Financing Transactions (SFT), | 18,104.10 |
| **2** | (Asset amounts deducted in determining Basel III Tier 1 capital) | 0.00 |
| **3** | Total on-balance sheet exposures (excluding derivatives and SFTs) (1 + 2) | **18,104.10** |
| **4** | Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin) | 0.00 |
| **5** | Add-on amounts for Potential Future Exposure (PFE) associated with all derivatives transactions | 0.00 |
| **6** | Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the operative accounting framework | 0.00 |
| **7** | (Deductions of receivables assets for cash variation margin provided in derivatives transactions) | 0.00 |
| **8** | (Exempted Central Counter Party (CCP) leg of client-cleared trade exposures) | 0.00 |
| **9** | Adjusted effective notional amount of written credit derivatives | 0.00 |
| **10** | (Adjusted effective notional offsets and add-on deductions for written credit derivatives) | 0.00 |
| 11 | **Total derivative exposures (sum of lines 4 to 10)** | **0.00** |
| **12** | Gross SFT assets (with no recognition of netting), after adjusting for sale accounting | 0.00 |
| **13** | (Netted amounts of cash payables and cash receivables of gross SFT assets) | 0.00 |
| **14** | Counterparty Credit Risk (CCR) exposure for SFT assets | 0.00 |
| **15** | Agent transaction exposures | 0.00 |
| 16 | **Total securities financing transaction exposures (sum of lines 12 to 15)** | **0.00** |
| | **Other off-balance sheet exposures** | |
| **17** | Off-balance sheet exposure at gross notional amount | 1.90 |
| **19** | (Adjustments for conversion to credit equivalent amounts) | 0.00 |
| 19 | **Off-balance sheet items (sum of lines 17 and 18)** | **1.90** |
| | **Capital & Total Exposures** | |
| 20 | **Tier 1 capital** | **1,521.51** |
| 21 | Total exposures (sum of lines 3, 11, 16 and 19) | 18,106.00 |
| 22 | **Basel III Leverage Ratio for the Bank** | **8.40%** |
| | **Summary comparison of accounting assets vs. leverage ratio exposure measure** | |
| **1** | Total consolidated assets as per published financial statements | 18,104.10 |
| **2** | Adjustment for investments in banking, financial, insurance or commercial entities that are | 0.00 |
| **3** | Adjustment for fiduciary assets recognized on the balance sheet pursuant to the operative | 0.00 |
| **4** | Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off- | 1.90 |
| **5** | Other adjustments | 0.00 |
| **6** | Leverage ratio exposure | **18,106.00** |

## 4. Risk Governance Framework & Risk Management Structure




The Bank has set up a risk governance framework based on the following:

a) The Board of Directors is responsible for overall governance and overseeing of core risk management activities of the Bank and the Bank's risk appetite and related strategies and policies are approved by the Board.
b) To ensure that the Bank has a sound system of risk management and internal controls in place, the Board has established the Risk Management Committee of the Board (RMCB). The RMCB assists the Board for overseeing and review of the Bank's risk management principles and policies, strategies, appetite, processes and controls.
c) The Risk Management Committee of the Board (RMCB), the Information Technology Strategy Committee of the Board (ITSCB) and the Audit Committee of the Board (ACB) assist the Board for overseeing and periodical review of the Bank's risk management principles and policies, strategies, appetites, processes and controls.
d) The RMCB is supported by the Risk Management Department and the Executive Level committees dealing with different functional areas of risk, facilitating effective execution of their responsibilities.
e) Segregation of duties across the 'three lines of defence' model, whereby front-office/ business functions as the first line, Risk Management and Compliance as the second line and Internal Audit as the third line. The roles are played by the functions are independent of one another.
f) Risk strategy is approved by the Board on an annual basis and is defined based on the Bank's risk appetite, in order to align risk, capital and performance targets.
g) All major risk classes are managed through focused and specific risk management processes; these risks include Credit Risk, Operational Risk, Market Risk and Liquidity Risk etc. Policies, processes and systems are put in place to enable the risk management capability.

h) Risk Management function is having appropriate representation on Executive Level Committees of the Bank to ensure that risk view is taken into consideration in business decisions. Stress testing tools and escalation processes are established to monitor the performance against approved risk appetite.

## 5. Risk Management Committees

The Risk Management Committee of the Board (RMCB) oversees and periodically reviews the processes and practices of risk management in the Bank. Credit Risk Management Committee (CRMC), Operational Risk & Business Continuity Management Committee (OR-BCMC) and Market Risk & Asset Liability Management Committee (MR-ALCO) support RMCB to facilitate effective execution of its responsibilities. The Information Security Governance Committee (ISGC) supports the Information Technology Strategy Committee of the Board. The Risk Management Department (RMD) through its Credit Risk, Operational Risk, Market Risk, Information Security, and Transaction Monitoring Divisions assists the various committees in effectively managing the risks. The RMD is headed by the Chief Risk Officer (CRO) who reports to the Managing Director & CEO on administrative matters and to the Risk Management Committee of the Board on functional matters. The CRO is responsible for formulating and implementing enterprise-wide integrated risk management systems for identification and management of risks in the Bank.

## 6. Credit Risk

Credit risk is the possibility of loss a bank might incur due to the following:

a) Default due to the inability or unwillingness of a borrower or counterparty to meet commitments in relation to lending, trading, settlement or other financial transactions or,

b) Reduction in portfolio value arising from actual or perceived deterioration in credit quality of borrowers or counterparties.

The Bank is exposed to credit risk through lending to various segments.

### 6.1 Credit risk governance

The objective of credit risk management is to maximize the Bank's risk-adjusted rate of return while maintaining credit risk exposure within acceptable limits. The Bank has put in place a Board approved Credit Risk Management Policy which is reviewed periodically to bring in refinements triggered by evolving concepts and actual experience. The Credit Risk Management Policy sets out the guidelines, principles and approach to manage credit risk for the Bank and a framework to identify, assess, measure, monitor and control and mitigate the credit risks in a timely and effective manner.

In addition, the Bank has the Loan Policy and the Loan Collection, Recovery & Stressed Assets Management Policy, approved by the Board of Directors. The Loan Policy covers the rules and regulations for processing and sanction of credit, Bank’s approach to monitoring of credit, and the Loan Collection, Recovery & Stressed Assets Management Policy covers the rules regarding NPA Management, provisioning, collection & recovery, and mechanisms like compromise settlements, restructuring, legal action, write-off etc.

### 6.2 Structure and Organization of Credit Risk Management Framework

Risk Management Committee of the Board (RMCB) oversees bank-wide risk management. The senior executive level Credit Risk Management Committee (CRMC) monitors implementation of credit risk management framework across the Bank and provides recommendations to the RMCB and the Board. CRMC ensures implementation of credit risk management policies and procedures, as approved by the RMCB and the Board, across the Bank and recommends changes thereto, considering any changes in the regulatory instructions, business or economic conditions. It also monitors quality of loan portfolio at periodic intervals, identifies problem areas and instructs business units with directions to rectify the deficiencies.

The Credit Risk Division of Risk Management Department, which is supported by all the business units, is entrusted with the responsibility for implementing credit risk identification, assessment, measurement, monitoring and control. Credit risk appetite tolerance limits are drawn up with inputs from the business units and the credit risk parameters and credit exposure / concentration limits set by the Bank's Board of Directors. The Division constructs credit risk identification systems, oversees quality of the Bank's loan portfolio, stressed loans and undertakes portfolio level asset quality reviews with support from the business and credit monitoring functions. The Division looks into early warning signals in the loan portfolio as a whole, analyses the trend of weak exposures, suggests portfolio wise remedial measures and monitors the actions taken.

CRMC of the Bank meets at least once in a quarter to take stock of Bank's credit risk profile, based on the reports placed by Credit Risk Division. An effective governance framework to ensure the independence of the credit risk unit from the business units is implemented.

### 6.3 Credit Process

The Loan Policy of the Bank details the credit norms to be adhered to for each of the customer segments. The guiding principles behind the credit sanction process are as under:

- 'Know Your Customer' is a leading principle for all activities.
- The acceptability of credit exposure is primarily based on the sustainability and adequacy of borrower's normal business operations and not based solely on the availability of security.

An empowerment matrix is prescribed to ensure that a competent authority takes informed decisions on credit proposals and on any deviations to the norms. There are separate credit origination and appraisal processes for all types of loans and advances.

### 6.4 Credit Scoring/ Rating Models

The foundation of credit risk management rests on the internal credit risk rating system. Credit scoring models are used for evaluating applications for credit. The Bank has developed rating tools specific to most products and market segments to objectively assess underlying risk associated with such exposures. The score cards/ rating system is validated on an annual basis by back testing with the standards of outstanding loans.

### 6.5 Risk Weights

The Bank adheres to RBI guidelines defined under the RBI Master Circular - Prudential Guidelines on Capital Adequacy and Market Discipline - New Capital Adequacy Framework (NCAF) as updated from time to time, for application of risk weights for credit risk measurement and capital computation purposes.

### 6.6 Concentration Risk

The Bank manages concentration risk by means of prudential limits prescribed by RBI, as well as internal limits. Credit concentration in the Bank's portfolios is monitored for the following:

(i) Single party /Group exposure: The Bank has set exposure limits individual borrower-wise and borrower group-wise which are continuously tracked and monitored.

(ii) Geography-wise exposure: The Bank continuously monitors the geographical concentration of the business and factors the inputs into strategic business planning. The Bank is conscious of its credit concentration in southern states and takes steps to reduce the same by lending in other geographies.

(iii) Industry exposure: The Bank's exposure to any single industry is currently not significant.

### 6.7 Credit Exposures & Risk Summary - 30-06-2022

**a) Exposure – Facility Type –Table 4 (₹ in Crores) (30-06-2022)**

| S. No. | Exposure Type | Amount |
|---|---|---|
| 1 | Gross Loans & Advances (Excluded Loan against Term Deposits - ₹108.99) Cr;) | 11,817.02 |
| 2 | Add: Undrawn exposure | 29.41 |
| 3 | Total Credit Exposure –Fund Based (1+2) | 11,846.43 |
| 4 | Add: Non-Fund Based Exposure (Excluded Contingent Liabilities against 100% | 0.00 |
| | **Total Credit Exposure (Total of 3+4 above)** | **11,846,43** |

**b) Geographic distribution of credit exposure -Table 5 (₹ in Crores) (30-06-2022)**

| S. No. | Exposure Type | Amount |
|---|---|---|
| 1 | Domestic Fund Based (Excluded Loan Against Term Deposits - ₹108.99 Cr) | 11,846.43 |
| 2 | Domestic Non-Fund based (Contingent Liabilities of ₹1.90 Cr with 100% Cash collateral) | 0.00 |
| 3 | Foreign Fund Based | 0.00 |
| 4 | Foreign Non-Fund Based | 0.00 |
| Total | | **11,846.43** |

**c) Credit Exposures by Risk Weights (30-06-2022) Table -6 (₹ in Crores)**

| S. No. | Risk Weight | Exposure | Risk Weighted Assets |
|---|---|---|---|
| 1 | Below 100% risk weight | 9,399.16 | 6,971.10 |
| 2 | 100% Risk weight | 1,041.35 | 752.74 |
| 3 | More than 100% | 1,405.92 | 125.80 |
| Total | | **11,846.43** | **7,849.64** |

**d) Sector wise distribution of Gross Loans & Advances (30-06-2022) Table -7 (₹ in Crores)**

| S. No. | Industry Classification | Gross Loan Portfolio | % Share |
|---|---|---|---|
| 1 | Agriculture and Allied Activities | 6,271.29 | 52.58% |
| 2 | Industries Sector | 754.46 | 6.33% |
| 4 | Trade & Services | 2,908.31 | 24.39% |
| 5 | Personal Loans and other Retail | 1,991.95 | 16.70% |
| **Total** | | **11,926.01** | **100.00%** |

**e) Credit Risk Mitigation Table -8 (30-06-2022) (₹ in Crores)**

| S. No. | Particulars | Exposure | Credit Risk Mitigant | Net Exposure |
|---|---|---|---|---|
| 1 | Gold Loan | 1,300.84 | 1,300.82 | 0.02 |
| 2 | Loan against FD | 108.99 | 108.99 | Nil |

### a) Maturity pattern of Assets Table -9 (₹ in Crores) –As on 30-06-2022

| Maturity Bucket | Cash, Balances with RBI | Balances with Banks, Money at Call & Short Notice, Term Deposits and other placements | Investments | Loans & advances * | Fixed assets | Other assets | Total |
|---|---|---|---|---|---|---|---|
| Day – 1 | 178.90 | 49.09 | 14.95 | 33.46 | 0.00 | 263.88 | **540.28** |
| 2-7 Days | 0.00 | 0.00 | 8.08 | 200.79 | 0.00 | 5.30 | **214.17** |
| 8-14 Days | 0.00 | 10.00 | 8.67 | 234.26 | 0.00 | 6.18 | **259.11** |
| 15-30 Days | 19.17 | 100.00 | 21.73 | 535.44 | 0.00 | 12.37 | **688.71** |
| 31 Days and up to 2 months | 21.45 | 0.00 | 86.60 | 526.83 | 0.00 | 6.18 | **641.06** |
| Over 2 Months and up to 3 months | 29.54 | 0.00 | 170.30 | 526.83 | 0.00 | 6.18 | **732.85** |
| Over 3 Months and up to 6 months | 61.31 | 0.00 | 69.53 | 1,450.31 | 0.00 | 12.37 | **1,593.52** |
| Over 6 Months and up to 1 year | 138.54 | 0.00 | 157.11 | 3,474.58 | 0.00 | 74.21 | **3,844.44** |
| Over 1 Year and up to 3 years | 199.32 | 0.50 | 321.46 | 3,952.64 | 0.00 | 0.00 | **4,473.92** |
| Over 3 Years and up to 5 years | 1.46 | 0.00 | 626.26 | 128.26 | 0.00 | 0.00 | **755.98** |
| Over 5 years and up to 7 years | 14.22 | 0.13 | 479.06 | 128.25 | 164.83 | 489.01 | **1,275.50** |
| Over 7 years and up to 10 years | 1.94 | 0.00 | 1,028.75 | 0.00 | 0.00 | 0.00 | **1,030.69** |
| Over 10 year and up to 15 years | 0.00 | 0.00 | 1,783.82 | 0.00 | 0.00 | 0.00 | **1,783.82** |
| Over 15 years | 28.66 | 0.00 | 53.23 | 0.00 | 0.00 | 0.00 | **81.89** |
| Total | **694.51** | **159.72** | **4,829.55** | **11,191.65** | **164.83** | **875.68** | **17,915.94** |

** NPA Excluded*

### 6.8 Classification of Non-Performing Assets

The Bank follows extant guidelines of the RBI on income recognition, asset classification, provisioning and classification of Non-Performing Assets (NPA) and tracking of Special Mention Accounts (SMA). All these are carried out strictly in accordance with the Income Recognition and Asset Classification (IRAC) norms and related circulars of RBI as updated from time to time.

#### 6.8.1 Provisioning & NPA

Provisions for NPAs are made at /or above the minimum required level in accordance with the provisioning norms adopted by the Bank and as per RBI directives on matters relating to prudential norms.

**(i) Amount of NPA as on 30th June 2022 Table-10 (₹ in Crores)**

| S. No. | Category | ₹ in Crores |
|---|---|---|
| **A** | **Amount of NPA (Gross)** | **734.36** |
| **A.1** | Substandard | 719.69 |
| **A.2** | Doubtful | 14.67 |
| **A.3** | Loss | |
| | NPA Provision | 294.94 |
| **B** | **Net NPAs** | **439.42** |
| **C** | **Advances** | |
| C1 | Gross Advances | 11,926.01 |
| C3 | Net Advances | 11,631.07 |
| **D** | **NPA Ratios** | |
| D.1 | Gross NPAs to gross advances (%) | 6.16% |
| D.2 | Net NPAs to net advances (%) | 3.78% |

**(ii) Movement of Gross NPA & Net NPA, FY 2022-23 Table -11 (₹ in crores)**

| Particulars | Gross NPA | Net NPA |
|---|---|---|
| Opening balance at April 1, 2022 | 949.60 | 455.96 |
| Add: Addition during the period | 207.50 | 155.17 |
| Less: Reduction/Upgradation/ Write-off/ during the period | 422.74 | 171.71 |
| **Closing balance at 30th June 2022** | **734.36** | **439.42** |

**(iii) Movement of NPA Provisions, FY 2022-23 - Table 12 (₹ in Crores)**

| Particulars | ₹ in crores |
|---|---|
| Opening balance at April 1, 2022 | 493.64 |
| Add: Provision made during the period | 130.33 |
| Less: Write off/ write back excess provision | 329.03 |
| **Closing balance at 30th June 2022** | **294.94** |

## 7. Operational Risk and Business Continuity Management

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk is primarily managed by prescribing adequate controls and mitigation measures which are being reviewed and updated on a regular basis to suit the changes in business practices, structure and risk profile.

Business continuity refers to the Bank's capability to continue delivery of its products/ services at acceptable predefined level following a disruptive incident. The Bank recognizes the need to continue and recover all critical business functions and to protect systems and data, which are critical to its operations during a crisis. Business Continuity Management (BCM) is a holistic management process that identifies potential impacts that could threaten the Bank, and provides a framework for building resilience and the capability for an effective response that safeguards the interests of its key stakeholders, reputation, brand and value-creating activities.

### 7.1 Structure and Organization of Operational risk & Business Continuity Management

Risk Management Committee of the Board oversees the bank-wide Operational Risk Management. Bank has put in place a detailed framework for Operational Risk Management under a Board approved Operational Risk Management Policy.

While Operational Risk Management is the responsibility of all functions and business units handling operational activities, the Operational Risk and Business Continuity Management Committee (OR-BCMC) at the executive level oversees bank-wide implementation of the Board approved policies and processes. The principal objective of the OR-BCMC is mitigation of operational risk in the institution by creation and maintenance of an explicit operational risk management process.

The OR-BCMC reviews the risk profile to take into cognizance future changes and threats, and concurs on areas of highest priority and related mitigation strategy with different functions and business units. The committee ensures that adequate resources are being assigned to mitigate risks as needed, and communicates to business units and functions, the importance of operational risk management in business activities.

Business Continuity Management in the Bank is also overseen by the Operational Risk & Business Continuity Management (OR-BCM) Committee, which is responsible for implementation of the Business Continuity Management process and procedures across the Bank. A comprehensive, Board approved, bank-wide Business Continuity Plan has been put in place to ensure continuity of critical operations of the Bank covering all identified disasters. A Crisis Management and Quick Response Team (CM-QRT) at Head Office level functions under the OR-BCM Committee. The CM-QRT takes responsibility and acts swiftly in case of breakdown or failure of critical systems, occurrence of natural disasters/ accidents or any other events (for example Covid19 pandemic) affecting business continuity.

Operational Risk management, Business Continuity Management and coordination of relevant activities under CM-QRT are the responsibilities of the Operational Risk Division of Risk Management Department. The Division is responsible for coordinating all the operational risk management and business continuity planning activities of the Bank, to facilitate achievement of the stated goals and objectives. Activities include building up an understanding of the risk profile, implementing tools related to operational risk management, and working towards the goals of improved controls and lower risk.

The Operational Risk Management model of the Bank facilitates conducting of Risk and Control Self-Assessments, (RCSA) scenario assessments, controls testing, investigation of incidents, issues tracking and development of action plans. Each of these activities can be linked to the other activities in the system, thereby providing an integrated and centralized framework for collecting, managing, and storing information.

The Bank has an internal framework for reporting and capturing Operational Risk incidents. The incidents reported are investigated to assess weaknesses in controls and identify areas for improvement. The Bank uses a Risk Management software for Credit, Market and Operational Risk management. Since RBI has not prescribed capital charge for Operational Risk for SFBs, the Bank has not computed capital charge for Operational Risk.

## 8. Market Risk

The Basel Committee on Banking Supervision defines Market Risk as the risk of losses in On or Off-balance sheet positions that arise from movement in market prices.

The major components of market risk include:

1. Interest rate risk: The potential loss due to movements in interest rates. This risk arises because a bank's assets usually have a significantly longer maturity than its liabilities.
2. Equity risk: The potential loss due to an adverse change in the stock price.
3. Foreign exchange risk: The potential loss due to change in value of the bank's assets or liabilities resulting from exchange rate fluctuations.
4. Commodity risk: The potential loss due to an adverse change in commodity prices.

### 7.1 Structure and organization of market risk management function

The Risk Management Committee of the Board (RMCB) oversees the bank-wide market risk management. Market Risk & Asset Liability Management Committee (MR-ALCO) is primarily responsible for establishing Market Risk Management and Asset Liability Management in the Bank.

The MR-ALCO, headed by the Managing Director & CEO, is responsible for implementing risk management guidelines issued by the regulator and monitoring adherence to the internal guidelines, procedures, practices, policies and risk management prudential limits. The major functions of MR-ALCO, with respect to managing risks in the banking and investment books of the Bank include:

- Designing and implementing effective market risk management and ALM framework.
- Reviewing new directives and regulatory limits for market risk, interest rate risk and liquidity risk, monitoring and revisions to tolerance limits prescribed in the Liquidity Risk Management Policy, Investment Policy and Market Risk Management Policy.
- Ensuring that business strategy of the Bank is in line with Bank's stated risk management objectives.
- Determining the structure, responsibilities and controls for managing Market Risk and for overseeing the liquidity positions.
- Ensuring independence of working of the Mid Office and Market Risk functions.

The Market Risk Division of the Risk Management Department is responsible for the design and implementation of the Bank's Market Risk Management/Asset Liability Management system. The Division is independent from business and trading units, and provides an independent risk assessment, which is critical to the MR-ALCO's key function of controlling and managing market risks in accordance with the mandate established by the Board and Risk Management Committee. Mid Office of the Bank's Treasury function is attached to the Market Risk Division of Risk Management Department. Mid Office prepares and analyses daily reports on various activities of the Bank's Treasury. The Mid Office, which is responsible for the critical functions of independent market risk monitoring, measurement and analysis, reports to the Bank's Chief Risk Officer.

## 7.2 Liquidity Risk

Liquidity risk management in the Bank is governed by the Board approved Market Risk Management Policy, Assets and Liabilities Pricing Policy and Liquidity Risk Management Policy which cover the Liquidity Risk, Interest Rate Risk (Banking and Trading book) and Market Risk framework. The Bank's Market Risk & Asset Liability Management Committee (MR-ALCO) is responsible for overseeing the management and governance of liquidity risk.

The liquidity profile of the Bank is analysed by tracking all cash inflows and outflows in the maturity ladder based on the actual maturity and expected occurrence predicted through behavioural analysis of cash flows. The renewal pattern and premature withdrawals of term deposits and drawdown of un-availed credit limits are also captured through behavioural studies.

The Bank computes the Regulatory prescribed Liquidity Ratios such as LCR and NSFR and are used as effective tools in Liquidity Management. Liquidity stress tests are conducted under different scenarios at periodical intervals to assess the impact on liquidity to withstand stressed conditions.

## 7.3 Interest Rate Risk in the Banking Book.

Interest rate risk refers to impact on Bank's Net Interest Income, and the value of its assets and liabilities arising from fluctuations in interest rate due to internal and external factors. Internal factors include the composition of Bank's assets and liabilities, quality, maturity, existing rates, and re-pricing period of deposits, borrowings, loans and investments. External factors cover general economic conditions. Rising or falling interest rates impact the Bank depending on whether the balance sheet is asset sensitive or liability sensitive.

As interest rate risk can impact both Net Interest Income (NII) and Economic value of capital, it is assessed and managed from both earnings and economic value perspective.

a) Earnings perspective: Analyses the impact on Bank's Net Interest Income (NII) in the short term through traditional gap analysis.
b) Economic perspective: Analyses the impact on the Net-worth of bank due to re-pricing of assets, liabilities and off-balance sheet items through duration gap analysis.

**Earnings at Risk (EaR) Table 13 (₹ in Crores)**

| Particulars | Impact on NII (30-06-2022) |
|---|---|
| Impact of 100 bps parallel shift in interest rate on both assets & liabilities on Net Interest Income (NII) | 7.95 |

**Market Value of Equity (MVE) Table 14 (₹ in Crores)**

| Particulars | Impact on MVE (30-06-2022) |
|---|---|
| Impact of 100 bps parallel shift in interest rate on both assets & liabilities on Market Value of Equity | 198.10 |

As the Reserve Bank of India has not prescribed capital charge for market risk for SFBs, the Bank has not computed capital charge for Market Risk.

# 8 Information Security & Cyber Security Risk Management

The Bank has established robust information and cyber security frameworks for securing the IT infrastructure and systems. The information security and cyber security policies of the Bank are approved and periodically reviewed by the Board of Directors. The IT Strategic Committee of the Board oversees its implementation. The Information Security Governance Committee (ISGC), headed by the Managing Director & CEO and comprising of members of the Senior Management from different business functions, is responsible at the Executive Level for the implementation of measures for ensuring information security and cyber security. ISGC provides clear direction and support for Information Security Risk Management initiatives in the Bank.

The ISGC monitors, reviews, directs and manages the Bank's Information Security Risk Management System within the Bank. This Committee functions as the apex body for handling Information Security risk related initiatives in the Bank, and reports to the Board of Directors through the IT Strategy Committee of the Board and keeps the Board apprised of relevant risks that needs attention.

The Information Security Division of Risk Management Department is headed by the Chief Information Security Officer (CISO), who reports to the Chief Risk Officer (CRO). The CISO is responsible for articulating and enforcing the policies that the Bank uses to protect its information assets apart from coordinating the information security related issues / implementation within the organization as well as relevant external agencies. The Information Security Division is responsible for creating, implementing and maintaining compliance with the appropriate Information Security Risk Management framework. The Division is responsible to measure the performance of information security controls across the overall enterprise and report risks including incidents and critical audit findings to the ISGC. The Division is responsible to schedule regular review meetings of the ISGC to report progress on key metrics, risk management program and other information security initiatives.

The Bank has implemented a 24 X 7 Security Operations Centre (SOC) to perform the task of detection and analysis of all potential incidents and notify the application owners which has been affected, for the containment, eradication and recovery from the incident. All cyber security incidents are recorded and reported to Information Security Division. The Information Systems of the Bank are subjected to Vulnerability Assessment and Penetration Testing (VAPT) on a periodical basis, as a preventive measure against cyber-attacks that could threaten the confidentiality, integrity and availability of data and the systems.

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