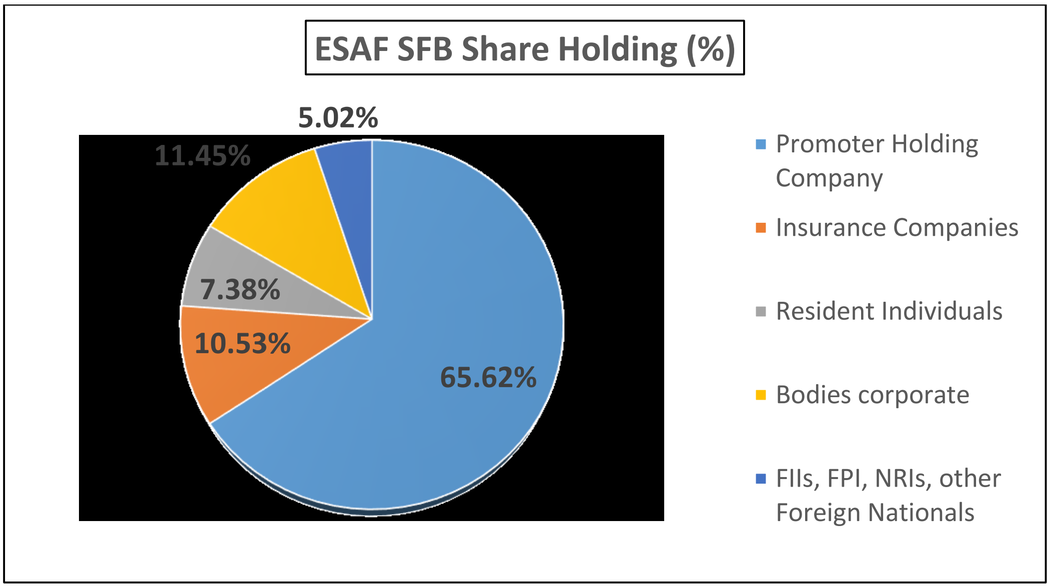
Pillar III Disclosures as of 31st March, 2019

ESAF Small Finance Bank Limited ("the Bank") is a public limited company incorporated in India on 05th May, 2016 under the provisions of Companies Act, 2013. The Bank received license from Reserve Bank of India (RBI) on November 18, 2016 to carry on the business of Small Finance Bank (SFB) in India and commenced its banking operations on March 10, 2017. The Bank is headquartered at Thrissur, Kerala, and provides services in urban, semi-urban and rural areas of the country, through its inclusive banking initiatives. The Bank does not have any foreign operations.

The shareholding pattern of the Bank is as shown below:

Description	Share Holding (%)
Promoter Holding Company	65.62
Insurance Companies	10.53
Resident Individuals	7.38
Bodies corporate	11.45
FIIs, FPI, NRIs, other Foreign Nationals	5.02
TOTAL	**100.00**



Pillar III Disclosures on the capital adequacy and risk management framework are detailed in the following sections:

1. Capital Adequacy

1.1 Capital 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 (CRAR) of 15%, with a minimum Tier I capital of 7.5%. As of now, Capital Conservation Buffer and Counter Cyclical Capital Buffer are not applicable for Small Finance Banks.

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 taken into account 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.

The Bank has a process for assessing the capital requirements and a strategy to maintain its capital levels. The Bank has also set up sound governance and control practices to identify, assess and manage risks, which are periodically reviewed by the Risk Management Committee of the Board (RMCB).

1.2 Capital Structure –Table 1

Breakup of capital funds is as follows:

Particulars (31st March 2019)	**₹ in Crores**
Tier I capital – I	
Paid Up Capital	427.80
Reserves	465.36
Perpetual Debt Instrument	48.00
Deductions – II	**1.76**
Intangible Assets (Prepaid expenses)	1.76
First loss credit enhancement provided for securitized assets	Nil
Second loss credit enhancement provided for securitized assets	Nil
Any Other Deductions	Nil
Tier I Capital Total (I-II) A	**939.40**
Tier II Capital – I	**173.05**

Particulars (31st March 2019)	₹ in Crores
General provisions on Standard Assets	21.52
Investment Fluctuation Reserve	0.53
Sub Ordinated term Debt	151.00
Deductions – II	
First loss credit enhancement provided for securitized assets	Nil
Second loss credit enhancement provided for securitized assets	Nil
Total Tier II Capital (I-II) B	**173.05**
Total Capital (A+B)	**1,112.45**

1.3 Capital Adequacy

a) Qualitative 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 for the period ended 31st March 2019 is 15% of the Risk Weighted Assets. The Bank's CRAR is well above the regulatory minimum level.

The CRAR has been assessed using Basel II standardized approach for credit risk only, since SFBs are not required to create separate capital charge for market risk and operational risk.

b) Internal Capital Adequacy Assessment Process (ICAAP) & Risk Appetite Framework (RAF)

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. The annual and quarterly assessments are put up to the Board of Directors of the Bank. In addition, the annual ICAAP report is also submitted to the RBI as a regulatory requirement.

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. The first step in material risk assessment is to identify all risks faced by the Bank and assess them for materiality.

The Bank's Internal Capital Adequacy Assessment Process has taken into account all material Risks including Pillar I and Pillar II risks for Capital Adequacy assessment. The Pillar I & Pillar II risks assessed in the Bank's ICAAP include the following:

Pillar I Risks	Credit Risk
	Market Risk
	Operational Risk
Pillar II Risks	Credit Concentration Risk
	Liquidity Risk
	Interest Rate Risk
	Strategic Risk
	Reputational Risk
	Compliance Risk
	IT and Cyber Security Risk
	People/ Human Resources Risk
	Group Risk
	Outsourcing Risk
	Internal Frauds & Malpractices Risk
	Governance Risk
	Regulatory Norms Violation Risk

The Bank has also put in place a Risk Appetite Framework (RAF) under the ICAAP. Risk Appetite framework is the overall approach, including policies, processes, controls and systems through which risk appetite is established, communicated, and monitored. It includes a risk appetite statement, risk limits, and an outline of the roles and responsibilities of those overseeing the implementation and monitoring of the RAF. Risk appetite is the aggregate level/ range and types of risk the Bank is willing to assume within its risk capacity to achieve its strategic objectives and business plan. The Risk Appetite and tolerance levels are not static. The limits and the appetites depend upon the prevailing market conditions and business strategies adopted by the Bank from time to time. The ICAAP document monitors the risk appetite set by the Board. Breaches, if any, in the risk appetite limits are reported in the ICAAP and act as warning signals for the functionaries to take note of and initiate corrective actions.

Under the ICAAP, the Bank also analyses the impact on Capital and other Pillar I risks under normal and stressed scenario by way of Stress Testing. Stress testing provides the Bank with a means for estimating the Bank's Risk exposures under stressed conditions, enabling development of appropriate strategies for mitigation and evaluation of the Bank's capacity to withstand stressed situations in terms of Profitability and Capital Adequacy. It also improves understanding of the Bank's Risk profile and therefore enables the Board of Directors and Senior Management to determine whether the Bank's Risk exposures correspond to its Risk appetite. Under stress testing the Bank follows the twin strategies of sensitivity analysis and scenario analysis

The ICAAP enables the Bank to review the capital impact of assessed Pillar II risks and to examine any new risk dimensions coming out of existing and new business / products. It acts as a sanity check for the feasibility of business plans based on projected risk profile and capital. Important elements of ICAAP including growth and profitability targets, scenario analysis, and stress testing are used in setting business plans and management policies. It is also used as a platform to sensitize Board, Senior Management, and key stakeholders about the RBI guidelines, risk concepts, risk appetite, risk profile, risk management framework and capital linkage enabling the strengthening of risk framework as well as institutionalization of a strong Risk culture within the Bank.

c) **Quantitative Disclosures: Table 2**

S. No.	Particulars As on 31-03-2019	₹ in Crores
A	**Capital Requirements for Credit Risk**	604.83
A.1	Portfolio Subject to Standardized approach	590.75
A.2	*For Off Balance Sheet Credit Portfolio	13.52
A3	For Off Balance Sheet Corporate Guarantee	0.56
B	**Capital Requirements for Market Risk**	Nil
B.1	For Interest Rate Risk	Nil
B.2	For Equity Risk	Nil
B.3	For Forex Risk (including gold)	Nil
B.4	For Commodities Risk	Nil
B.5	For Options risk	Nil
C	**Capital Requirements for Operational Risk**	**Nil**
	Total Capital Requirement (A+B+C)	**604.83**
	Total Risk Weighted Assets (RWA for all types of assets)	**4,032.22**
	Total Capital Funds	**1,112.45**
	CRAR (%)	**27.59%**
	Tier -1 Capital Adequacy Ratio (%)	23.30%
	Tier -2 Capital Adequacy Ratio (%)	4.29%

*Off Balance sheet portfolio includes Securitization, Assignment & Inter Bank Participation Certificates (IBPC). As on 31-03-2019 it amounts to ₹ 385.27 Crs.

2. Risk Management

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 Management Committee (ORMC) and Asset Liability Management Committee (ALCO) support RMCB to facilitate effective execution of the above 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, Market Risk, Operational Risk, Information Security, AML & Transaction Monitoring and Internal Financial Control Divisions assist the above 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.

3. 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 customer 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 objective of credit risk management is to maximize a bank's risk-adjusted rate of return while maintaining credit risk exposure within acceptable limits.

3.1 Credit risk governance

The Bank has put in place the Loan Policy, NPA Management Policy and Credit Risk Management Policy, approved by the Board of Directors. While the Loan Policy covers the rules and regulations for processing and sanction of credit, Bank's approach to monitoring of credit, etc., the NPA Management policy covers the rules regarding NPA Management, provisioning, collection & recovery, and mechanisms like compromise settlements, restructuring, legal action, write-off etc. and the Credit Risk Management Policy describes credit risk identification process, procedure for measurement of credit risk and risk mitigation strategies.

3.2 Structure and Organization of Credit Risk Management Framework

The Bank has put in place comprehensive Board approved Credit Risk Management Policy. The 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 credit risks in a timely and effective manner.

The credit risk governance framework establishes the responsibility and approach through which the Board of Directors and the management of the Bank manage credit risk. Risk Management Committee of the Board (RMCB) oversees bank wide risk management. The senior executive level Credit Risk Management Committee (CRMC) manages implementation of credit risk management framework across the Bank and provides recommendations to the RMCB and the Board. CRMC ensures implementation of credit risk policy 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 of implementing processes for credit risk identification, assessment, measurement, monitoring and control. Credit risk appetite statements 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 / RMCB and RBI. The Division constructs credit risk identification systems, monitors quality of the bank's loan portfolio, identifies problem credits and undertakes asset quality reviews with support from the business units. The Division captures early warning signals in the loan portfolio for identification of weak exposures, suggests remedial measures and monitors the actions taken.

CRMC of the Bank meets at least once in three months to take stock of Bank's credit risk profile, based on the reports placed by Credit Risk Division.

Further, the Bank has put in place a detailed Loan Policy, spelling out various aspects of credit dispensation and credit administration. An effective governance framework to ensure the independence of the credit risk unit from the business units is implemented. Through an effective, Board-approved credit risk governance framework, the Bank seeks to ensure adequate risk oversight, monitoring, and control of credit risks.

3.3 Credit Process

The Loan Policy of the Bank details the credit norms to be adhered to for each customer segment. 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. Credit scoring models are used for evaluating applications for credit. The score card is expected to evolve and get fine-tuned when more and more cases are sanctioned based on detailed credit appraisal.

3.4 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.

Credit Risk Mitigants have the effect of reducing the net exposure for application of risk weights. Credit Risk Mitigation techniques classified as eligible for reduction in the net exposure include:

i. Eligible financial collateral
ii. Guarantees
iii. On-balance sheet netting

3.5 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. Going forward, the Bank intends to track the exposure to specific industries and also to sensitive sectors, which would contribute to formulating the growth strategy of the Bank.

3.6 Credit Exposures & Risk Summary

a) Exposure – Facility Type –Table 3

S. No.	Exposure Type	₹ in Crores
1	Gross Loans & Advances	4,587.06
2	Add: Non SLR Investments	644.34
3	Total Fund Based *(Total of 1+2 above)*	5,231.40
4	Add: Non Fund Based	3.76
	Total *(Total of 3+4 above)*	**5,235.16**

b) Geographic distribution of credit portfolio. -Table 4

S. No.	Exposure Type	₹ in Crores	Percentage
1	Domestic @	4,587.06	100%
2	Foreign	Nil	0%
	Total	4,587.06	100%

@ Excluded are the following

1. Non-SLR investments (Rs. 644.34 Cr) which includes Certificate of Deposits (CD), and Pass Through Certificates (PTC).
2. Corporate guarantee given for securitisation of Rs.3.76 Cr.

b – 1) State-wise distribution of loan portfolio-Table 5 (₹ in Crores)

S. No.	State	Portfolio Outstanding	% of Total Portfolio
1	Kerala	2,386.26	52.02%
2	Tamil Nadu	1,331.30	29.02%
3	Maharashtra	228.16	4.98%
4	MP	226.34	4.94%
5	Chhattisgarh	121.69	2.65%
6	Karnataka	129.05	2.81%
7	Jharkhand	59.72	1.30%
8	Pondicherry	32.28	0.71%
9	Bihar	42.74	0.93%
10	West Bengal	17.08	0.37%

S. No.	State	Portfolio Outstanding	% of Total Portfolio
11	Assam	11.00	0.24%
12	Orissa	0.77	0.02%
13	Delhi (NCT)	0.17	0.00%
14	AP	0.50	0.01%
	Total	**4,587.06**	**100.00%**

The Bank is taking steps for reducing the geographic credit concentration by expanding its loan book to other states and geographies where the reach is less at present.

c) Distribution of portfolio between secured and unsecured business Table -6 (₹ in Crores)

S. No.	Exposure Type	₹ in Crores
1	Secured	151.10
2	Unsecured	4,435.96
	Total	**4,587.06**

The Bank is taking steps to diversify the loan portfolio by increasing the secured lending portfolio in a phased manner.

d) Sector wise distribution Table -7 (₹ in Crores)

S. No.	Industry Classification	Total Exposure	% of Total Exposure
1	Agriculture and Allied Activities	2,590.66	56.48%
2	Advances to Industries Sector eligible as Priority sector lending	577.52	12.59%
3	MSE Trade & Services	776.25	16.92%
4	Personal Loans and other Retail	642.63	14.01%
	Total	**4,587.06**	**100.00%**

e) Maturity pattern of Assets Table -8 (₹ in Crores)

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	71.31	89.24	0.20	16.15	0.00	0.29	**177.19**
2-7 Days	0.00	170.00	126.74	96.93	0.00	81.75	**475.42**
8-14 Days	0.00	35.00	76.74	113.08	0.00	2.05	**226.87**
15-30 Days	1.93	50.00	1.95	258.47	0.00	4.09	**316.44**
31 Days and up to 2 months	2.79	11.82	2.82	343.71	0.00	2.05	**363.19**
Over 2 Months and up to 3 months	4.57	0.00	78.61	343.71	0.00	2.05	**428.94**
Over 3 Months and up to 6 months	14.28	83.71	290.16	932.64	0.00	4.09	**1,324.88**
Over 6 Months and up to 1 year	51.39	14.61	146.94	1,319.66	0.00	24.56	**1,557.16**
Over 1 Year and up to 3 years	71.18	0.00	72.14	1,042.11	0.00	0.00	**1,185.43**
Over 3 Years and up to 5 years	3.74	0.20	3.79	23.32	0.00	0.00	**31.05**
Over 5 years and up to 7 years	4.72	0.00	188.58	23.27	89.94	107.74	**414.25**
Over 7 years and up to 10 years	0.03	0.13	109.90	0.00	0.00	0.00	**110.06**
Over 10 year and up to 15 years	0.00	0.00	199.76	0.00	0.00	0.00	**199.76**
Over 15 years	20.80	0.00	232.42	0.00	0.00	0.00	**253.22**
Total	**246.74**	**454.71**	**1,530.75**	**4,513.05**	**89.94**	**228.67**	**7,063.86**

** NPA Excluded*

f) **Credit Exposure by Risk Weights Table -9 (₹ in Crores)**

S. No.	Risk Weight	Gross Outstanding Credit	Risk Weighted Exposure for Credit
1	Below 100% risk weight	4,176.90	3,092.53
2	100% Risk weight	398.97	398.97
3	More than 100% risk weight	11.19	13.99
	Total	**4,587.06**	**3,505.49**

g) **Credit Risk Mitigation Table -10 (₹.in Crores)**

S. No.	Particulars	Exposure	Credit Risk Mitigant	Net Exposure
1	Gold Loan	31.57	31.57	Nil
2	Loan against FD	47.91	47.91	Nil

3.7 Classification of Non-Performing Assets

3.7.1 Non-performing Assets

An asset including a leased asset becomes non-performing when it ceases to generate income for the Bank. A Non-Performing Asset (NPA) is a loan or an advance where:

a) Interest and/or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan
b) The account remains ‘out of order’ as indicated in paragraph (i) below in respect of an Overdraft/Cash Credit (OD/CC).
c) The bill remains overdue for a period of more than 90 days, in case of bills purchased and discounted.
d) The instalment of principal or interest thereon remains overdue for two crop seasons for short duration crops
e) The instalment of principal or interest thereon remains overdue for one crop season for long duration crops

(i) ‘Out of Order’ status:

An account is treated as ‘out of order’ if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days, as on the date of balance sheet or the credits are not enough to cover the interest debited during the same period, these accounts are treated as ‘out of order’.

(ii) Overdue:
An amount due to the Bank under any credit facility is overdue, if it is not paid on the due date fixed by the Bank.

(iii) Special Mention Accounts:
The Bank identifies incipient stress in accounts by creating a sub asset category named Special Mention Accounts (SMA). It is considered as a corrective action plan to arrest slippages of standard assets to NPA status. Accordingly, the Bank is identifying three sub categories, under SMA as below:

- SMA -0- : Principal or interest payment or any other amount wholly or partly overdue between 1-30 days.
- SMA -1- : Principal or interest overdue between 31 – 60 days.
- SMA -2- : Principal or interest overdue between 61-90 days.

3.7.2 Provisioning

Provision for non-performing advances comprising Sub-standard and Doubtful Assets is made in accordance with RBI guidelines.

(i) Amount of NPA as on 31 March 2019 Table-11

S. No.	Category	₹ in Crores
A	Amount of NPA (Gross)	**74.01**
A.1	Substandard	57.19
A.2	Doubtful (100% provision –Unsecured)	16.82
A.3	Loss	0
B	**Net NPAs**	**35.20**
C	Advances	
C.1	Gross Advances	4,587.06
C.2	NPA Provisions	38.81
C.3	**Net Advances**	**4,548.25**
D	**NPA Ratios**	
D.1	Gross NPAs to gross advances (%)	1.61%
D.2	Net NPAs to net advances (%)	0.77%

(ii) Movement of NPA for the Year ending 31 March 2019 Table -12 (₹ in crores)

Particulars	Gross NPA	Net NPA
Opening balance at April 1, 2018	121.05	84.81
Addition during the period	76.08	35.15
Reduction/Upgradation/ Write-off/ during the period (Net)	123.12	84.76
Closing balance at 31st March 2019	74.01	35.20

(iii) Movement of NPA Provision for the Period ended 31st March 2019 - Table 13

Particulars	₹ in crores
Opening balance at April 1, 2018	36.24
Provision made during the period	101.20
Write off/ write back excess provision	98.63
Closing balance at 31st March 2019	38.81

4. Securitization Exposure

4.1 Qualitative Disclosures

The Bank undertakes Securitization / Loan Assignment transactions with the objective of maximizing return on capital employed, managing liquidity and maximizing yield on assets. The revised securitisation guidelines issued by RBI on May 07

, 2012 define minimum holding period, minimum retention requirements, due diligence, credit monitoring, stress testing requirements etc. The Bank undertakes sale transactions through both securitization and loan assignment routes in the following roles.

Originator / Seller: The Bank originates assets in its books and subsequently down sells them through the securitization or assignment route.

Servicing and collection agent for sold assets: The Bank undertakes the activity of collections and other servicing activities including preparation of monthly pay out reports.

Credit Enhancement Provider: The Bank may provide credit enhancement on securitisation (sale) transactions undertaken by the Bank for meeting shortfall arising out of delinquencies and prepayment losses in the underlying pool sold.

4.2 Risks involved

4.2.1 Regulatory & Legal Risks

The risks that arise as an originator of securitisation transactions, are mainly on account of non-compliance of transaction structures with the extant regulatory guidelines. In case the assets transferred do not meet the true sale criteria defined by RBI, the assets would be deemed to be on the balance sheet of the originator itself and the originator will be required to hold capital against the full value of securitised assets. Further, if the regulatory guidelines in respect of giving representations and warranties concerning the assets sold are not complied with or in case of non-compliance of regulatory guidelines on credit enhancement facility provided, the originator would require to maintain capital against the full value of securitised assets.

The Legal Risks arise when there is conflict between the provisions of the transaction document and those of the underlying financial facility agreement.

4.3 Accounting Transfer and servicing of assets

The Bank transfer loans through securitisation transactions. The transferred loans are derecognized and gains / losses are accounted for, fully complying with the regulatory guidelines in this regard.

In accordance with RBI guidelines for securitization of standard assets, the profit / premium arising from sell down / securitization is amortised over the life of the transaction based on the method prescribed in the guidelines. Losses, if any, arising in the sell down / securitisation transaction, is recognised. (upfront in the statement of profit and loss).

4.4 Quantitative details

4.4.1 Quantitative details of securitization transactions originated. Table -14 (₹ in Crores)

Particulars	FY 2017-218	FY 2018-2019
Total number of loan assets securitised (Numbers)	3,29,090	1,46,644
Book value of loan assets securitized	553.03	120.49
Sale consideration received for the securitized assets	539.73	116.27
Interest spread on Securitization during the period	40.97	41.12
Form of services provided	Credit enhancement & post securitisation asset servicing	
Quantum (outstanding value) of services provided:	-	-
Cash Collateral	41.11	36.85
Over Collateral	26.66	17.51
Exposure to own securitization	8	8

4.4.2 Quantitative details of Assignment Transactions originated. Table 15 (₹ in Crores)

Particulars	FY 2017-218	FY 2018-2019
Total number of loan assets assigned (Numbers)	Not Applicable	Not Applicable
Book value of loan assets assigned	Not Applicable	Not Applicable
Sale consideration received for the assigned assets	Not Applicable	Not Applicable
Interest spread on Assignment during the period*	14.36	0.57
Form of services provided	Post transaction asset servicing	
Quantum (outstanding value) of services provided:	-	-

* Interest spread on Assignment transactions originated in ESAF Microfinance and transferred to ESAF SFB on commencement of the Bank.

5. 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.

$$\text{Leverage Ratio} = \frac{\text{Capital Measure (Tier I Capital)}}{\text{Exposure Measure}}$$

Leverage Ratio as on 31-03-2019 – Table 16

Leverage Ratio		
	Particulars	**(₹ in Crores)**
On Balance Sheet Exposure		
1	On-balance sheet items (excluding derivatives and Securities Financing Transactions (SFT), but including collateral)	7,057.49
2	(Asset amounts deducted in determining Basel III Tier 1 capital)	0
3	Total on-balance sheet exposures (excluding derivatives and SFTs) **(1 + 2)**	7,057.49
4	Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	0
5	Add-on amounts for Potential Future Exposure (PFE) associated with all derivatives transactions	0
6	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the operative accounting framework	0

Leverage Ratio		
	Particulars	**(₹ in Crores)**
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	0
8	(Exempted Central Counter Party (CCP) leg of client-cleared trade exposures)	0
9	Adjusted effective notional amount of written credit derivatives	0
10	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)	0
11	**Total derivative exposures (sum of lines 4 to 10)**	0
12	Gross SFT assets (with no recognition of netting), after adjusting for sale accounting transactions	0
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	0
14	Counterparty Credit Risk (CCR) exposure for SFT assets	0
15	Agent transaction exposures	0
16	**Total securities financing transaction exposures (sum of lines 12 to 15)**	0
Other off-balance sheet exposures		
17	Off-balance sheet exposure at gross notional amount	58.33
18	(Adjustments for conversion to credit equivalent amounts)	0
19	**Off-balance sheet items (sum of lines 17 and 18)**	**58.33**
Capital and total exposures		
20	**Tier 1 capital**	**939.40**
21	**Total exposures (sum of lines 3, 11, 16 and 19)**	**7,115.82**
Leverage ratio		
22	**Basel III leverage ratio**	**13.20%**
Summary comparison of accounting assets vs. leverage ratio exposure measure		
	Particulars	(₹ in Crores)

Leverage Ratio		
	Particulars	**(₹ in Crores)**
1	Total consolidated assets as per published financial statements	7,057.49
2	Adjustment for investments in banking, financial, insurance or commercial entities that are consolidated for accounting purposes but outside the scope of regulatory consolidation	0
3	Adjustment for fiduciary assets recognized on the balance sheet pursuant to the operative accounting framework but excluded from the leverage ratio exposure measure	0
4	Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off- balance sheet exposures)	58.33
5	Other adjustments	0
6	**Leverage ratio exposure**	**7,115.82**

6. Liquidity Risk

Liquidity refers to the Bank's ability to fund decreases in liabilities and / or increase in assets and meet both cash and collateral obligations at reasonable cost without adversely affecting its financial status. Liquidity risk arises if the Bank is unable to meet such obligations. The Bank's Asset Liability Management Committee (ALCO) is responsible for overseeing the management and governance of liquidity risk.

Liquidity risk management in the Bank is governed by the Board approved Asset Liability Management and Market Risk Management Policy, which covers the broad liquidity risk, Interest rate risk (Banking and Trading book) and Market Risk framework in accordance with RBI guidelines and as permitted under the rules applicable to Small Finance Banks.

7. 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. Asset Liability Management Committee (ALCO) also known as Market Risk

Management Committee is primarily responsible for establishing Market Risk Management and Asset Liability Management in the Bank.

The ALCO headed by MD & 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 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 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/ALM system. The Division is independent from business and trading units, and provides an independent risk assessment, which is critical to the 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 Interest Rate Risk in the Banking Book.

7.2.1 Qualitative Disclosures

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. Economic 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.

The Asset-Liability Management Committee (ALCO) is responsible for evolving appropriate systems and procedures for on-going identification and analysis of Balance Sheet Risks and laying down parameters for efficient management of these risks through Asset-Liability Management Policy of the Bank. ALCO, therefore, periodically monitors and controls the risks and returns, funding and deployment, setting Bank's lending and deposit rates, and directing the investment activities of the Bank. ALCO also develops the market risk strategy by clearly articulating the acceptable levels of exposure to specific risk types (i.e. Interest rate, liquidity etc.)

RBI has stipulated monitoring of interest rate risk through a statement of Interest Rate Sensitivity (Re-pricing Gaps) to be prepared on a monthly basis. Accordingly, ALCO reviews interest rate sensitivity statement on monthly basis and monitors the Earnings at Risk (EaR) which measures the change in Net Interest Income of the Bank due to parallel change in interest rate on both assets and liabilities.

RBI has also stipulated to estimate the impact of change in interest rates on economic value of Bank's assets and liabilities through interest rate sensitivity under Duration Gap Analysis (IRS –

DGA). Bank also carries out Duration Gap Analysis on a monthly basis as stipulated by RBI. The impact of interest rate changes on the market value of equity is monitored through Duration Gap Analysis by recognizing the changes in value of assets and liabilities by a given change in the market interest rate. The change in value of equity (including reserves) with 2% parallel shift in interest rates for both assets and liabilities is estimated.

7.2.2 Quantitative Disclosures

a) Earnings at Risk (EaR) Table 17 (₹ in Crores)

	Impact on NII **(31-03-19)**
Impact of 100 bps parallel shift in interest rate on both assets & liabilities on Net Interest Income (NII)	5.06

b) Market Value of Equity (MVE) Table 18 (₹ in Crores)

	Impact on MVE **(31-03-19)**
Impact of 200 bps parallel shift in interest rate on both assets & liabilities on Market Value of Equity	28.67
Impact of 100 bps parallel shift in interest rate on both assets & liabilities on Market Value of Equity	14.34

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. Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputational risk.

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.

8.1 Structure and organization of operational risk management function

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 Management Committee (ORMC) at the executive level oversees bank-wide implementation of the Board approved policies and processes. The principal objective of the ORMC is mitigation of operational risk in the institution by creation and maintenance of an explicit operational risk management process.

The ORMC 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.

8.2 Business Continuity Management

The Operational Risk Management Committee also functions as the Business Continuity Management (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.

Operational Risk management, Business Continuity Management and coordination of relevant activities 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 ORM model of the Bank facilitates conducting of Risk and Control Self Assessments, 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 is in the process of using an enterprise-wide Risk Management software solution, SAS Enterprise GRC, for management of Credit, Market and Operational Risks. The application automates the management of governance, risk, and compliance (GRC) data, and facilitates the entry, collection, transfer, storage, tracking, and reporting of operational losses, gains, recoveries, and key risk indicators (KRIs) that are drawn from multiple locations across the organization.

It facilitates conducting of Risk and Control Self Assessments, 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 GRC information.

The Bank has also framed a whistle blower policy, which is open to employees and vendors for raising their concerns, with full confidentiality, on any fraud, malpractice or any other untoward activity or event.

Since RBI has not prescribed capital charge for Operational Risk for SFBs, the Bank has not computed capital charge for Operational Risk.

8.3 AML and Transaction monitoring as a Risk Management activity

Anti-Money Laundering (AML) initiatives have evolved to be one of the major focus areas for financial institutions, with the widespread prevalence of financial crimes and malpractices. The regulatory controls and compliance requirements in place and the objective of ensuring that the Bank's customer base excludes persons attempting money laundering and other financial crimes, have placed prime importance on the AML programme of the Bank. In view of the increasing importance of this function, the Bank has attached its AML & Transaction Monitoring Division to Risk Management Department.

The AML & Transaction Monitoring Division of the Risk Management Department functions with focus on the following aspects:

- Risk categorisation of customers at the time of account opening, and transaction monitoring along the lines of the risk categorisation of the customers.
- Maintenance of a compliance culture across the organization ensuring that all employees starting from branch staff, understand money laundering risks and the consequences of breaches of the AML norms.
- Effective implementation of the KYC/AML Policy of the Bank ensuring that the Bank is not used for money laundering or terrorist financing activities
- Development and maintenance of a comprehensive AML/ Combating Financing of Terrorism (CFT) programme in line with the regulatory requirements covering systems and controls, training of staff and management oversight and ensure its effective implementation.
- Reporting on cash transactions above the limits specified, transaction involving receipts by non-profit organizations and transactions involving the use of forged or counterfeit currency notes, to the Director, Financial Intelligence Unit- India.

9. Information Security Risk Management

Robust information and cyber security frameworks are established for securing the IT infrastructure and systems of the Bank. Oversight of Information Security Governance for the Bank is the responsibility of the Information Security Governance Committee (ISGC). The ISGC is a management level committee headed by the Managing Director & CEO. ISGC is the central representative body of senior management from different business functions to provide 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 acts as apex committee 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, who reports to the Chief Risk Officer directly.

10. Internal Financial Control (IFC)

The Bank has developed an Internal Financial Control (IFC) Framework in line with requirements of the Companies Act, 2013. To implement this, an Internal Financial Control Division is established under the Risk Management Department. IFC is defined as "the policies and procedures adopted by the company to ensure orderly and efficient conduct of its business, including adherence to company's policies, safeguarding of its assets, prevention and detection of frauds and errors, accuracy and completeness of accounting records, and timely preparation of reliable financial information." The Audit Committee of the Board oversees implementation of Internal Financial Controls in the Bank as per the Companies Act, 2013. The Companies Act, 2013 also specifies the duties of the Audit Committee which includes evaluation of IFC and submitting a report to the Board of Directors, who in turn make an assertion in Director's Responsibility Statement that Internal Financial Controls (IFCs) have been laid down and that such IFCs are adequate and operating effectively.

In order to ensure effective working of the IFC Framework, the IFC Division coordinates with identified officials in each Department/ Function. These officials and the respective Head of Departments are responsible for ensuring that IFC documentation is current and up to date. The various departments ensure that the process changes and new products introduced are put up to the Product and Process Approval Committee(PPAC). The processes approved by the PPAC are incorporated in the IFC documentation of the respective function. IFC Division checks for this updation. Further, IFC Division, with assistance from Operational Risk Division of the Risk Management Department and IT Department identifies any design level control gaps, as a result of the changes in the process or introduction of a new product, and highlights to the respective department and Internal Audit Department

The Bank has identified and documented Risk Control Matrices (RCM) incorporating all the major processes along with the key risks associated with them, and controls at entity and process levels, mitigating those risks. To ensure that the Financial Controls are adequate and operating effectively, periodical review and testing is done. The reporting of the status is made to the Audit Committee of the Board (ACB), which has the overall responsibility of ensuring the adequacy of IFC Framework and operating effectiveness.

The IFC Division maintains repository of all Process Walk-through Documents and the Risk Control Matrices (RCMs). Based on the Risk Assessment, processes are categorized into different Risk categories for the purpose of determining testing frequency. The prioritization and scheduling of testing is done on the basis of Risk Assessment. Testing includes both Test of Design Gaps as well as Test of Operating Effectiveness. The Internal Audit Team performs the testing of the controls documented in the RCMs based on the overall Testing framework aligned with IFC requirements. The Bank follows testing cycle from April to March.

Internal Audit Team consolidates the Testing Results of Controls and the gaps highlighted. These Gaps are discussed with the various departments and a remediation plan is prepared by the respective function/department wherever required. After certifications from Heads of Departments and Internal Audit, Head – IFC Division confirms to the Chief Financial Officer, who will certify to the Audit Committee of the Board on the Bank's IFC compliance, as per the provision of the Companies Act, 2013.

11. Risk Management for protecting interests of stake holders

- The ESAF SFB articulates its business strategy and conducts operations within a structured risk management framework, with focus on active management of all financial and non-financial risks faced by the Bank. The Bank endeavours to establish itself as a professionally serious organisation in management of risks, with an ultimate goal of protecting the interests of all its stakeholders, including the shareholders, customers, investors, employees and all others who directly and indirectly deal with the Bank in various areas and geographies of its operations.

- A committee of senior executives vets all new products and processes and changes thereto before they are implemented in the Bank for managing the financial and non-financial risks in a manner consistent with its risk appetite.
- The focus and efforts of the Bank in identifying, measuring, monitoring, managing and mitigating risks, and on exercising control on the business and socio-economic environment in which it operates, to the required extent, ensure that all of its valuable stakeholders are protected from any undesirable events, outcomes, sufferings and losses, in the best manner possible.

12. Conclusion

The transformation from a Microfinance institution to a Small Finance Bank has brought with it a plethora of opportunities and challenges relating to funding sources, credit delivery and administration, putting in place the required infrastructure, policies and processes, recruitment and training manpower etc. Within the short time of commencing operations, the Bank has been successful in diversifying its funding sources and credit delivery as well as putting in place the required systems, policies and procedures. Additional infrastructure facilities are also being put in place and recruitment and training of staff to meet the challenges ahead are progressing. The policies, systems and processes are being regularly improved and updated to ensure full compliance with the directions and guidelines issued to Small Finance Banks by Reserve Bank of India from time to time.

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