



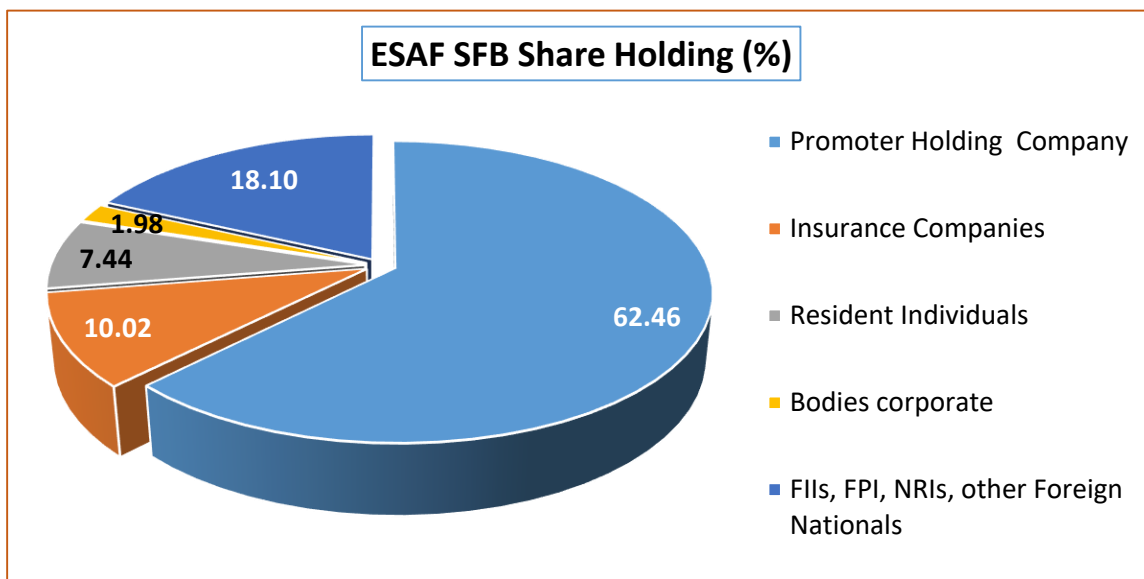
Pillar 3 Disclosures as of 31st March 2021

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 in principle approval from Reserve Bank of India (“RBI”) to establish a Small Finance Bank in the private sector under section 22 of the Banking Regulation Act, 1949 on September 16, 2015; received the license from the Reserve Bank of India on November 18, 2016 and commenced its banking operations from March 10, 2017. As per RBI Approval, the name of the Bank is included in the Second Schedule to the Reserve Bank of India Act, 1934 with effect from 12 November 2018.

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 provides micro, retail and corporate banking, para banking activities such as debit card, third party financial product distribution, in addition to Treasury and permitted Foreign Exchange Business. The Bank does not have any foreign operations.

The shareholding pattern of the Bank is as shown below:

Description	Share Holding (%)
Promoter Holding Company	62.46
Insurance Companies	10.02
Resident Individuals	7.44
Bodies corporate	1.98
FII's, FPI, NRIs, other Foreign Nationals	18.10
TOTAL	100.00



Pillar 3 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 Ratio (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 (31 st March 2021)	₹ in Crores
Tier I capital –(I)	
Paid Up Capital	449.47
Reserves	898.46
Perpetual Debt Instrument	48.00
Total	1,395.93
Deductions – (II)	
Intangible Assets	
Any Other Deductions	7.03
Total Deductions	7.03
Total Tier I Capital Total (I-II) A	1,388.90
Tier II Capital – (III)	
General provisions on Standard Assets	80.62
Investment Fluctuation Reserve	4.13
Sub Ordinated term Debt	89.00
Total	173.75
Deductions – (IV)	
Total Deductions for Tier II	0.00
Total Tier II Capital (III-IV) B	173.75
Total Capital (A+B)	1,562.65

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 is 15% of the Risk Weighted Assets. The Bank's CRAR at 24.23 % is 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 assessments are put up to the Board of Directors of the Bank and the quarterly assessments are put up to the Risk Management Committee (RMCB). 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 1 and Pillar 2 risks for Capital Adequacy assessment. The Pillar 1 & Pillar 2 risks assessed in the Bank's ICAAP include the following:

1.4 Pillar 1 & Pillar 2 Risks Assessed - Table 2

Risk Type	S.No	Risk Name
Pillar 1 Risks	1	Credit Risk
	2	Market Risk
	3	Operational Risk
Pillar 2 Risks	1	Credit Concentration Risk
	2	Liquidity Risk
	3	Interest Rate Risk
	4	Strategic Risk
	5	Reputation Risk
	6	Compliance Risk
	7	IT and Cyber Security Risk
	8	People Risk
	9	Group Risk
	10	Outsourcing & Vendor Risk
	11	Fraud Risk
	12	Governance Risk
	13	Settlement Risk
	14	Legal Risk
15	Process Risk	
16	Sustainability Risk	
17	Money Laundering & Terrorism Financing 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 tolerance 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 capacity to achieve its strategic objectives and business plans. The Risk Appetite and tolerance levels are not static. The limits and the

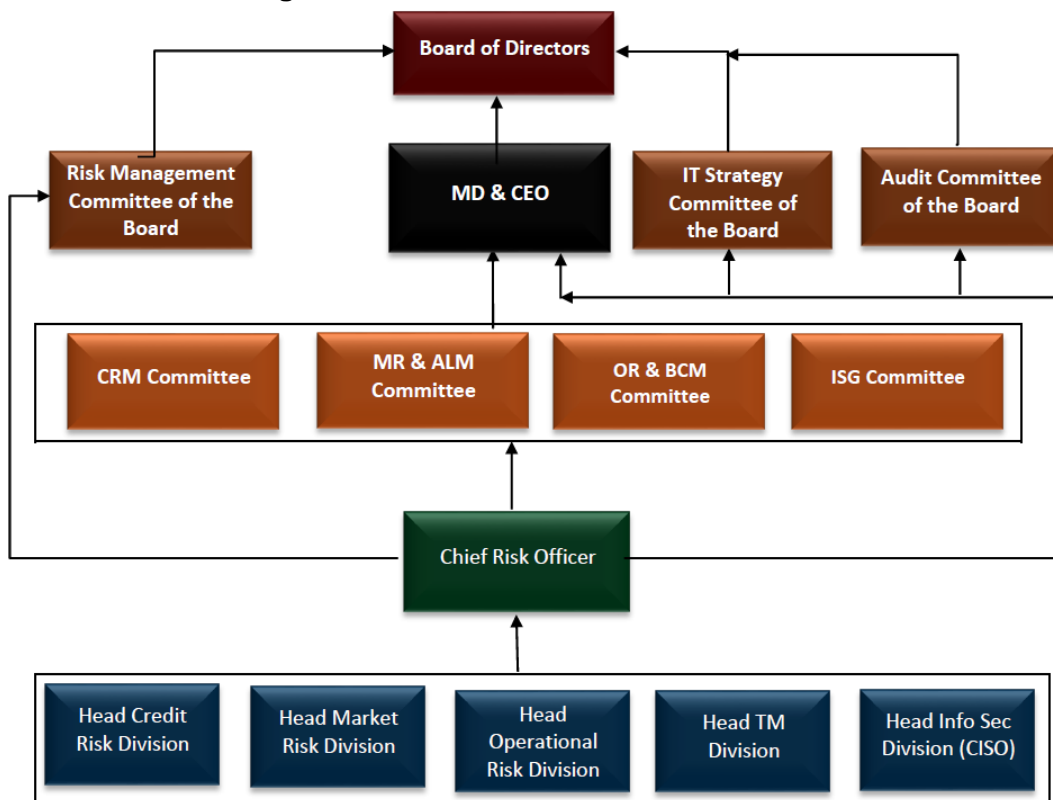
appetites depend upon the prevailing market conditions and business strategies adopted by the Bank from time to time. The ICAAP document monitors the risk appetite set by the Board. Breaches, if any, in the risk appetite limits are reported in the ICAAP and act as warning signals for the functionaries to take note of and initiate corrective actions.

Under the ICAAP, the Bank also analyses the impact of the major Pillar 1 and Pillar 2 risks on the Capital under normal and stressed scenarios 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, Liquidity 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 2 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 management culture within the Bank.

1.5 Risk Governance Framework

1.5.1 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 oversight of core risk management activities of the Bank.
- b) The Bank's risk appetite, risk tolerance and related strategies and policies are approved by the Board.
- c) 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 in relation to the oversight and review of the Bank's risk management principles and policies, strategies, appetite, processes and controls.
- d) 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 in the oversight and periodical review of the Bank's risk management principles and policies, strategies, appetite, processes and controls.
- e) The RMCB is supported by the Risk Management Department and various Executive Level committees dealing with different functional areas of risk, facilitating effective execution of their responsibilities.
- f) Segregation of duties across the 'three lines of defence' model, whereby front-office roles, risk management & oversight, compliance and Internal audit roles are played by functions independent of one another.
- g) 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.
- h) All major risk classes are managed through focused and specific risk management processes; these risks include Credit Risk, Market Risk, Operational Risk and Liquidity Risk etc. Policies, processes and systems are put in place to enable the risk management capability.
- i) 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.

2. 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, Market Risk, Operational 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.

2.1 Executive Level Committees --Table 3

Risk	Committee
Credit Risk, Credit Concentration Risk	CRMC
Market Risk, Liquidity Risk, Interest Rate Risk	MR-ALCO
Operational Risk, Strategic Risk ,Reputation Risk, Compliance Risk, People Risk, Group Risk, Outsourcing and Vendor Risk, Fraud Risk , Governance Risk, Settlement Risk, Legal Risk, Process Risk, Sustainability Risk, Money Laundering & Terrorism Financing Risk.	OR-BCMC
IT & Information Security/Cyber Security Risk	ISGC

Quantitative Disclosures: Table 4

S. No.	Particulars As on 31-03-2021	₹ in Crores
A	Capital Requirements for Credit Risk	967.34
A.1	Portfolio Subject to Standardized approach	967.34
A.2	For Off Balance Sheet Credit Portfolio	0
A3	For Off Balance Sheet Corporate Guarantee	0
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)	967.34
	Total Risk Weighted Assets (RWA for all types of assets)	6,448.90
	Total Capital Funds	1,562.65
	CRAR (%)	24.23%
	Tier -1 Capital Adequacy Ratio (%)	21.54%
	Tier -2 Capital Adequacy Ratio (%)	2.69%

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 (wilful default) 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. As on 31-03-2021, 84.78 % of the Bank's credit exposure is to the micro credit segment.

3.1 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, etc. 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.

3.2 Structure and Organization of Credit Risk Management Framework

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) 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 processes for 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. Through an effective, Board-approved credit risk governance framework, the Bank seeks to ensure adequate risk overseeing, 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 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.

3.4 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.

3.5 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.

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

3.6 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. 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.

3.7 Credit Exposures & Risk Summary - 31-03-2021

a) Exposure – Facility Type –Table 5 (₹ in Crs)

S. No.	Exposure Type	₹ in Crores
1	Gross Loans & Advances (Excluded Loan against Term Deposits - ₹80.56 Cr.)	8,334.44
2	Add: Undrawn exposure	34.70
3	Total Credit Exposure –Fund Based (1+2)	8,369.14
4	Add: Non Fund Based Exposure (Excluded Bank Guarantees against 100% Liquid securities coverage – ₹1.50 Cr)	0
5	Total Credit Exposure (Total of 3+4 above)	8,369.14

b) Geographic distribution of credit exposure -Table 6 (₹ in Crs) (31-03-2021)

S. No.	Exposure Type	₹ in Crores
1	Domestic Fund Based (Excluded LAD - ₹80.56 Cr)	8,369.14
2	Domestic Non Fund based (Excluded BG – ₹1.50 Cr)	0.00
3	Foreign	0.00
4	Foreign Non Fund Based	0.00
	Total	8,369.14

c) Total Credit Exposures by Risk Weights (31-03-2021) Table -7 (₹ in Crores)

S. No.	Risk Weight	Exposure	Risk Weighted Assets
1	Below 100% risk weight	7,409.17	5,419.62
2	100% Risk weight	224.45	213.45
3	More Than 100 %	735.52	133.37
	Total	8,369.14	5,766.44

d) State-wise distribution of Gross Loans & Advances (31-03-2021)-Table 8 (₹ in Crores)

State	Gross Loan Portfolio	% Share
Kerala	4,643.99	55.19%
Tamil Nadu	1,684.08	20.01%
Madhya Pradesh	441.18	5.24%
Maharashtra	440.52	5.24%
Karnataka	307.39	3.65%

State	Gross Loan Portfolio	% Share
Chhattisgarh	297.18	3.53%
Jharkhand	174.79	2.08%
Bihar	102.87	1.22%
Delhi	63.33	0.75%
Pondicherry (UT)	47.45	0.57%
Assam	42.66	0.51%
West Bengal	41.50	0.49%
UP	38.02	0.45%
Gujarat	26.99	0.32%
Rajasthan	19.97	0.24%
Orissa	16.28	0.19%
Telangana	10.96	0.13%
Andhra Pradesh	5.59	0.07%
Chandigarh (UT)	5.00	0.06%
Punjab	2.83	0.03%
Uttarakhand	2.19	0.03%
Tripura	0.23	0.003%
Total	8,415.00	100%

e) Sector wise distribution of Gross Loans & Advances (31-03-2021) Table -9

(₹ in Crores)

S. No.	Industry Classification	Gross Loan Portfolio	% Share
1	Agriculture and Allied Activities	3,748.52	44.54%
2	Industries Sector	947.44	11.26%
4	Trade & Services	1,465.79	17.42%
5	Personal Loans and other Retail	2,253.25	26.78%
	Total	8,415.00	100.00%

f) Credit Risk Mitigation Table -10 (31-03-2021) (₹ in Crores)

S. No.	Particulars	Exposure	Credit Risk Mitigant	Net Exposure
1	Gold Loan	653.72	626.17	27.55
2	Loan against FD	80.56	80.56	Nil

a) Maturity pattern of Assets Table -11 (₹ in Crores) –As on 31-03-2021

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	115.53	200.72	10.00	27.17	0.00	1,190.48	1,543.90
2-7 Days	0.00	0.00	0.00	163.01	0.00	2.91	165.92
8-14 Days	0.00	0.00	0.00	190.18	0.00	3.39	193.57
15-30 Days	9.30	0.00	24.93	434.70	0.00	6.78	475.71
31 Days and up to 2 months	17.42	0.00	0.00	552.79	0.00	3.39	573.60
Over 2 Months and up to 3 months	14.24	0.00	8.17	552.79	0.00	3.39	578.59
Over 3 Months and up to 6 months	41.53	0.00	0.00	1,457.97	0.00	6.78	1,506.28
Over 6 Months and up to 1 year	79.90	0.00	0.00	2,020.37	0.00	40.68	2,140.95
Over 1 Year and up to 3 years	110.29	0.21	0.00	2,255.25	0.00	0.00	2,365.75
Over 3 Years and up to 5 years	5.84	0.00	202.12	98.39	0.00	0.00	306.35
Over 5 years and up to 7 years	6.36	0.13	251.22	98.38	138.51	381.77	876.37
Over 7 years and up to 10 years	1.18	0.00	735.55	0.00	0.00	0.00	736.73
Over 10 year and up to 15 years	0.00	0.00	678.12	0.00	0.00	0.00	678.12
Over 15 years	26.48	0.00	21.97	0.00	0.00	0.00	48.45
Total	428.07	201.06	1,932.08	7,851.00	138.51	1,639.57	12,190.29

* NPA Excluded

3.8 Classification of Non-Performing Assets

3.8.1 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.
- 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.

3.8.2 Provisioning

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 31st March 2021 Table-12 (₹ in Crores)

S. No.	Category	₹ in Crores
A	Amount of NPA (Gross)	564.00
A.1	Substandard	473.31
A.2	Doubtful (All 100% provision)	90.69
A.3	Loss	0.00
	NPA Provision	247.42
B	Net NPAs	316.58
C	Advances	
C1	Gross Advances	8,415.00
C3	Net Advances	8,167.58
D	NPA Ratios	
D.1	Gross NPAs to gross advances (%)	6.70%
D.2	Net NPAs to net advances (%)	3.88%

(ii) Movement of NPA during the FY 2020-21 Table -13 (₹ in crores)

Particulars	Gross NPA	Net NPA
Opening balance at April 1, 2020	100.86	42.17
Add: Addition during the period	473.46	316.74
Less: Reduction/Upgradation/ Write-off/ during the period	10.32	42.33
Closing balance at 31st March 2021	564.00	316.58

(iii) Movement of NPA Provision during the FY 2020-21 - Table 14 (₹ in Crores)

Particulars	₹ in crores
Opening balance at April 1, 2020	58.69
Add: Provision made during the period	194.46
Less : Write off/ write back excess provision	5.73
Closing balance at 31st March 2021	247.42

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 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 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 transfers 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 -15 (₹ in Crores)

Particulars	FY 2019-2020	FY 2020-2021
Total number of loan assets securitised (Numbers)	0	0
Book value of loan assets securitized	0	0
Sale consideration received for the securitized assets	0	0
Interest spread on Securitization during the period	8.63	0
Form of services provided	Credit enhancement & post securitisation asset servicing	
Outstanding value as on	31-03-2020	31-03-2021
Cash Collateral	0	0
Over Collateral	0	0
Exposure to own securitization	0	0

4.4.2 Quantitative details of Assignment Transactions originated. Table 16
(₹ in Crores)

Particulars	FY 2019-2020	FY 2020-2021
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	0	0
Form of services provided	Post transaction asset servicing	

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 31-03-2021 – Table 17

	Particulars	(₹ in Crores)
On Balance Sheet Exposure		
1	On-balance sheet items (excluding derivatives and Securities Financing Transactions (SFT), but including collateral)	12,338.65
2	(Asset amounts deducted in determining Basel III Tier 1 capital)	0
3	Total on-balance sheet exposures (excluding derivatives and SFTs) (1 + 2)	12,338.65
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
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

	Particulars	(₹ in Crores)
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	1.50
18	(Adjustments for conversion to credit equivalent amounts)	0
19	Off-balance sheet items (sum of lines 17 and 18)	1.50
Capital and total exposures		
20	Tier 1 capital	1,388.91
21	Total exposures (sum of lines 3, 11, 16 and 19)	12,340.15
22	Basel III Leverage Ratio	11.26%
Summary comparison of accounting assets vs. leverage ratio exposure measure		
1	Total consolidated assets as per published financial statements	12,338.65
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)	1.50
5	Other adjustments	0
6	Leverage ratio exposure	12,340.15

6. 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.

6.1 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 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. Liquidity Risk

Liquidity Risk means a Bank's inability to meet its current or future obligations on the due date. 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

Market Risk & Asset Liability Management Committee (MR-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, Assets and Liability Pricing Policy and Liquidity Risk Management Policy which cover the 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.

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's ability to meet its obligations and fund itself in a crisis scenario is critical and accordingly, liquidity stress tests are conducted under different scenarios at periodical intervals to assess the impact on liquidity to withstand stressed conditions.

8. Interest Rate Risk in the Banking Book.

8.1 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. 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.

The Market Risk & Asset Liability Management Committee (MR-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 as prescribed by the Asset Liability Management Policy of the Bank. MR-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. MR-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, MR-ALCO reviews interest rate sensitivity statement on a 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% and 1% parallel shift in interest rates for both assets and liabilities is estimated.

8.2 Quantitative Disclosures

a) Earnings at Risk (EaR) Table 18 (₹ in Crores)

Particulars	Impact on NII (31-03-2021)
Impact of 100 bps parallel shift in interest rate on both assets & liabilities on Net Interest Income (NII)	5.80

b) Market Value of Equity (MVE) Table 19 (₹ in Crores)

Particulars	Impact on MVE (31-03-2021)
Impact of 200 bps parallel shift in interest rate on both assets & liabilities on Market Value of Equity	133.99
Impact of 100 bps parallel shift in interest rate on both assets & liabilities on Market Value of Equity	66.99

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.

9. 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.

9.1 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 ORM 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.

9.2 Business Continuity Under the Covid19 Pandemic Scenario

COVID19, the global pandemic has affected the world economy including India, leading to significant increase in volatility in financial markets and decline in economic activities. The Bank has been proactive in dealing with the biggest operational threat, i.e. the Covid19 scenario. The Bank Initiated Business Continuity measures from 6th March 2020 and convened regular meetings of the Crisis Management and Quick Response Team (CM-QRT). The Bank has remained in continuous contact with customers and staff through helpdesk and customer calls to address disruptions to customer service and related functions, while taking care of the members of staff and their health. The Disaster Recovery systems are being tested periodically and monitored continuously. Network connectivity and hardware availability across the Bank are ensured. Uninterrupted functioning of ATMs is ensured by centralised monitoring and regular cash replenishment.

The key components of the Bank's Business Continuity Planning for managing Pandemic Risk are -

- i. Arrangements to reduce the likelihood of the Banks' operations being significantly affected by the pandemic event; such as re-skilling the employees to equip themselves to adopt appropriate actions as warranted by the situations, regularly communicating and coordinating with critical service providers and suppliers, and testing of all the technology and systems to ensure uninterrupted functioning.
- ii. Comprehensive framework of facilities, systems and procedures that provide the Bank the capability to continue its critical operations in the event of prolonged disruptions.
- iii. Structured mechanism to understand the impact of customer reactions and the potential demand for, and increased reliance on, online banking, telephone banking, ATMs, and support-call services and to encourage customers to use digital banking facilities in a larger manner.

- iv. Mechanism to ensure that the Bank's pandemic planning practices and capabilities are effective, which will enable critical operations to continue.
- v. Programme to ensure on-going review of business continuity planning by having in place appropriate policies, standards, and procedures.

The Bank has been able to address the challenges of Covid19, by providing services to customers even during the most difficult times of Covid19 crisis and contained the operational disruptions, cyber security threats and associated risks. Adherence to the Covid19 protocol and documented BCP procedures has helped the Bank in successfully managing business continuity during the Covid19 crisis. The Bank continues to monitor and manage business continuity in a structured manner by collective efforts of its workforce and top management, under the guidance of the apex level Operational Risk and Business Continuity Management Committee and the Crisis Management and Quick Response Team.

10. Transaction Monitoring as a Risk Management activity

The Bank has a transaction monitoring structure and system in place that is matching to its size, activities, complexities and risks. The IT driven systems monitor all accounts and transactions on a daily basis. 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 Bank has developed an Anti-Money Laundering / Combating Financing of Terrorism programme (AML/ CFT) by establishing appropriate procedures, software applications and allocation of responsibilities to various officials. 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 Transaction Monitoring Division to Risk Management Department.

The 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.
- Inculcating a strong culture of compliance across the organization ensuring that all employees 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 instructions covering systems and controls, training of staff and management oversight for 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 (FIU-Ind).
- Monitoring of transactions in digital and core banking channels for identifying and preventing frauds and other malpractices.

11. Information & Cyber Security Risk Management

IT and Cyber Security Risk can be defined as any risk of financial loss, disruption, or damage to the reputation of an organization from a failure of its Information Technology systems. Information Technology systems have become critical to every aspect of banking operations. Information Security and cyber security risks are emerging as major operational risks for banks. Information

and cyber security risk may arise from the failure to respond to security and privacy requirements, human error, internal fraud through software manipulation, external fraud by intruders, obsolescence in applications and machines, reliability issues (including software malfunctions) or mismanagement.

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 Information Technology Department is primarily responsible for identification, measurement, control, and monitoring of technology to avoid risks that threaten the safety and soundness of the systems and technology of the Bank.

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.

12. Internal Financial Controls (IFC)

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 Bank has developed an Internal Financial Control (IFC) framework in line with requirements of the Companies Act, 2013. 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 reports to the Board of Directors, who in turn confirms that Internal Financial Controls (IFCs) have been laid down and that such IFCs are adequate and operating effectively.

Heads of Departments are responsible for ensuring that IFC documentation is current and up to date. Operational Risk Division of the Risk Management Department identifies any design level control gaps due to changes in the products, processes and systems.

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 Bank 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 Department 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 the tests of controls are completed by Internal Audit, the Chief Financial Officer certifies to the Audit Committee of the Board on the Bank's IFC compliance, as per the provision of the Companies Act, 2013.

13. Risk Management aims at 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, are intended to ensure that all of its valuable stakeholders are protected from any undesirable events, outcomes, sufferings and losses, in the best manner possible.

14. Conclusion

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, ever since commencement of operations. Recruitment and training of employees are carried out on a continuous basis. Policies, systems and processes are regularly reviewed and updated to ensure compliance with the directions and guidelines issued to Small Finance Banks by Reserve Bank of India, as modified from time to time.

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