

Pillar 3 Disclosures as of December 31, 2019

Equitas Small Finance Bank Limited (hereinafter referred to as the 'Bank' or 'ESFBL') is a private sector bank domiciled in India and incorporated under the provisions of the Companies Act, 2013. Equitas Finance Limited ("EFL"), the wholly owned subsidiary of Equitas Holdings Limited ("EHL") was converted into a Small Finance Bank (SFB) and changed its name to Equitas Small Finance Bank Limited. The Bank commenced operations as a SFB effective September 5, 2016 and became a Scheduled Bank effective December 23, 2016 vide Official Gazette Notification dated February 4, 2017. The Bank provides banking services and financial services in urban and semi-urban areas as well as rural areas through its inclusive banking initiatives. The Bank is headquartered in Chennai and there are no foreign operations of the Bank.

Pillar 3 disclosures on the capital adequacy and risk management framework are detailed in the following sections:

1. Capital Adequacy

1.1 Capital Adequacy Assessment

The Bank is subject to the capital adequacy framework as per the "Operating Guidelines for Small Finance Bank" from Reserve Bank of India (RBI). As per capital adequacy framework, the Bank is required to maintain a minimum Capital to Risk Weighted Assets (CRAR) of 15%, with minimum Tier I capital as 7.5%. As of now, capital conservation buffer and counter cyclical buffer are not applicable for small finance banks.

For the purpose of capital adequacy, only credit risk is covered, since there is no separate capital charge prescribed for market risk and operational risk as per the direction of RBI. For credit risk, RBI has prescribed Basel II Standardized Approach and has permitted the use of external rating based risk weights for rated exposure and regulatory retail approach for small retail loans.

The Bank has a process of assessing the capital requirements and a strategy to maintain its capital levels. Besides computing CRAR under the Pillar I requirement, the Bank also periodically undertakes stress testing to assess the impact on capital and risk weighted under various plausible stressed scenario. The Bank has set up sound governance and control practices to identify, assess and manage risks. The Risk Management Committee of the Board reviews results of stress testing.

1.2 Capital Structure

Breakup of capital funds (as per Basel II disclosures) is as follows:

Particulars	₹ in Lacs
Tier I capital	224,359
Paid Up Capital	105,340
Reserves	164,082
Deductions	
Intangible Assets	15,630
First loss credit enhancement provided for securitized assets	367
Second loss credit enhancement provided for securitized assets	-
Any Other Deductions	
Total Deductions	15,997
Tier I Capital Total	253,425
Tier II Capital	12,845
General provisions	4372
Investment Reserve	1073
Sub Ordinated term Debt	7,400
Deductions	
First loss credit enhancement provided for securitized assets	367
Second loss credit enhancement provided for securitized assets	-
Total deductions	367
Tier II Capital Total	12,478
Total Capital	2,65,903

1.3 Capital Adequacy

As per RBI guidelines for small finance banks, the capital to risk weighted assets (CRAR) has been assessed using Basel II standardized approach for credit risk only and no separate capital charge prescribed for market risk and operational risk. Trading book also has credit risk, which is assessed as part of market risk – specific risk charge framework. Since, there is no market risk charge prescribed for SFBs, the credit risk for trading book is also assessed and included in the credit risk weighted assets.

S. No.	Particulars	₹ in Lacs
A	Credit Risk	
A.1	Portfolio Subject to Standardized approach	168,376
A.2	For Securitized Portfolio	-
B	Market Risk	-
B.1	For Interest Rate Risk	-
B.2	For Equity Risk	-
B.3	For Forex Risk (including gold)	-
B.4	For Commodities Risk	-
B.5	For Options risk	-
C	Operational Risk	-
	Total Capital Requirement (A+B+C)	168,376
	Total Risk Weighted Assets	11,22,505
	Total Capital Funds	2,65,903
	CRAR (%)	23.69%
	Tier -1 (CET1) Capital Adequacy Ratio (%)	22.58%
	Tier -2 Capital Adequacy Ratio of the Bank (%)	1.11%

2. Credit Risk

Credit risk is the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms. The objective of credit risk management is to maximize a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable limits.

2.1 Credit Risk Management Framework

The Bank's credit risk management framework consists of a tiered governance structure that defines, monitors and reviews policies and risk limits periodically with appropriate use of statistical techniques.

The bank has an approved delegation of authorities including credit committee for credit approvals. The risk management committee at the management level proactively assess portfolio quality, prudential limits and inherent risks. It also frames policies and sets limits to mitigate identified risk. Governance control is vested with the Risk Management Committee (RMC) of the Board, which monitors and provides guidance on the risk assessment and capital adequacy as well as ensures timely and effective implementation of policies. Policies such as the lending policy, investment policy, credit risk policy, product credit policies, MSE/Real estate policy, Wilful defaulter policy are defined to effectively manage credit risk.

The risk management function in the Bank is clearly demarcated and independent from the operations and business units of the Bank. The Risk Management function is not assigned any business targets.

2.2 Credit Process

The product credit policy details the credit norms to be adhered to for each customer segment within specific products. An empowerment matrix is prescribed to ensure that a competent authority takes an informed decision on any deviations to these norms. All major retail products are covered by credit scoring models which predict the probability of default based on transactional parameters and historic portfolio data on defaults. These statistical models help achieve standardization and avoid biases in decision making. These models will be further monitored periodically to reflect recent portfolio performance. In addition, early warning indicators are tracked closely and appropriate action is initiated.

Large value exposures are assessed based on qualitative and quantitative parameters. An internal rating model uses these quantitative and qualitative inputs to assess the risk profile of the borrower. Internal rating is reviewed periodically.

As per the board approved lending policy the Bank maintains a robust internal rating mechanism in line with conventional rating standards. Based on the aggregate score ratings range between CR1 – Lowest risk to CR 9 – Default Grade. The internal rating is mandatory for approval of a large value exposure and the rating is considered while pricing the loan to reflect the underlying risk.

2.3 Concentration Risk

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

- *Single/Group party exposure:* The Bank has individual borrower-wise exposure limits as well as group-wise borrowing limits which are continuously tracked and monitored
- *Geography-wise exposure:* The Bank continuously monitors the geographical concentration of the business and factors the inputs into strategic business planning. The bank is aware of its concentration in the South, especially Tamil Nadu, and is taking steps to reduce the same by growing the retail book in other regions and through product diversification
- *Industry exposure:* The Bank tracks the exposure to specific industries as also sensitive sectors. The analysis further contributes to formulating the growth strategy of the Bank

2.4 Portfolio Management

ESFBL monitors its portfolio across different parameters and analyzes the spread of risk among different asset classes. The bank is taking steps to diversify the portfolio and increase the secured lending portfolio. It also analyses the portfolio performance of different customer segments within products as well as portfolio performance for known risk indicators such as LTV, tenure, geography, etc. ESFBL monitors portfolio at risk (PAR), which is an overdue portfolio (1 day overdue and more) across products and business lines to identify any impending stress.

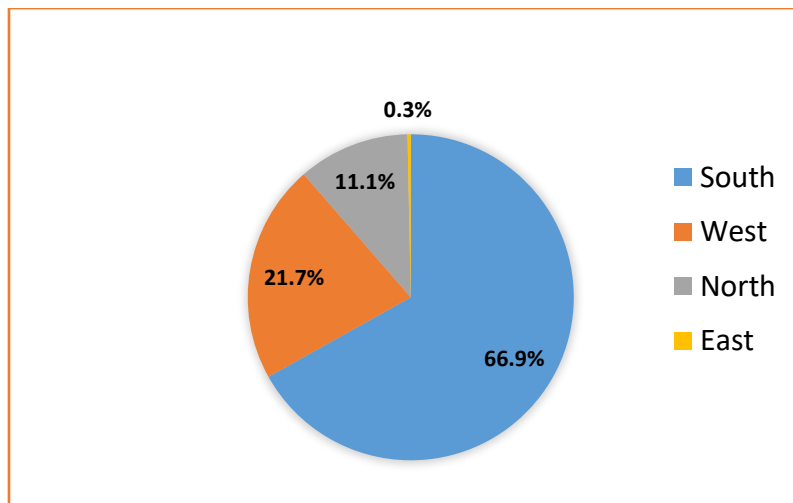
2.5 Credit Exposures & Risk Summary

a) Exposure – Facility Type

S. No.	Exposure Type	₹ in lacs
1	Fund Based*	13,95,797
2	Non Fund Based	172
	Total	13,95,969

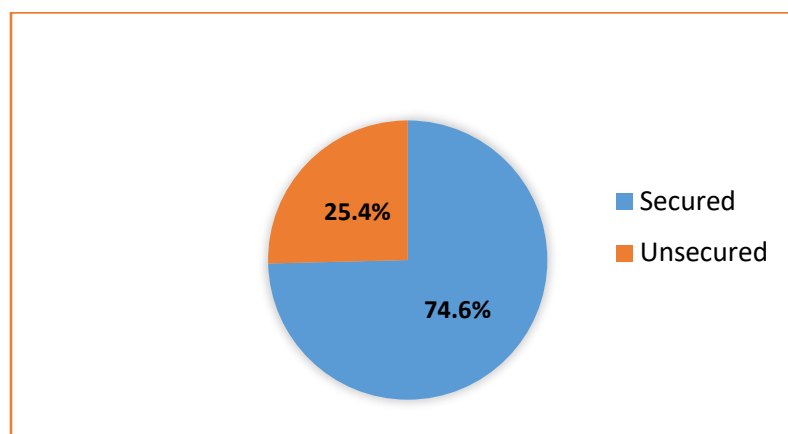
*Fund based exposures (net of provisions) also include Non SLR investments, Lending to TREPs, Balances with Banks and exclude SLR, & managed assets.

b) Geographic distribution of portfolio :



This is based on the total exposure, for advances

c) Distribution of portfolio between secured and unsecured businesses :



d) Industry-wise distribution:

Industry type	Exposure(in lakhs)	% of Exposure
Retail	8,67,274	62.13%
- of which Microfinance	3,50,439	
- of which Housing	52,739	
Commercial Real Estate	8,628	0.62%
Vehicles	3,58,726	25.70%
NBFC	66,835	4.79%
Banks*	7,102	0.51%
Other Financial Intermediaries**	8,745	0.63%
Other industries	78,659	5.63%
Total	13,95,969	100.00%

Exposure is net of IBPC

**Balances with Banks*

***Includes Lending under Market Reverse Repo/TREPS*

Exposures (net of provisions) also include Non SLR investments, Balances with Banks and excludes SLR & managed assets.

e) Maturity pattern of Assets*

(₹ in lacs)

Maturity Bucket	Cash, Balances with RBI	Balances with Banks and money at call & Short Notice	Investments	Loans & advances	Fixed assets	Other assets	Total
Day-1	18,887	1,37,292	47,471	1,691	-	18	2,05,359
2-7 days	-	-	-	17,319	-	766	18,086
8-14 days	-	-	-	17,340	-	1,577	18,917
15-30 days	2,061	-	12,514	16,748	-	19,170	50,493
31 days and up to 2 months	3,214	1	19,519	44,631	-	376	67,743
Over 2 months and up to 3 months	2,541	-	15,431	46,593	-	738	65,303
Over 3 months and up to 6 months	3,718	-	22,575	1,33,076	-	12,855	1,72,224
Over 6 months and up to 1 year	6,859	353	46,647	2,38,932	-	223	2,93,013
Over 1 year and up to 3 years	10,679	-	64,848	5,29,279	-	206	6,05,013
Over 3 years and up to 5 years	4	175	4,137	1,81,246	-	247	1,85,810
Over 5 years	248	-	1,527	2,18,425	20,771	3,060	2,44,031
Total	48,212	1,37,822	2,34,669	14,45,281	20,771	39,237	19,25,991

* Advances are gross up of IBPC

f) Credit Exposure by Risk Weights*

₹ in lacs

S. No.	Risk Weight	Amount of Exposure *
1	Below 100% risk weight	11,88,145
2	100% Risk weight	1,82,462
3	More than 100% risk weight	25,362
	Total	13,95,969

*Exposures (net of provisions) include Non SLR investments, Balances with Banks and exclude SLR & managed assets.

g) Credit Risk Mitigation

Portfolio covered by eligible financial collateral are as below -

₹ in lacs

S. No.	Particulars	Outstanding	Credit Risk Mitigation	Net Exposure
1	Gold Loan	2,369	2,369	0
2	Loan against FD	2,409	2,409	0

2.6 Classifications of Non-Performing Assets

a. Classification

Advances are classified as Performing Assets (Standard) and Non-performing Assets (NPAs) in accordance with the RBI guidelines on Income Recognition and Asset Classification (IRAC). Further, NPAs are classified into sub-standard, doubtful and loss assets based on the criteria stipulated by RBI. The advances are stated net of specific provisions made towards NPAs, unrealized interest on NPAs, if any etc. Interest on NPAs is transferred to an interest suspense account and not recognized in the Profit and Loss Account until received.

b. Provisioning

Provision for non-performing advances comprising Sub-standard, Doubtful and Loss Assets is made at a minimum in accordance with the RBI guidelines. In addition, specific loan loss provisions in respect of non-performing assets are made based on management's assessment and estimates of the degree of impairment of advances, based on past experience, evaluation of security and other related factors; the nature of product and delinquency levels. Loan loss provisions in respect of non-performing advances are charged to the Profit and Loss Account and included under Provisions and Contingencies.

Provisions made in excess of the Bank's policy for specific loan loss provisions for non-performing assets and regulatory general provisions are categorised as Floating Provision. Creation of Floating Provision is considered by the Bank up to a level approved by the Board of Directors. In accordance with the RBI guidelines, Floating Provisions are utilised up to a level approved by the Board with prior permission of RBI, only for contingencies under extraordinary circumstances for making specific provisions for impaired accounts.

Amount of NPA as on December 31, 2019

S. No.	Category	₹ in Lacs
A	Amount of NPA (Gross)	41,796
A.1	Substandard	20,215
A.2	Doubtful 1	12,045
A.3	Doubtful 2	8,392
A.4	Doubtful 3	465
A.5	Loss	679
B	Net NPAs (Net of floating provision)	23,640
C	Advances	
C.1	Gross Advances	13,86,537
C.2	Net Advances	13,70,281
D	NPA Ratios	
D.1	Gross NPAs to gross advances (%)	3.01%
D.2	Net NPAs to net advances (%)	1.73%

Movement of NPA for the YTD ending December 31, 2019

₹ in lacs

Particulars	Gross NPA	Net NPA
Opening balance at April 1, 2019	29,570	18,641
Addition during the period	31,518	19,553
Reduction/write-off during the period	19,292	12,654
Closing balance	41,796	25,540

Movement of Provision for the YTD ending December 31, 2019

Particulars	₹ in lacs
Opening balance at April 1, 2019	10,929
Provision made during the period	11,965
Write off/ write back excess provision	6,638
Closing balance	16,256

3. Leverage Ratio

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

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

Leverage Ratio		
	Particulars	(₹ in Lakhs)
On balance sheet exposure		
1	On-balance sheet items (excluding derivatives and SFTs, but including collateral)	18,50,991
2	(Asset amounts deducted in determining Basel III Tier 1 capital)	15,996
3	Total on-balance sheet exposures (excluding derivatives and SFTs) (sum of lines 1 and 2)	18,34,995
Derivatives exposures		
4	Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	-
5	Add-on amounts for PFE associated with <i>all</i> derivatives transactions	-
6	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the operative accounting framework	-
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)/	-
8	(Exempted CCP leg of client-cleared trade exposures)	-
9	Adjusted effective notional amount of written credit derivatives	-
10	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)	-
11	Total derivative exposures (sum of lines 4 to 10)	-
Securities financing exposures		
12	Gross SFT assets (with no recognition of netting), after adjusting for sale accounting transactions	-
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	-
14	CCR exposure for SFT assets	-
15	Agent transaction exposures	-
16	Total securities financing transaction exposures (sum of lines 12 to 15)	-
Other off-balance sheet exposures		
17	Off-balance sheet exposure at gross notional amount	32242
18	(Adjustments for conversion to credit equivalent amounts)	-23566
19	Off-balance sheet items (sum of lines 17 and 18)	8676
Capital and total exposures		
20	Tier 1 capital	2,53,425
21	Total exposures (sum of lines 3, 11, 16 and 19)	18,43,671
Leverage ratio		
22	Basel III leverage ratio	13.75%

Summary comparison of accounting assets vs. leverage ratio exposure measure		
	Particulars	(₹ in Lakhs)
1	Total consolidated assets as per published financial statements	18,50,991
2	Adjustment for investments in banking, financial, insurance or commercial entities that are consolidated for accounting purposes but outside the scope of regulatory consolidation	
3	Adjustment for fiduciary assets recognized on the balance sheet pursuant to the operative accounting framework but excluded from the leverage ratio exposure measure	15,996
4	Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off- balance sheet exposures)	8,676
5	Other adjustments	-
6	Leverage ratio exposure	18,43,671

4. Liquidity Risk

Liquidity refers to the Bank's ability to fund increase in assets or withdrawals of liabilities and meet both expected and unexpected cash and collateral obligations at reasonable cost without adversely affecting its financial condition and liquidity risk arises where 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 (standalone) is governed by Board approved Asset Liability Management (ALM) Policy which provides the framework for its monitoring & management. The Bank actively manages its liquidity risk covering both market funding risk and market liquidity risk. The Bank maintains a diversified funding profile with emphasis on building retail franchise to increase customer deposits. The Bank ensures that there is sufficient liquidity headroom available, including liquid assets, at all times to manage any contingency. Liquidity risk is assessed from both structural and dynamic perspective and the Bank uses various approaches like stock approach, cash flow approach & stress test approach to assess liquidity risk. The Bank uses liquidity gap analysis to measure cash flow mismatches at different time bands. The cash flows are bucketed based on the residual maturity or expected behavior of assets, liabilities and off-balance sheet items. Bank also manages its liquidity on a dynamic basis to supplement the liquidity gap analysis by estimating net cash outflow or inflows for business units considering their business projection for the next 3 months. The Bank also employs stock approach to assess various aspects of liquidity risk such as stability of funds, liquid assets cover, funding concentration, etc.

The Bank follows scenario based approach for Liquidity Stress Testing. These scenarios & assumptions are employed to evaluate the impact of stress on the existing liquidity position of the Bank. Market Liquidity Risk is considered through haircuts to sell liquid assets considering instrument type, expected change in interest rate in liquidity crisis, etc. The Bank has also implemented Basel-III liquidity standard i.e Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). Both these standard are maintained to ensure sufficient liquidity to absorb stress and support growth.

5. Market Risk

Market Risk may be defined as the possibility of loss to a bank caused by changes in the market variables such as interest rates, credit spreads, equity prices, etc. The market risk for the Bank is governed by 'Market Risk Management Policy' and 'Treasury & Investment Policy', which are approved by the Board. These policies ensure that transactions in debt and capital markets are conducted in accordance with acceptable business practices and are as per the extant regulatory guidelines.

Market Risk Management unit is independent of the dealing function and the settlements function and reports directly to the Chief Risk Officer. The unit is responsible for identifying and escalating any risk, limit excesses on a timely basis. This unit ensures that market risks are identified, assessed, monitored and reported for management decision making.

For small finance bank, Reserve Bank of India has not prescribed capital charge for market risk. Since market risk framework also covers specific risk charge, therefore, to assess the credit risk in the trading book, an external rating based approach is used and risk weighted assets so computed are included under credit risk.

6. Interest Rate Risk in Banking Book

Adverse movements in interest rates can affect both interest earnings and fair or economic value of the financial instruments. The very nature of the financial intermediation business makes the Bank susceptible to interest rate risk and unmanaged risk could potentially pose a significant threat to the Bank's earnings and capital. Interest rate risk results from both trading book and banking book. The impact of interest rate risk on trading book is actively measured using trading book risk metrics like PV01, duration, etc. For banking book, interest rate risk arises through mismatches in re-pricing of interest rate sensitive assets (RSA), rate sensitive liabilities (RSL) and rate sensitive off-balance sheet items.

As interest rate risk can impact both net interest income (NII) and value of capital, it is assessed and managed from both earning and economic perspective. Assets Liabilities Management Committee (ALCO) is the guiding body for management of IRRBB in the Bank and ensure adherence sets the overall policy and risk limits as approved by the Board. Earning at Risk (EaR) is a short term interest rate risk measure which assesses the change in NII by estimating the impact on interest income from rate sensitive assets and interest expense on rate sensitive liabilities including off-balance sheet items. The Bank has set limit for change in NII for given change in interest rates to manage the re-pricing gaps. Bank also uses Economic Value of Equity (EVE), which is a long term risk measure to assess the change in value of equity due to change in economic value of asset and liabilities. The duration gap approach is used to determine the sensitivity of EVE. Modified duration is computed for all assets, liabilities (excluding equity capital) and rate sensitive derivatives to assess the Leveraged Duration Gap / Duration of Equity. Leveraged Duration gap is computed and is subject to interest rate shocks to assess the impact on EVE. Bank has defined a threshold for change in EVE as percentage of net-worth for a given change in interest rate.

Details of increase (decline) in earnings and economic value of equity for upward (downward) rate shocks based on the Balance Sheet as at Dec 31, 2019 are given below:

₹ in lacs

Interest Rate Risk (Entire Book)		31-Dec-2019	
		If Interest rate were to go down by 100 bps	If Interest rate were to go up by 100 bps
Earning Perspective	Impact on NII	406	-406
Economic Perspective	Impact on EVE	12,957	-12,957

The table below elucidates the increase (decline) in earnings and economic value of equity for upward (downward) rate shocks for **Banking Book** as at Dec 31, 2019.

₹ in lacs

Interest Rate Risk (Banking Book)		31-Dec-2019	
		If Interest rate were to go down by 100 bps	If Interest rate were to go up by 100 bps
Earning Perspective	Impact on NII	670	-670
Economic Perspective	Impact on EVE	10,955	-10,955

7. Operational Risk

Operational Risk is defined as the risk of losses resulting from inadequate or failed internal processes, people and systems or from external events, which includes but is not limited to legal risk. It is inherent in all activities arising out of a bank's business and operations and could result in financial losses, litigation, regulatory fines or other damage to the bank. The severity of impact on the bank, its employee and customers is dependent on the efficacy with which operational risk is managed by the bank. The goal is to keep operational risk at appropriate levels, in light of the bank's financial strength, the characteristics of its businesses, the markets in which it operates, and the competitive and regulatory environment in which it operates.

Consistent with these objectives the Board has approved an Operational Risk Management policy of ESFB to achieve the following:

- Provide a comprehensive view of operational risks across business for proactively assessing key risks and initiating mitigating measures;
- Reduce 'Impact' and 'Probability' of risk events through introduction of sound practices for operational risk, embedding right sized controls in a proactive manner to minimize losses from operational failures;
- Create awareness by developing a common understanding and taxonomy of risks across the Bank and embed risk ownership by business;

The Policy also specifies the composition, roles and responsibilities of Operational Risk Management Committee (ORMC). ORMC is responsible for overseeing all material operational risks, responses to risk issues and the adequacy and effectiveness of controls within a given operational risk control area. Operational risk exposures (risk and control self-assessment results, operational risk incidents analysis and key risk indicators) are monitored by the ORMC.

The business units and supporting operational functions are accountable for operational risks and controls in their respective areas, which they manage as per the policies, standards, processes, procedures; and operational risk management framework laid down by the independent operation risk management (ORM) function. Bank has identified Operational Risk Support Managers for each business department for effective implementation of the Operational Risk Management Framework. ORM team along with product and process managers facilitates the business and operation groups for carrying out risk and control self-assessments on a periodic basis. ESFB has a comprehensive Product and Process Approval framework. All the new products including modifications thereof are reviewed by the control groups such as risk, compliance, legal, audit, etc. and then approved by Product Committee. The processes whether new or modifications are presented to the management team for approval after review by the control groups.

ESFBL has an internal framework for reporting and capturing operational risk loss events. Significant incidents reported are investigated to assess weaknesses in controls and identify areas for improvement. ESFBL also has 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.

8. Information and Cyber Security

There is an independent information security group, which addresses information and cyber security related risks. The function is governed by a Board approved policies on information security and cyber security. These policies are supported by sub-policies, procedures and process documents.

ESFB is committed to information security & compliance and follows the Cyber Security framework for Banks as mandated by RBI. The Bank carries out periodical awareness exercise to ensure employees are updated on information security practices. The information security function is driven by both technology and process driven controls.

Disaster recovery and Business Continuity Plan (BCP) has been established for significant businesses to ensure continuity of operations and minimal disruption to customer services. These plans are periodically tested and reviewed to ensure their effectiveness.