

## **Pillar III Disclosures as of June 30, 2020**

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 has its headquarter at Chennai and there are no foreign operations of the Bank.

The Pillar III 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
<b>Tier I capital</b>	<b>273,066</b>
Paid Up Capital	105,340
Reserves	167,725
<b>Deductions</b>	
Intangible Assets	22,738
First loss credit enhancement provided for securitized assets	159
Second loss credit enhancement provided for securitized assets	-
Any Other Deductions	
Total Deductions	<b>22,897</b>
<b>Tier I Capital Total</b>	<b>250,168</b>
<b>Tier II Capital</b>	<b>12,029</b>
General provisions	4679
Investment Reserve	1349
Sub Ordinated term Debt	6,000
<b>Deductions</b>	
First loss credit enhancement provided for securitized assets	159
Second loss credit enhancement provided for securitized assets	-
Total deductions	159
<b>Tier II Capital Total</b>	<b>11,869</b>
<b>Total Capital</b>	<b>2,62,038</b>

## 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
<b>A</b>	<b>Credit Risk</b>	
A.1	Portfolio Subject to Standardized approach	1,82,075
A.2	For Securitized Portfolio	-

<b>B</b>	<b>Market Risk</b>	-
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	-
<b>C</b>	<b>Operational Risk</b>	-
	<b>Total Capital Requirement ( A+B+C)</b>	1,82,075
	<b>Total Risk Weighted Assets</b>	12,13,831
	<b>Total Capital Funds</b>	2,62,038
	<b>CRAR (%)</b>	21.59%
	Tier -1 (CET1) Capital Adequacy Ratio (%)	20.61%
	Tier -2 Capital Adequacy Ratio of the Bank (%)	0.98%

## 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 reviews the portfolio quality, inherent risks and prudential risk limits on periodic basis. Governance control is vested with the Risk Management Committee (RMC) of the Board, which monitors and provides guidance on the risk management practices, risk assessments, capital adequacy as well as ensures timely and effective implementation of various risk related policies. Bank has various Board approved policies - Lending policy, Investment policy, Credit risk policy, MSE Policy, Real Estate policy, Wilful defaulter policy, etc. 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.

Considering the current unprecedented scenario of COVID-19, the Bank is closely watching the portfolio in order to maintain the asset quality and minimize the impact. The Bank had extended the support to its customers, by way of granting moratorium towards the payment of principal and/or interest to majority of its client base, in accordance with RBI circulars dated March 27, 2020 and April 17, 2020. Through the circular dated May 23, 2020, the moratorium period was extended

by RBI till August 31, 2020. Despite the starting of Unlock 1.0 from June, the cash flows/income for our clients may not have reached levels seen in pre-COVID times. Hence the bank has continued to provide its support to its customers by providing the moratorium for the extended period as well, basis the request from the customers and assessing the same on a case to case basis. The Bank is in touch with its customers and the feedback from them helps to better understand and monitor the overall asset quality. The Bank also conducts periodic stress testing for credit risk and have drawn new scenarios to assess the impact of pandemic on the credit quality factoring the moratorium given to borrowers under COVID regulatory package.

## 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 analyses 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

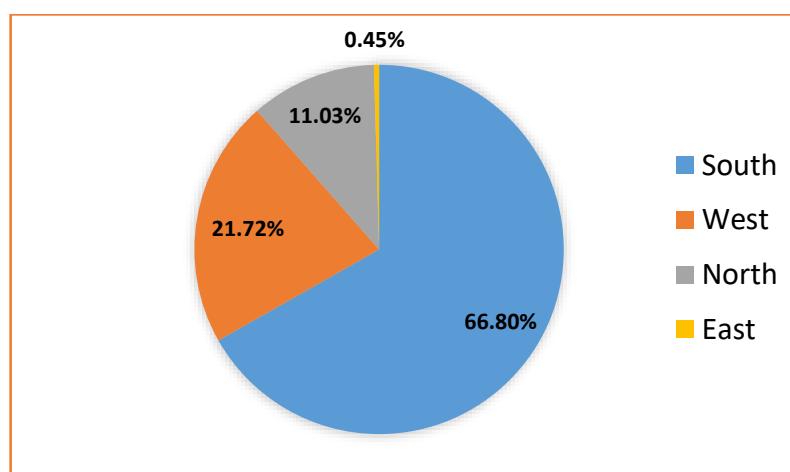
### a) Exposure – Facility Type

S. No.	Exposure Type	₹ in lacs
1	Fund Based*	14,70,540
2	Non Fund Based#	1306
	<b>Total</b>	<b>14,71,846</b>

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

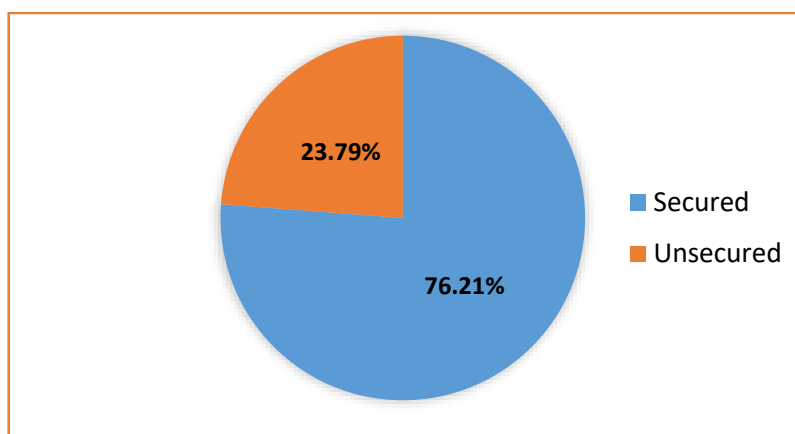
# includes Corporate guarantee for Securitization

### 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***	9,21,390	62.60%
- of which Microfinance	3,06,786	
- of which Housing	60,353	
Commercial Real Estate***	9,897	0.67%
Vehicles	3,75,167	25.49%
NBFC	65,906	4.48%
Banks*	7,654	0.52%
Other Financial Intermediaries**	5,563	0.38%
Other industries	86,269	5.86%
<b>Total</b>	<b>14,71,846</b>	<b>100%</b>

*Exposure is net of IBPC and net of provisions.*

*Exposures also include Non SLR investments, Balances with Banks and excludes SLR & managed assets.*

\*Balances with Banks

\*\*includes TREPS / Lending under Market Reverse Repo

\*\*\*Exposure to CRE & Retail is net-off IBPC

**e) Maturity pattern of Assets**

(₹ in lacs)

Maturity Bucket	Cash & RBI Balance	Balances with Banks & Placements	Investments	Loans & Advances*	Fixed Assets	Other Assets	Total
Day – 1	19,271	1,49,119	1,19,293	524	-	13	<b>2,88,220</b>
2 – 7 Says	-	-	5,000	7,995	-	472	<b>13,467</b>
8 – 14 Days	-	-	-	7,600	-	2,136	<b>9,736</b>
15 – 30 Days	2,031	353	15,805	5,911	-	14,988	<b>39,087</b>
31 Days & up to 2 Months	2,974	1	23,148	21,307	-	781	<b>48,212</b>
Over 2 Months & up to 3 Months	1,036	-	8,067	46,956	-	1,017	<b>57,077</b>
Over 3 Months & up to 6 Months	2,713	-	21,112	1,22,482	-	1,713	<b>1,48,020</b>
Over 6 Months & up to 1 Year	6,122	-	47,648	2,36,213	-	17,410	<b>3,07,393</b>
Over 1 Year & up to 3 years	8,270	-	99,882	6,19,079	-	21,282	<b>7,48,512</b>
Over 3 Years & up to 5 years	2	181	4,122	2,01,458	-	12,162	<b>2,17,926</b>
Over 5 Years	483	-	3,781	2,69,337	19,766	15,804	<b>3,09,173</b>
<b>Total</b>	<b>42,902</b>	<b>1,49,654</b>	<b>3,47,858</b>	<b>15,38,862</b>	<b>19,766</b>	<b>87,779</b>	<b>21,86,822</b>

\*Note: Loans & Advances are grossed up for IBPC & the contractual inflows are adjusted for moratorium permitted by RBI due to COVID-19 pandemic

**f) Credit Exposure by Risk Weights\***

₹ in lacs

S. No.	Risk Weight	Amount of Exposure *
1	Below 100% risk weight	12,46,736
2	100% Risk weight	2,02,224
3	More than 100% risk weight	22,886
	<b>Total</b>	<b>14,71,846</b>

\*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	2,430	2,430	0
2	Loan against FD	2,737	2,737	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 categorized as Floating Provision. The Bank up to a level approved by the Board of Directors considers Creation of Floating Provision. 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 June 30, 2020

S. No.	Category	₹ in Lacs
A	Amount of NPA (Gross)	41,667
A.1	Substandard	16,773
A.2	Doubtful	23,990
A.3	Loss	41,667
B	Net NPAs (Net of floating provision)	16,773
C	Advances	
C.1	Gross Advances	14,57,291
C.2	Net Advances	14,38,862
D	NPA Ratios	
D.1	Gross NPAs to gross advances (%)	2.86%
D.2	Net NPAs to net advances (%)	1.48%

### Movement of NPA for the YTD ending June 30, 2020

₹ in lacs

Particulars	Gross NPA	Net NPA
Opening balance at April 1, 2020	41,732	24,761
Addition during the period	1,539	-775
Reduction/write-off during the period	1,604	749
Closing balance	41,667	23,237

### Movement of Provision for the YTD ending June 30, 2020

Particulars	₹ in lacs
Opening balance at April 1, 2020	16,970
Provision made during the period*	2,314
Write off/ write back excess provision	855
Closing balance	18,429

\*Excludes COVID-19 related provisions made by the Bank during the year.

### 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.

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

Leverage Ratio		
	Particulars	(₹ in Lakhs)
On balance sheet exposure		
1	On-balance sheet items (excluding derivatives and SFTs, but including collateral)	20,86,822
2	(Asset amounts deducted in determining Basel III Tier 1 capital)	22,897
3	<b>Total on-balance sheet exposures</b> (excluding derivatives and SFTs) (sum of lines 1 and 2)	<b>20,63,925</b>
Other off-balance sheet 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	<b>Total derivative exposures (sum of lines 4 to 10)</b>	<b>-</b>
Other off-balance sheet 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	<b>Total securities financing transaction exposures (sum of lines 12 to 15)</b>	<b>-</b>
Other off-balance sheet exposures		
17	Off-balance sheet exposure at gross notional amount	28347
18	(Adjustments for conversion to credit equivalent amounts)	-20993
19	<b>Off-balance sheet items (sum of lines 17 and 18)</b>	<b>7354</b>
<b>Capital and total exposures</b>		
20	<b>Tier 1 capital</b>	<b>2,50,168</b>
21	<b>Total exposures (sum of lines 3, 11, 16 and 19)</b>	<b>20,71,278</b>
<b>Leverage ratio</b>		
22	<b>Basel III leverage ratio</b>	<b>12.08%</b>

<b>Summary comparison of accounting assets vs. leverage ratio exposure measure</b>		
	<b>Particulars</b>	<b>(₹ in Lakhs)</b>
1	Total consolidated assets as per published financial statements	19,31,455
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	20,459
4	Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off- balance sheet exposures)	6,934
5	Other adjustments	-
<b>6</b>	<b>Leverage ratio exposure</b>	<b>19,17,930</b>

#### 4. Liquidity Risk

Liquidity refers to Bank's ability to fund an increase in assets or withdrawal of liabilities and meet both expected and unexpected cash & collateral obligations at reasonable cost without adversely impacting its financial condition. The liquidity risk arises when 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 behaviour of assets, liabilities and off-balance sheet items. In view of the COVID-19 pandemic, the Reserve Bank of India on 27<sup>th</sup> March 2020, announced slew of relief measures to support the economy and the financial system. These measures permit lending entities to offer a three-month moratorium on all term loans outstanding as on March 1, 2020 and interest deferment on working capital facilities. This period was extended by RBI till August 31, 2020 through its circular dated May 23, 2020. The Bank extended the moratorium to borrowers in accordance with its Board approved policies. As a prudent measure,

the Bank had suitably adjusted the contractual inflows from the borrower's account to reflect the impact of moratorium allowed to the borrowers by RBI due to COVID-19 lockdown.

The 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 had also implemented Basel-III liquidity standard i.e., Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). LCR measures the adequacy of High Quality Liquidity Asset to cover short term net outflows under severe stress conditions. These measures have been incorporated as part of Bank's risk appetite definitions and thresholds. The Bank had implemented LCR framework since January 2016 and the LCR is maintained well above the regulatory threshold at all times. In view of the exceptional liquidity stress conditions prevailing due to COVID-19 pandemic, the RBI had vide its notification dated 17<sup>th</sup> April 2020, reduced the LCR requirements for Banks to 80%. The LCR requirement will reset to 90% on 1<sup>st</sup> October 2020 and to 100% on 1<sup>st</sup> April 2021. The Net Stable Funding Ratio (NSFR) measures the ratio of Available Stable Funding (>1 year) and the Required Stable Funding (>1 year) to support long-term lending and other long term assets. For banks in India, the RBI had released the guidelines for implementation and prescribed NSFR threshold of at least 100% from 1<sup>st</sup> April 2020. However, the implementation of NSFR had been deferred to 1<sup>st</sup> October 2020 as a relief measure provided by RBI to combat COVID-19 pandemic. The Bank is on track to meet the NSFR requirements as per the guidelines.

## **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 had not prescribed capital charge for market risk. Since market risk framework also covers specific risk charge, the credit risk in the trading book is

also assessed using external rating based approach 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 ensures adherence to 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 had set limit for change in NII for a 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 June 30, 2020 are given below:

₹ in lacs

Interest Rate Risk (Entire Book)		30-June-2020	
		If Interest rate were to go up by 100 bps	If Interest rate were to go down by 100 bps
<b>Earning Perspective</b>	Impact on NII	-1,494	1,494
<b>Economic Perspective</b>	Impact on EVE	-19,296	19,296

The table below elucidates the increase (decline) in earnings and economic value of equity for upward (downward) rate shocks for **Banking Book** as at June 30, 2020.

₹ in lacs

Interest Rate Risk (Banking Book)		30-June-2020	
		If Interest rate were to go up by 100 bps	If Interest rate were to go down by 100 bps
<b>Earning Perspective</b>	Impact on NII	-1,825	1,825
<b>Economic Perspective</b>	Impact on EVE	-16,239	16,239

## 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;

ESFB is having the following structure and techniques to manage the operational risks:

- a) 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.
- b) Bank has identified Operational Risk Support Managers (ORSM) for each business department for effective implementation of the Operational Risk Management Framework.
- c) ORM team along with the ORSM, product and process managers facilitates the business and operation groups for carrying out risk and control self-assessments on a periodic basis.
- d) The Bank has implemented a KRI policy and risk indicators are identified and defined in a structured manner for key operational risks across the Bank. The KRI’s include measurable metrics with defined thresholds and are regularly monitored for any exceptions.
- e) ESFBL 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.

- f) ESFBL has an internal framework for reporting and capturing operational risk loss events. Unusual incidents reported are investigated to assess weaknesses in controls and identify areas for improvement.
- g) 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.
- h) ESFBL has a Fraud Risk Management Unit (FRM) team which is involved in online transaction monitoring of customer accounts for any suspicious or fraudulent transactions
- i) Recently, bank has also introduced the process of carrying out a Failure Mode and Effect Analysis for all the new processes released to ensure key risks in the process are highlighted prior to launch and an action plan with timeframe is obtained to bring down the risk levels.

In the wake of the recent COVID situation, bank immediately set up a taskforce in line with the regulatory guidelines and ensured BCP of all critical activities quickly. Bank enabled work from home to ensure continuation of operations (retail liabilities operations, retail assets operations, clearing and settlement, treasury operations, etc.), control functions (risk management units, middle office function, compliance, fraud risk monitoring) and customer contact services.

Further, because of COVID-19, adequate measures like curbing of official travel, minimal staff in branches with limited working hours, promoting alternate modes of banking and periodic awareness from the Top Management on the guidelines to be followed and adhered to are also being sent across to all the employees in the bank.

## **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. The bank has put in place a layered security defence and this include firewalls, intrusion prevention system and anti-DDoS at perimeter level; IPSec and TLS encryption at channels level; Tiered architecture to make sure the placement of servers and components at different zones including DMZ and trusted zone; proactive defence through Web Application firewall, Vulnerability Assessment and Penetration testing, well defined rules in Proxies and anti-virus systems. Bank has secured the email gateway through DMARC and SPAM controllers and implemented a data leakage prevention solution

A security operation centre is in place which monitors alerts and anomalies 24x7. This monitors the Bank's perimeter and internal network and systems. Bank also creates awareness to its customers and employees. Bank has put in place Anti Phishing and Anti Rogue application identification and take down. This is a brand protection exercise.

Considering the COVID 19 situation, bank has put in place controls to ensure security for change in work environment where the work force connect remotely. The bank has strengthened its monitoring. Also the bank has conducted phishing awareness to its employees through simulation and also through emails. Bank also has sent awareness to customers through emails and SMS. Further the advisories and alerts from regulators and CERT-In are acted upon within time to make sure the banks cyber and information assets are protected.