# PILLAR 3 DISCLOSURE

**March 31st, 2020**

This document is a disclosure report which is prepared in compliance with the directions of Reserve Bank of India (RBI) vide its circular RBI/2015-16/58; DBR.No.BP.BC.1/21.06.201/2015-16 dated July 1, 2015.

The report provides a review as on 31st March 2020 of North East Small Finance Bank (NESFB) with key observations on capital adequacy, the credit quality of its asset book and issues relating to liquidity risk and operational risk.

The Bank is headquartered in Guwahati, Assam 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 Assessment

### 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 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. 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.

| CRAR as of Mar 2020 | (₹ In Crs) | (₹ In Crs) |
|---|---|---|
| **Capital Base (After Adjustments)** | **Mar-19** | **Mar-20** |
| Tier 1 Capital | 336.67 | 348.57 |
| Tier 2 capital | 8.37 | 25.801 |
| **Total Capital** | 345.04 | **374.371** |
| **Risk Weighted Assets** | | |
| Credit RWA | **1511.86** | **1498.43** |
| On Balance Sheet | **1511.86** | **1498.43** |
| Off Balance Sheet | 0 | 0 |
| **Total RWA** | **1511.86** | **1498.43** |
| Tier 1 Capital Ratio | 22.27% | 23.26% |
| Tier 2 Capital Ratio | 0.55% | 1.72% |
| **Total Capital Ratio** | **22.82%** | **24.98%** |

## 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 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, Willful 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.

**Credit Origination and Appraisal System**
There are separate Credit Origination and Appraisal Processes for Micro Finance Segment, Agriculture Finance Segment, MSME Segment and Retail segments. Within these segments, the Bank has adopted underwriting standards for different client segments that is based, inter alia, on ticket size, availability of security and other risk parameters. The credit sanctions are provided by experienced credit

professionals with delegated approval authorities as per Bank's Board approved credit policy, based on detailed appraisal memorandum that takes into account business and financial risks of the proposal. The Micro Finance segment, on the other hand, relies largely on standardized product programs for credit risk assessment and approvals.

**Credit Rating Framework**

The Bank has developed a Credit Scoring Model for all asset loans. The minimum threshold for approval of cases is clearly defined along with actual sanction of cases through detailed appraisal. While credit scoring would be one of the important parameters for deciding pricing of loans, it will be pertinent for the Bank to consider the expectations of the customers as regards rate of interest to remain competitive at this stage when it is stepping into new segments.

**Credit Documentation**

Standard documentations are finalized and registered in consultation with the legal and compliance department.

**Delegation of powers**

The Bank has adopted 'Four Eyes' principle for credit approval which reduces risk from errors and ensure compliance. The principle dictates that generally at least two people must create, examine and approve any credit proposal.

**Post Sanction Monitoring**

Credit monitoring involves follow-up and supervision of the Bank's exposures with a view to maintaining the asset quality at the desirable level, through proactive and corrective actions, aimed at controlling and mitigating the credit risk to the Bank.

Effective and on-going follow-up and supervision of borrower accounts are the important component in the Bank's credit monitoring process. It is critical and important to strengthen the credit monitoring mechanism and the Bank strives to graduate to stringent/leading practices in monitoring on an on-going basis. The Bank accord special emphasis on credit monitoring at all times.

**Monitoring Standards – Portfolio level:**

The Bank is performing portfolio monitoring on a monthly basis with specific focus on the following key aspects

- Portfolio origination performance – Number of applications, Priority Sector Lending (PSL) compliant loans, etc.
- Portfolio asset quality – Delinquencies in various buckets days
- Portfolio concentration limits – Concentration across tenor, single borrower, group borrower level, geography, product, etc.

Risk Management Department is responsible for conducting portfolio level monitoring and publishing relevant MIS reports.

**Periodic Quality & Control Reviews:**

Internal audit exercise is conducted by way of periodic reviews and checks to ensure adherence to established credit policies and procedures. On a periodic basis, a sample of applications and approvals & rejects are selected and checked for adherence to the credit filters, credit underwriting and verification criteria. Feedback provided to branches, changes made to the process as a result of these reviews are documented.

### 2.3 Credit Concentration Risk

Credit Risk (including credit concentration risk) i.e. the risk of financial losses in credit assets (including off-balance sheet instruments) caused by deterioration in the current conditions of counterparties. We have an exclusive "Lending policy" which covers the RBI guidelines for overall Credit portfolio and Lending operations and apart from the above, there exists an overall Credit Risk policy.

However, concentration risk arises due to creation of large position in a single asset or sector or an individual or group of similar borrowers. As a prudential measure aimed at better risk management and avoidance of concentration of credit risks, the Reserve Bank of India has advised the banks to fix limits on their exposure to specific industry or sectors and has prescribed regulatory limits on banks' exposure to single and group borrowers in India.

As per the RBI guidelines on Small finance Banks, the below prudential limits are set in our credit risk policy that is monitored on continuous basis and is being reported to Credit Risk Management Committee on monthly basis and Board RMC on quarterly basis.

The Bank manages concentration risks using prudential limits. Credit Concentration in the bank's portfolio 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.

- Industry Exposure: The Bank tracks the exposure to specific industries and sectors. The analysis further contributes to formulating the growth strategy of the Bank.

- Geography-wise Exposure: The Bank continuously monitors the geographic concentration of the business and factors the inputs into its strategic business planning. The bank is aware of its concentration in Assam and is taking steps to reduce the same by growing its asset book in other states and through product diversification.

### 2.4 Portfolio Management

NESFB 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. NESFB 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 and Risk Summary

| S. No. | Exposure Type | ₹ in Crs |
|---|---|---|
| 1 | Fund Based – Loans & Advances (Book Value) | 1358 |
| 2 | Fund Based – Non SLR (Book Value) | 30 |
| 3 | Non-Fund Based | 0 |
| | **Total** | **1388** |

Fund based exposures also includes Non SLR investments and excludes managed assets & IBPC

### Geographical Concentration

| Months | O/S as on Mar-18 | | O/S as on Mar-19 | | O/S as on Mar-20 | |
|---|---|---|---|---|---|---|
| **States** | **₹ Cr.** | **%** | **₹ Cr.** | **%** | **₹ Cr.** | **%** |
| Arunachal Pradesh | 15 | 1.41% | 19 | 1.37% | 21 | 1.55% |
| Assam | 988 | 91.03% | 1264 | 89.99% | 1208 | 88.95% |
| Manipur | 18 | 1.67% | 27 | 1.92% | 12 | 0.88% |
| Meghalaya | 13 | 1.16% | 22 | 1.54% | 18 | 1.33% |
| Mizoram | 0 | | 5 | 0.36% | 8 | 0.59% |
| Nagaland | 4 | 0.33% | 4 | 0.26% | 6 | 0.44% |
| Sikkim | 24 | 2.17% | 27 | 1.91% | 31 | 2.28% |
| Tripura | 15 | 1.42% | 24 | 1.68% | 29 | 2.14% |
| West Bengal | 9 | 0.81% | 14 | 0.99% | 25 | 1.84% |
| **Total** | **1085** | **100.00%** | **1404** | **100%** | 1358 | 100.00% |

### Asset product Concentration

| Product-wise Portfolio Distribution | Outstanding as of March-18 | | Outstanding as of March-19 | | Outstanding as of March-20 | |
|---|---|---|---|---|---|---|
| **Products** | **₹ Cr.** | **%** | **%** | **%** | **₹ Cr.** | **%** |
| EDL retail | | | 0.7 | 0.0% | 5.54 | 0.4% |
| Employment Generation Mission (EGM) | | | 0.1 | 0.0% | 0.01 | 0.0% |
| Entrepreneur Development Loan (EDL) Group Lending | 2.25 | 0.21% | 2.6 | 0.2% | 1.97 | 0.1% |
| Micro Credit Loan | 1078.94 | 99.41% | 1390.0 | 99.0% | 1255.06 | 92.4% |
| Micro Business Loan | | | 0.0 | 0.0% | 60.44 | 4.4% |
| Micro Enterprise Loan (ME) | 0.22 | 0.02% | 0.8 | 0.1% | 0.78 | 0.1% |
| IGL | | | 2.1 | 0.2% | 18.69 | 1.4% |
| Self Help Group (SHG) | 3.54 | 0.33% | 1.9 | 0.1% | 0.20 | 0.0% |
| Institutional TL | | | 2.0 | 0.1% | 6.34 | 0.5% |
| Welfare Loan (WLF) | 0.34 | 0.03% | 4.0 | 0.3% | 0.06 | 0.0% |
| ODFD/Demand Loan | | | | | 9.25 | 0.7% |
| **Total** | **1085.29** | **100** | **1404.3** | **100.0%** | **1358.35** | **100%** |

### Sector wise Concentration

| Sector-wise Portfolio Distribution | Outstanding as on Mar-19 | | Outstanding as on Mar-20 | |
|---|---|---|---|---|
| **Sector** | **₹ Cr.** | **%** | **₹ Cr.** | **%** |
| Agri & Allied | 496 | 0.35% | 526 | 38.72% |
| Industry | 73 | 0.05% | 60 | 4.41% |
| Personal | 7 | 0.00% | 22 | 1.61% |
| Services | 828 | 0.59% | 751 | 55.26% |
| **Total** | 1404 | 1.00% | **1358** | 100.00% |

**Maturity Pattern of Advances (in INR Crs)**

| S.no. | Maturity buckets | Net Loans & advances | Investments | Deposits | Borrowings |
|---|---|---|---|---|---|
| 1 | 1 day | 0.01 | 206.03 | 4.67 | 0.01 |
| 2 | 2 days to 7 days | 0.07 | 0.57 | 61.51 | - |
| 3 | 8 days to 14 days | 0.70 | 0.41 | 17.88 | - |
| 4 | 15 days to 30 days | 2.17 | 58.87 | 30.88 | - |
| 5 | 31 days to 3 months | 3.61 | 5.03 | 31.63 | - |
| 6 | Over 3 month & upto 6 month | 32.20 | 19.85 | 81.21 | 59.10 |
| 7 | Over 6 month & upto 1 year | 197.90 | 23.69 | 158.73 | 64.29 |
| 8 | Over 1 year & upto 3 years | 1,065.23 | 38.47 | 501.99 | 201.60 |
| 9 | Over 3 years & upto 5 years | 46.26 | 0.20 | 1.42 | 425.00 |
| 10 | Over 5 years | 0.12 | 0.03 | 0.21 | - |
| | | **1,348.28** | **353.15** | **890.14** | **749.99** |

## 2.6 Non-Performing Assets and its Classifications

**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.

**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. 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. As part of Covid-19 Regulatory package Bank has made additional provisions as required by RBI Guidelines on these matters. Additionally, Bank has made Provisions for Upper Assam as well.

The details of the Provisions are given below

| **Provisions as of March 31st, 2020** | **Rs in Crores** |
|---|---|
| Standard Advances | 13.42 |
| Sub Standard Provisions | 5.4 |
| Doubtful Provisions | 4.67 |
| Covid- 19 Prov | 15.73 |
| Floating Provisions | 6.46 |
| Total Provisions | 45.68 |

**Movement of NPA**

| Particulars | March 31, 2019 | March 31, 2020 |
|---|---|---|
| Gross NPAs to Gross Advances (%) | 1.02% | 1.93% |
| Net NPAs to Net Advances (%) | 0.32% | 1.20% |
| **Movement of Gross NPAs** | | |
| (a) Opening Balance | 9.28 | 14.30 |
| (b) Additions (Fresh NPAs) during the year | 6.67 | 20.37 |
| **Sub-total (A)** | **15.94** | **34.67** |
| (c) Reductions during the period: | | |
| (i) Up-gradations | 0.17 | 0.01 |
| (ii) Recoveries (excluding recoveries made from upgraded accounts) | 1.48 | 0.24 |
| (iii) Technical/ Prudential Write-offs | - | 8.13 |
| (iv) Write-offs other than those under (iii) above | - | - |
| **Sub-total (B)** | **1.64** | **8.38** |
| **Closing Balance (A-B)** | **14.30** | **26.29** |

## 3. Leverage Ratios

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**

| | |
|---|---|
| **Tier 1 capital in Rs Crs - (A)** | 348.57 |
| **Exposure in Rs Crs – (B)** | 2057.69 |
| **Leverage Ratio (A/B)** | 16.94 |

## 4. 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 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.

RMD is responsible for identifying and escalating any risk pertaining to Market Risk on a timely basis. The Department ensures that market risks are identified, assessed, monitored and reported for management decision making.

For market risk purposes, investment books- Available for Sale (AFS) and Held for Trading (HFT) are considered as trading book. Since capital charge for market risk in the trading book is not prescribed for pillar 1 for SFBs, it is not assessed separately.

## 5. Interest Rate risk in Banking Book

Interest Rate Risk in banking Book (IRRBB) refers to the risk of loss in earnings or economic value of the bank's Banking Book as a consequence of movement in interest rates. The Bank is exposed to interest rate risk on most of its assets and liabilities due to change in interest rates. IRRBB risk mainly arises through mismatches in repricing of interest Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL) and rate sensitive off-balance sheet items in the banking book.

IRRBB has the potential to make NII volatile. The Bank strives to manage the asset and liability position of the balance sheet to achieve a profile that controls the impact of changes in interest rates on the Bank’s NII and economic value. Bank has adopted duration gap approach to assess interest rate risk from economic value perspective.

**Measurement and outcome of the Interest Rate Risk**
Interest rate risk is the exposure of a bank's financial condition to adverse movements in interest rates. Interest rate risk can pose a significant threat to a bank's earnings and capital base. Changes in interest rates affect a bank's earnings by changing its net interest income and the level of other interest sensitive income and operating expenses.

Following process/reports has been adopted to measure/monitor:

1. Interest Rate Sensitivity Gap Reports (EaR): RMD would seek to monitor interest rate sensitivity by generating interest rate sensitive gap reports, which provide a cash flow bucketing, based on re-pricing profile and frequency of interest rate sensitive assets and liabilities. This report is submitted to RBI for month end dates.

**Table as on March 31,2020**

| **Earnings at Risk** | **(₹ In Crores)** |
|---|---|
| Impact on 250 basis points change in interest rate | -2.83 |
| Impact on 300 basis points change in interest rate | -3.40 |
| Impact on 400 basis points change in interest rate | -4.53 |

2. Modified Duration Gap Measures (MVE): Modified duration seeks to measure sensitivity of the market. This report is submitted to RBI on monthly basis as of month end.

According to the RBI guidelines on ALM framework dt: 04 November 2010, drop in the Market value of Equity (MVE) should not be more than 20 % with an interest rate shock of 200 basis points. However as per our ALM policy limit of drop in MVE is set as 18% for an interest rate shock of 200 bps. RBI advises bank to allocate capital under Pillar 2 if the set limit of MVE for 200 bps shock is breached.

**OUTCOME**
As of 31st Mar 2020, with a 200-bps shock, percentage change in the MVE (Market value of Equity) is given below.

| As on | **31-03-2019** | **31-03-2020** |
|---|---|---|
| **Economic Value of Equity** | **Amount in Rs. Crs** | **Amount in Rs. Crs** |
| **Net Worth** | 352.68 | 365.27 |
| RSA | 1593.19 | 1863.34 |
| RSL | 1368.36 | 1640.13 |
| DA | 1.33 | 2.61 |
| DL | 2.66 | 2.43 |
| W = RSL / RSA | 0.86 | 0.88 |
| DGAP = DA - W (DL) | -0.96 | 0.47 |
| Leverage Ratio = RSA / Equity | 4.52 | 5.10 |
| Modified Duration of Equity (DGAP * Leverage) | -4.33 | 2.38 |
| For 200 bps shock | 8.66% | -4.76% |
| For 100 basis points shock | 4.33% | -2.38% |

## 6. Liquidity Risk

Liquidity risk has two categories - Funding Liquidity Risk & Market liquidity Risk. Funding liquidity risk is that of sustaining a loss due to an inability to obtain required funds and conduct fund management, because of a deterioration of market conditions or bank's financial conditions, and then being forced to raise funds at a remarkably higher rate of interest than usual. Market liquidity risk is the risk that bank cannot easily offset or eliminate a position at a prevailing market price because of inadequate market depth or market disruption.

Liquidity being crucial to the ongoing viability of the bank, management of liquidity risk by the bank aims to control related risk exposure which ensures that earnings are commensurate with the levels of risk.

**Measurement of Liquidity Risk:**

The Bank has in place a policy as follows for this purpose:

1. ALM Committee of the bank meets, at such periodicity as the Management may determine, to review important matters related to liquidity risk and control.
2. A well-defined ALM Policy is in place and the same to be reviewed / updated annually.
3. Impact of Liquidity Risk is currently assessed through gap analysis for maturity mismatches based on residual maturity in different time buckets and management of the same is done based on the mismatch limits set in ALM policy.
4. Currently bucketing is done as per the RBI prescribed standard guidelines.

The capital towards liquidity risk shall be assessed based on the following parameters:

- Level of market borrowings
- Negative cumulative mismatches in near time buckets

The bank has to provide additional capital of the maximum negative cumulative mismatch up to 30 days during the breached period. Under Basel guidelines on liquidity standards Liquidity coverage ratio (LCR) takes in to account the time period of 30 days, hence we reckon the negative cumulative mismatch up to 30 days' period.

However, the impact on market borrowings for funding the negative gap, will reckoned to allocate additional capital.

**Measurement and outcome of the Liquidity Risk**

According to the bank's ALM policy, the Net Cumulative negative mismatch of the cumulative cash outflows for the buckets 1day, 2-7 days, 8-14 days, 15- 30 days should not exceed 5%, 10%, 15%, 20% respectively.

In line with the above limits, as of Mar 2020, our cumulative mismatch is computed and the same is given below:

| Buckets | Cumulative Mismatch (₹ In Crs) | Cumulative Gap as % to cumulative outflows | Limits |
|---|---|---|---|
| Day 1 | 266.93 | 4688% | -5.00% |
| 2-7 days | 202.29 | 275% | -10.00% |
| 8-14 days | 200.05 | 202% | -15.00% |
| 15-30 days | 287.14 | 221% | -20.00% |
| 31 days and upto 2 months | 277.88 | 193% | -25.00% |
| More than 2 months and upto 3 months | 283.20 | 173% | -25.00% |
| 3 months and upto 6 months | 195.49 | 64% | -25.00% |
| 6 months and upto 1 year | 292.17 | 55% | -30.00% |
| Over 1 year and upto 3 years | 759.60 | 61% | -35.00% |
| Over 3 years and upto 5 years | 357.05 | 21% | -35.00% |
| Over 5 years | 1130.35 | 68% | -35.00% |

**Dynamic Liquidity Analysis**

Bank manages its liquidity on dynamic basis to supplement the liquidity gap analysis by capturing net cash outflow or inflows for business units considering their business projections for next 3 months.

**Stock Liquidity Indicators**

Bank also possess liquidity through various stock liquidity indicators on a periodic basis and the outcome as of March 31, 2020 as of below.

| Ratios | Limit | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 |
|---|---|---|---|---|---|---|
| **Volatile Liabilities ratio** | **Max. 40%** | -0.37% | -10.28% | -4.42% | -8.88% | -3.67% |
| **Illiquid assets to total assets ratio** | **Max. 85%** | 87.31% | 81.01% | 78.81% | 73.64% | 75.68% |
| **Illiquid assets to core deposits ratio** | **Max. 500%** | 329.45% | 287.26% | 245.85% | 219.84% | 204.43% |
| **Available liquid assets ratio** | **Max. 40%** | 13.26% | 19.62% | 22.27% | 29.42% | 27.00% |
| **Volatile liabilities to total assets ratio** | **Max. 60%** | 12.96% | 12.09% | 19.13% | 23.69% | 24.50% |
| **Core deposits ratio** | **Min. 20%** | 29.27% | 32.06% | 36.34% | 38.78% | 42.49% |
| **Liquid investments to volatile liabilities ratio** | **Min. 60%** | 102.29% | 162.31% | 116.39% | 124.22% | 110.19% |

## 7. LIQUIDITY COVERAGE RATIO (LCR)

**Background**

The Reserve Bank, being a member of the BCBS, is fully committed to the objective of the Basel III reform package and, therefore, intends to implement these proposals for banks operating in India. Accordingly, draft guidelines on Liquidity Risk Management and Basel III Framework on Liquidity Standards have been prepared and published in Feb 2012.

Accordingly, under the Operational Guidelines to SFB, we are required to maintain the LCR ratio as per the below table

| | Till Dec. 31, 2017 | By Jan 1, 2018 | By Jan 1, 2019 | By Jan 1, 2020 | By Jan 1, 2021 |
|---|---|---|---|---|---|
| **Minimum LCR** | 60% | 70% | 80% | 90% | 100% |

**LCR Position as on March 31,2020**

As per requirement of RBI, LCR should be tracked on an ongoing basis and disclosure should be made in financial statements for each quarter on simple average basis of daily observations. However, the Bank is calculating LCR on monthly basis and accordingly disclosure has been made on simple average basis of monthly observations.

| | Quarter ended March 31, 2019 | Quarter ended June 30, 2019 | Quarter ended September 30, 2019 | Quarter ended December 31, 2019 | Quarter ended March 31, 2020 |
|---|---|---|---|---|---|
| **LCR** | 1830% | 1577% | 1399% | 559% | 166% |

**8. 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 bank's business and operations and could result in financial losses, litigation, regulatory fines or other damages to the bank. The severity of impact on the bank, its employee and customer are 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 board has approved an Operational Risk Management policy (ORM) of NESFB which covers the following elements

- **Governance**: Operational Risk Management (ORM) governance structure includes Board of Directors, and ERMC (Executive Risk Management Committee). Roles and responsibility of the oversight bodies are detailed in the relevant paragraphs.
- **ORM Policy and Procedures**: ORM Policy and processes covering, Risk and Control Self-Assessment (RCSA), Key Risk Indicator (KRI), Loss Data Management (LDM), New Product Approval are separately documented and approved from relevant authorities.
- **ORM Organization Structure**: Bank's Organizational structure for managing operation risks consists of the following three lines of defence.
    - Business Unit
    - Operational Risk Management department
    - Internal Audit department
- **Operational Risk Assessment and Measurement Tools:** The primary tool for measuring operational risk across the Bank shall include internal operational loss data, regulatory penalties and frauds. These loss data is used primarily for assessing and monitoring operational risk exposures including compliance risk across the Bank. ERMC is empowered to modify and implement any additional tools apart from the ones currently in place
- **Reporting:** Reports on Operational Risk exposures approved by ERMC are used at stipulated frequencies to monitor operational risk exposures within the overall ORMF. Relevant reports will be submitted to relevant entities such Board, ERMC, business and support unit heads as described in the respective policy and process documents.

## 9. IT & Information Security

The Bank has an independent information security department, which addresses information and cyber security related risks and reports to Chief Risk Officer (CRO). The Bank has a defined governance structure in place under the Information Security & Cyber Risk Committee, which includes representatives from Business, Operations, Security & Cyber Risk management functions that is responsible for overall IT Risks. Bank Information and Cyber Risk Management Committee provides direction for mitigating the operational risk in IT security.

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.