PILLAR 3 DISCLOSURE

Based on 31.03.2024 Audited position

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 2024 of North East Small Finance Bank (NESFB) with key information on capital adequacy, the credit quality of its asset book, liquidity risk and operational risk.

The Bank is headquartered in Guwahati, Assam and there are no foreign operations of the Bank.

The bank does not have any subsidiary, associate or joint venture for consolidation purposes. Thus, disclosures in the document pertain to the Bank as a standalone and independent entity.

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

1. <u>Capital Adequacy Assessment</u>

1.1 Capital Adequacy Assessment

The Bank is subject to the Basel II New capital adequacy framework (NCAF) 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 Small Finance Banks. 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 scenarios. 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:

Qualitative Disclosure-

Bank's regulatory capital is classified into Tier- I and Tier- II capital as stipulated in BASEL II norms (NCAF) of the RBI. Tier-I Capital includes Paid up Equity Share Capital, Share Premium, Statutory Reserve, Other Disclosed Free Reserves.

Tier - II Capital includes Subordinate debt instruments, General provision and Investment reserves.

Quantitative Disclosure-

CAPITAL FUNDS POSITION AS ON MARCH 31, 2024	Net Amount (in Cr)
TIER - I CAPITAL:	
Common Equity	
Paid Up Capital	₹ 469.38
Less: Investment in Subsidiaries	₹ 0.00
Add: Reserves & Surplus:	
1) Statutory Reserve	₹ 19.77
2) Share Premium	₹ 2.34
3) Balance in P&L A/c	₹(430.57)
Less: Deductions from capital	₹ (6.90)
Total Tier I Capital Funds	**₹ 54.02**
TIER - II CAPITAL:	
Tier II Capital (eligible amount post haircut)	₹ 27.01
Investment Reserve	-
Provision for Standard Assets	₹ 4.44
General provision	-
Tier II Capital Funds	**₹ 31.44**
TOTAL CAPITAL FUNDS	**₹ 85.46**

1.3 Capital Adequacy

As per RBI guidelines for small finance banks, the capital to risk weighted assets (CRAR) has been assessed using the Basel II standardized approach for credit risk. Further, RBI vide its communication dated November 08, 2017, has clarified that no separate capital charge is prescribed for market risk and operational risk, therefore the same has not been considered while computing CRAR ratio. Since the market risk framework also covers specific risk charges, therefore, to assess the credit risk in the trading book, an external rating-based approach is used and risk weighted assets computed are included under credit risk.

The Capital Management Framework of the Bank is administered by the Finance & Accounts Department and the Risk Management Department under the supervision of the Board and the Risk Management Committee of the Board (RMCB).

Capital Requirements for Various Risks	
Particulars	**Amount (Rs. in Cr)**
A. Credit Risk	₹ 113.38
B. Market Risk	-
C. Operations Risk	-
D. Total Capital Required for 15% CRAR (A+B+C)	**₹ 113.38**
E. Total Risk Weighted Assets (Credit)	**₹ 755.90**
F. Total Capital Funds of the Bank	**₹ 85.46**

The Bank's capital management framework includes an Internal Capital Adequacy Assessment Process (ICAAP) which determines the adequate level of capital for the bank to meet the regulatory norms and current and future business needs. Under the ICAAP, the Bank performs stress testing to assess the impact on capital and risk weighted under various plausible stressed scenarios. The bank conducts these stress tests on its various portfolios as prescribed by the RBI and assesses the impact on its capital ratios and the adequacy of capital for current and future periods.

CRAR	**(₹ In Crs)**
Capital Base	**Mar-24 A**
Tier 1 Capital	₹ 54.02
Tier 2 capital	₹ 31.44*
Total Capital	**₹ 85.46**
Risk Weighted Assets	
Credit RWA	**₹ 755.90**
On Balance Sheet	**₹ 755.90**
Off Balance Sheet	-
Total RWA	**₹ 755.90**
Tier 1 Capital Ratio	7.15%
Tier 2 Capital Ratio	4.16%
Total Capital Ratio	**11.31%**

** Tier 2 is Rs 30.20cr + 4.43cr = 34.63 Crs, but since sub-debt is limited to 50% of T1, its limited to 27.00+4.43 = 31.44cr*

The Bank's present CRAR, though below the regulatory level, is already on an improvement path due to capital infusion from the GIPL group. Bank is undergoing a merger with the GIPL group, which would further strengthen the Bank's capital position. As soon as the merger process is complete, Bank's CRAR will be well above the regulatory level and bank's internal risk appetite limit. The merger process is on track and is expected to complete within FY24-25.

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 Governance Framework

The bank's Credit Risk Governance Framework consists of a tiered 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 a Credit Committee for credit approvals. The Loan Review Committee at the management level proactively assesses portfolio quality, prudential limits and inherent risks. Governance control is vested with the Executive Risk Management Committee (ERMC) and 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, credit monitoring policy, collections policy, 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 & Policies

All credit risk related aspects are governed by Board approved Credit Risk Management Policy and Credit Policy. These policies cover all customers and products of the Bank which possess credit risk. The key principles underlying the Policy framework at the Bank are as follows: -

1. The Bank constantly reviews and updates the delegation of Authority to accommodate for organizational restructuring, changing regulatory environment, competitive scenario etc. Any exposure greater than specified threshold follows the Credit Committee approach.

2. New products proposed to be offered by the Bank are approved as per the New Product Approval Policy and are approved by the Product Approval Committee (PAC).

Credit Origination and Appraisal System

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.

The Bank has adopted underwriting standards for different client segments that are 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.

Credit Rating Framework

The Bank has developed Credit Score Cards for all credit advances. The minimum threshold for approval of cases is clearly defined, along with sanctioning of cases through a detailed appraisal process. The relationship managers and other contact point mechanisms ensures compliance and implementation of various policies & processes in the Bank through a strong customer centric approach, by understanding about the customer beyond the documents and assessing the customer’s willingness to pay, ability to pay, potential to grow and potential risk factors in customer’s job industry/business.

Credit Documentation

Collateral/security documents are finalized and registered in consultation with the legal and compliance department. The RM/RO and Credit Operations are jointly responsible for ensuring that proper documentation is obtained as per the checklist provided by the Credit, Legal and Compliance department. The Credit Operations and Central Processing Team (CPC) are responsible for the safe custody of all documentation.

Delegation of Power (DOP)

The authority for approval of credit proposals, within limits stipulated, is delegated by the Board of Directors to specific approval authorities. The authorities exercise their powers within the framework of the norms prescribed by the Board of Directors. Loans are approved at various levels. Approval powers accorded to the above authorities are guided by the DOP.

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. The process is governed by the board approved Credit Risk Management Policy and Credit Risk Monitoring Policy.

Effective and on-going follow-up and supervision of borrower accounts are the important component in the Bank’s credit monitoring process. The Bank accords special emphasis on credit monitoring at all times and continuously strives to improve the monitoring practices

Monitoring Standards – Portfolio level:

The Bank is performing portfolio monitoring through the daily MIS reviews and regular Loan Review Committee meetings, 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 and asset classes

- Portfolio concentration limits – Concentration across tenor, single borrower, group borrower level, geography, product, industry/sectors, etc.
- Account level monitoring for >=25L loans - delinquency days, outstanding and security cover

The 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.

Definition of Non Performing Asset (NPA) -

The Bank classifies its loans and advances into performing and non-performing loans in accordance with, Master Circular - Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances dated April 1, 2023.

An NPA is defined as a loan or an advance where: -

i. interest and/ or installment of principal remain overdue for a period of more than 90 days in respect of a term loan,
ii. the account remains 'out of order' for 90 days in respect of an Overdraft/Cash Credit (OD/CC),
iii. the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
iv. the installment of principal or interest thereon remains overdue for two crop seasons for short duration crops, the installment of principal or interest thereon remains overdue for one crop season for long duration crops,
v. The amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitization transaction undertaken in terms of guidelines on securitization.
vi. In respect of derivative transactions, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

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. The Bank has a board approved Credit Policy applicable to all lending activities. The more nuanced product parameters applicable to each of the products are laid out in respective product documents encompassing the principles of Credit Policy.

However, concentration risk can arise due to creation of large positions in a single asset or sector or an individual or group of similar borrowers. As a prudential measure aimed at better risk management, the Bank has defined below limits on exposure to single/group borrowers, industry/sector, and geography in line with the Reserve Bank of India guidelines on Small Finance Banks.

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. As of 31st March 2024, the top 20 Borrowers account for <3% of Total Advances.

- 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. Furthermore, in the FY 2024-25 the bank has plans to scale its digital loan offerings which will allow the bank to reduce the Geographical Concentration.

- Secured Exposure: The bank has increased its secured loans exposure from 52% to 76% from March 2023 to March 2024, through improved collections and sell-off of non performing pool of unsecured assets to ARC.

Geographical Concentration

(Amount in INR Crs)

State	Advances - Balance in Rs Cr	Deposits - Balances in Rs Cr	Total Business in Rs Cr	Total Business %
Arunachal Pradesh	15.34	25.09	40.43	1.72%
Assam	664.78	928.89	1593.67	67.69%
Manipur	34.53	77.04	111.57	4.74%
Meghalaya	28.95	183.01	211.96	9%
Mizoram	22.09	169.32	191.41	8.13%
Nagaland	10.02	10.4	20.42	0.87%
Sikkim	14.96	59.05	74.01	3.14%
Tripura	22.65	51.25	73.9	3.14%
West Bengal	21.32	15.53	36.85	1.57%
Grand Total	**834.64**	**1519.57**	**2354.22**	**100%**

2.4 Portfolio Management

NESFB monitors its portfolio across different parameters and analyzes the spread of risk among different asset classes. It also analyzes 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.
The business and collections team are part of the Loan Review Committee, where the identified and impending stress segments are discussed, and a final course of action is decided by the respective business units.

2.5 Credit Exposures and Risk Summary

S. No.	Exposure Type	₹ in Crs
1	Fund Based – Loans & Advances (Book Value)	834.57

2	Non-Fund Based	0
	Total	834.57

Maturity Pattern of Assets:
The maturity pattern of assets at March 31, 2024 is detailed in the table below:

(Amount in INR Crs)

Maturity Bucket	Cash, balances with RBI	Balances with banks and money at call & short notice	Investments	Net Loans & Advances	Fixed Assets	Other Assets	Total
1 Day	107.8	2.7	0.0	1.9	0.0	0.0	**112.5**
2-7 Days	0.0	0.0	0.0	11.3	0.0	0.6	**11.9**
8-14 Days	0.0	0.0	0.0	13.5	0.0	0.0	**13.5**
15-30 Days	4.4	50.0	23.3	29.8	0.0	6.8	**114.3**
31 Days to 2 Months	1.4	4.2	10.7	53.1	0.0	2.5	**71.8**
2-3 Months	1.5	0.0	11.4	53.3	0.0	2.2	**68.3**
3-6 Months	1.3	5.9	20.2	145.6	0.0	1.2	**174.2**
6-12 Months	5.1	0.0	51.0	234.1	0.0	0.0	**290.2**
1-3 Years	11.4	6.0	306.1	157.0	0.0	39.9	**520.5**
3-5 Years	30.4	0.0	125.5	35.8	0.0	71.8	**263.6**
Over 5 Years	0.5	0.0	2.0	0.8	28.1	16.3	**47.6**
Total	**163.8**	**68.7**	**550.2**	**736.3**	**28.1**	**141.3**	**1,688.4**

2.6 Non-Performing Assets and its Classifications

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.

Classification of gross NPA

In crores

Particulars	31st March 2024 (Audited)
Sub- Standard	86.24
Doubtful	12.96
Loss	0.00
Total Gross NPA	**99.20**

Net NPA:

In crores

Particulars	31st March 2024 (Audited)
Gross NPA	99.20
Less: Provisions	32.14
Net NPA before floating Provisions	67.06
Less : Floating Provision	-
Net NPA	**67.06**

Gross and Net NPA Ratios:

Particulars	31st March 2024 (Audited)
Gross NPA to Gross Advances	11.89%
Net NPAs to net Advances	8.36%

Movement of Gross NPAs:

In crores

Particulars	31st March 2024 (Audited)
Opening balance as on April 1 2023	347.33
Additions during the year	255.25
Recoveries (excluding Recoveries made from upgraded accounts)*	502.70
Upgradation	0.68
Increase in Same Category	-
Write offs	-
Closing balance	**99.20**

*Note:- * Includes INR 494.24 crores towards sale of stressed assets to ARC.*

Movement of Provisions for NPAs:

In crores

Particulars	31st March 2024 (Audited)		
	NPA Provision	Provision Floating / Restructuring Provision	Total
Opening Balance as on April 1, 2023	305.17	15.00	320.17
Provisions made during the year	94.99	-	94.99
Any other adjustment, including transfer between provisions	-	-	-
Write-back of excess provisions (including Write off – Technical and Actual)	368.02	15.00	383.02
Closing Balance	**32.14**	**-**	**32.14**

Provisioning:

Specific loan loss provisions are made as per the rates prescribed by RBI and Bank's internal policy. The provisions towards Standard Assets are made as per the extant RBI notifications and shall not be netted from gross advances but shall be shown separately as 'Contingent Provisions against Standard Assets' under 'Other Liabilities and Provisions'.

NPA accounts are written off based on Bank's internal policy. Amounts recovered during the year against bad debts written off in earlier years are recognized in the Profit and Loss Account as Miscellaneous income under the head 'Other Income' (Schedule - 14).

Floating Provision:

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 provisions. Creation of floating provisions is approved by the Board of Directors in accordance with the RBI guidelines. Floating provisions are used only for contingencies under extraordinary circumstances and for making specific provisions for impaired accounts as per Board approval and regulatory approval. Floating provisions, if any, are shown under "Other liabilities and Provisions" (Schedule 5).

Non-performing Investment:

Currently, the bank does not have any non-performing investment.

Provision for Standard Asset:

(In crores)

Particulars	**31st March 2024** (Audited)
Opening balance as on 01.04.2023	36.70
Provision made/reversed during the year	(25.40)
Any other adjustment, including transfer between provisions	(6.86)
Closing balance	4.44

For exposure amounts after risk mitigation subject to the standardized approach, the amount of the Bank's exposure in the following four major risk buckets as well as those that are deducted:

(In crores)

Particulars	**31st March 2024 (Audited)**
- Below 100% risk weight	1,448.93
- 100% risk weight	213.05
- More than 100% risk weight	24.57
- Deducted from capital	6.90

3. **Credit Risk Mitigation – Disclosure for standardized approach**

The Bank generally looks to have credit exposures backed by tangible security. The Bank's Board approved Credit Policy includes the valuation process of acceptable security. The policy covers different aspects of valuation requirement, valuation approach, valuator selection, valuation periodicity, etc.

The acceptable security should have the following parameters:

- Specifically itemized and identifiable: The underlying security of the credit facility should be clearly identifiable and itemized in the Credit appraisal memo/ valuation report.
- Liquidity: The security should be in a form that can be liquidated in the event of default or bankruptcy of the borrower.
- Repossession: The Bank should have the legal right to repossess the security in case the borrower defaults and the collateral should be easy to repossess as per the provisions of law.
- Market value: The security is periodically revalued and therefore the current value of the security should be easily discoverable in the market.

The bank considers deposits, securities issued by Central and State Governments, raw material, stock in trade, other goods, movable assets such as machineries, vehicles, animal husbandry, etc. as security.

Exposure cover by eligible financial collateral are as below

(In crores)

Particulars	Amount
Total exposure covered by eligible financial collateral	633.04
Total	**633.04**

4. Leverage Ratios

The Bank is also assessing leverage ratio as per Basel III framework. The leverage ratio is computed by dividing Tier I Capital by total exposures of the Bank. 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

(In crores)

Tier 1 capital - (A)	54.02
Exposure Measure- (B)	1,679.65
Leverage Ratio (A/B)	3.22%

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 Policy’ and ‘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.

The Risk Management Department 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. The Treasury mid-office which reports to the CRO does independent valuations of the investments and the allied market and interest rate risks and reports to ALCO and RMCB.

Currently the Bank holds only sovereign bonds including T-Bills, State development loans and Government securities. The bank has no open positions in FX, Derivatives and Equity.

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

6. Interest Rate risk in Banking Book

Interest rate risk in Banking Book (IRRBB) is defined as an adverse impact on financials of Bank, due to change in the interest rates. As Financial Intermediary, Interest Rate Risk is an inherent part of the Banking Business. Mismanagement of IRR poses a significant threat to Bank's earnings and Capital. Impact of change in interest rates would be on Net Interest Income ('NII') in the immediate term and would be on the Bank's Capital in the long term as the economic value of the assets, liabilities and off-balance sheet positions get affected due to variation in market interest rates. The ALCO of the Bank is the guiding body for management of IRRBB, sets the overall framework and risk limits with approval of the Board. The Treasury is entrusted with the responsibility of IRRBB and works out appropriate strategies in consultation with ALCO to mitigate the interest rate risk. ALM Risk unit, which is a part of risk management independently measures, monitors & reports the interest rate risk as defined by policy.

The findings of various IRRBB measures are submitted to the ALCO, the committee for providing strategic guidance and direction for the ALM measures. Non-rate sensitive liabilities and assets primarily comprise of capital, reserves and surplus, other liabilities, cash and balances with RBI, current account balances with banks, fixed assets and other assets. 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. Market Value of Equity (MVE), 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 by using Duration Gap Approach. Bank uses below approaches to compute the impact of change in interest rate as per regulatory/internal guidelines:

i. IRST (Traditional Gap Approach) - To compute Earnings at Risk (Ear) i.e., to assess impact on NII.
ii. IRSD (Duration Gap Approach) – To compute impact on Bank's Market Value of Equity (MVE), due to change in economic value of Asset & Liabilities.

Details of Parallel Rate shock on Earnings and Market value of equity as on March 31, 2024, are given below:

(Amount in Rs. Cr)

Interest Rate Risk	+200 bps	-200 bps
Earnings at Risk (EAR)	- 0.12	+ 0.12
Impact on Market Value of Equity (MVE)	- 14.47	+14.47

7. Liquidity Risk

Liquidity refers to the 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 a 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.

According to the bank's ALM policy, the Net Cumulative negative mismatch of the cumulative cash outflows for the buckets 1 day, 2-7 days, 8-14 days, 15- 30 days should not exceed -5%, -10%, -15%, -20% respectively. There are no breaches in the regulatory or internal limits set on Cumulative mismatch percentage as of the 31st March 2024 based structural liquidity statement.

Contingency Funding Plan (CFP), approved by the Board sets out a process to manage liquidity in the event of liquidity crunch or a run on the Bank. In the event of a liquidity crisis, the ALCO will be responsible for providing directions for managing the situation. If ALCO is not in a position to be convened at short notice, the Chief Financial Officer (CFO), Chief Risk Officer (CRO) and the Head of Treasury are mandated to evaluate the stage of the crisis and take necessary action.

8. Liquidity Coverage Ratio (LCR)

The Bank computes the Liquidity Coverage Ratio (LCR) to manage short-term liquidity risk, ensuring that we have enough high-quality liquid assets to cover net cash outflows over a 30-day stress period. This regulatory requirement under Basel III promotes financial stability, enhances market confidence, and mitigates liquidity risk by encouraging banks to hold a buffer of assets that can be quickly converted to cash. Additionally, it supports stress testing and contingency planning, helping the bank to proactively address potential short term liquidity issues. The LCR is reported regularly to key management, ALCO, Risk Management Committee of the Board (RMCB) and RBI. The Bank's LCR as of 31st March 2024 was 164%, which was higher than the regulatory requirement of 100%.

9. 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 the 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 employees and customers 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 ERMC (Executive Risk Management Committee) and RMCB. 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 by relevant authorities.
- **ORM Organization Structure**: Bank's Organizational structure for managing operation risks consists of the following three lines of defense.
    - Business Unit
    - Operational Risk Management department & Compliance
    - 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. This 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:** Operational risk losses, near misses, incidents and RCSA are reported to the ERMC and RMCB on a regular basis. This is followed by a Root Cause Analysis of each reported incident to strengthen the controls and to book losses on identified operational risk events.

10. IT & Information Security

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