Expected Credit Loss (ECL) Policy

(Reviewed by the Board of Directors of the Company on July 07, 2023)

I. Overview of the Expected Credit Loss (ECL) model

The Company recognises impairment allowance for expected credit loss on financial assets held at amortised cost. The Company recognises loss allowances (provisions) for expected credit losses on its financial assets (including non-fund exposures) that are measured at amortised costs or at fair value through other comprehensive income account.

The ECL provision is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit loss. The 12-month ECL is the portion of the lifetime ECL that represent the ECLs that result from default events on financial assets that are possible within 12 months after the reporting date.

The Company performs an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument.

The Company applies a three-stage approach to measuring expected credit losses (ECLs).

Stage 1: 12-months ECL

For financial assets where there has not been a significant increase in credit risk since initial recognition and that are not credit impaired upon origination, the portion of the lifetime ECL associated with the probability of default events occurring within the next 12 months is recognised.

Stage 2: Lifetime ECL – not credit impaired

For financial assets where there has been a significant increase in credit risk since initial recognition but are not credit impaired, a lifetime ECL (i.e. reflecting the remaining life time of the financial asset) is recognised.

Stage 3: Lifetime ECL – credit impaired

Financial assets are assessed as credit impaired when one or more events that have a detrimental impact on the estimated future cash flows of that asset have occurred. For financial assets that have become credit impaired, a lifetime ECL is recognised and interest revenue is calculated by applying the effective interest rate to the amortised cost (net of provision) rather than the gross carrying amount.

The Company has identified a zero bucket for financial assets that are not overdue.

II. Estimation of Expected Credit Loss

The Company has calculated ECL using three main components: a probability of default (PD), a loss given default (LGD) and the exposure at default (EAD). ECL is calculated by multiplying the PD, LGD and EAD and adjusted for time value of money using a rate which is a reasonable approximation of EIR.

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Probability of Default (PD) - The Probability of Default is an estimate of the likelihood of default over a given time horizon. The Company uses historical information where available to determine PD.

Exposure at Default (EAD) - The Exposure at Default is an estimate of the exposure at a future default date, considering expected changes in the exposure after the reporting date, whether scheduled by contract or otherwise, expected draw downs on committed facilities.

Loss Given Default (LGD) – The Loss Given Default is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realisation of any collateral.

III. Comparison of ECL Model and Income Recognition & Asset Classification (IRAC) Norms

ECL Model uses evaluation of credit loss based on probability of default which needs to re-evaluated and can be subjective.

IRAC Norms is an arbitrary standard set by Reserve Bank of India (RBI) and have been in practise in India for long time.

A comparison of provisions needs to be evaluated and presented in the financial statements. In case of Stage 3 assets/substandard assets, higher of the two may be provided as a measure of prudence.

IV. Periodic re-evaluation

The probability of default and the loss given default may be periodically re-evaluated by the Board/Audit Committee.

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