# KLM AXIVA FINVEST LIMITED

# POLICY FOR EXPECTED CREDIT LOSSES

| Version | Date of approval by the Board | Remarks |
|---|---|---|
| Version 1 | 07.07.2023 | Initiation of the Policy |
| Version 2 | 13.02.2026 | First Annual review |

## Contents

## 1. 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.

## 2. Scope

This policy applies to all financial instruments subject to impairment under Ind AS 109, including:

- Gold Loans

  Gold loans are granted against the security of gold ornaments and are generally considered very safe financial assets; however, appraisal risk, custody risk, and price risk can lead to credit losses

- MSME Loans (Secured / Unsecured)

  MSME loans are secured by immovable properties, such as land and buildings, as well as financial instruments. Equitable mortgages are created in large-exposure cases, making them generally safe financial assets; however, improper valuation of assets, inadequate verification of title deeds, and errors in legal vetting can lead to credit losses

- Microfinance Loans (Joint Liability Group / Individual Lending)

  MFI loans are unsecured credit facilities provided without collateral and are generally considered higher-risk financial assets. Defaults and delayed payments are common in this asset class. Any loan default, especially after maturity without timely payments, can cause significant credit losses.

- Off-balance sheet exposures, if any

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.

## 3. Regulatory Framework & Guidance

- Ind AS 109 – Financial Instruments
- RBI Guidelines for Implementation of Ind AS by NBFCs
- Master Direction – NBFC – Scale Based Regulation (SBR)

- RBI Circulars on Prudential Norms on Income Recognition, Asset Classification and Provisioning (IRACP)
- Other applicable MCA and RBI circulars/amendments

## 4.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.

The ECL shall be calculated using the following formula

$$ECL = EAD \times (PD \times LGD)$$

### 4.1Exposure 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.
The computation of the Expected Credit Loss (ECL) includes the outstanding principal, accrued interest, and off-balance sheet exposures, where applicable.

### 4.2 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.

- For Gold Loans: LOW

use historical data with low default probabilities, Gold price movements

- For MSME Loans: Medium

collateral, bureau scores, Cash flow and Vintage of business.

- For Microfinance: medium

Repayment track record, group-level credit history of the loans.

### 4.3 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.

- Gold Loans: Low

  Low LGD due to liquid collateral, The Company maintains physical possession of the gold and holds the legal right to auction it in case of default.

- MSME: Medium

  Medium LGD Based on security cover, legal enforceability, recovery experience

- Microfinance: High

  : High LGD due to unsecured nature of the loans.

## 5. Reporting & Disclosure

- ECL provision movement shall be reported quarterly to the Audit Committee of the Board and will be used for quarterly financials
- Disclosures as required by Ind AS 107 and Ind AS 109 shall be made in the Annual Financial Statements, including:
  - Reconciliation of ECL across stages
  - Inputs, assumptions and estimation techniques used
- The Company compares the impairment allowance calculated under Ind AS with the provisioning required under RBI IRACP norms; if the Ind AS provision is lower than the IRACP requirement, the difference is transferred to an Impairment Reserve from the profits as per RBI guidelines on an annual basis.

## 6.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.

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## 7. Roles and Responsibilities

| Function | Responsibility |
|---|---|
| Finance Team | Development, monitoring, and validation of ECL models |
| Finance Team | Recognition and disclosure of ECL in financial statements |
| Credit Team | Providing inputs on SICR, credit risk ratings, and borrower data |
| IT Team | Ensuring data integrity and system support for ECL calculations |
| Internal Audit | Review of ECL framework compliance |
| Board / Committees | Oversight, policy approval, and periodic review |

## 8. Custody and Review of the Policy

The Finance Department shall be the custodian of the Policy. This policy shall be reviewed annually or more frequently in case of:

- Changes in regulatory guidelines (RBI/Ind AS)
- Significant changes in product profile or credit risk environment
- Observations from internal or external audits

## 9.Automation of ECL Provision

The computerization and automation of ECL, SMA, and SICR processes is a critical requirement. Accordingly, all departments must work in close coordination with the IT Department to achieve this objective