N.B.I. INDUSTRIAL FINANCE COMPANY LIMITED

Expected Credit Loss Policy

(Adopted by the Board of Directors of the Company at their meeting held on 16.05.2024)

Background

The Reserve Bank of India (RBI) vide its circular no RBI/2019-20/170 DOR (NBFC).CC.PD.No.109/22.10.106/2019-20 dated March 13, 2020 on "**Implementation of Indian Accounting Standards by Non-Banking Financial Companies and Asset Reconstruction Companies**" has directed to have a Board approved policy for computation of Expected Credit Loss (ECL) that addresses policies, procedures and controls for assessing and measuring credit risk on all lending exposures, commensurate with the size, complexity and risk profile specific to the NBFC. The parameters and assumptions considered in the ECL estimation as well as their sensitivity to the ECL output need to be documented.

In view of the above, Policy on Expected Credit Loss ("the Policy") has been prepared prescribing the guiding principles for assessing and measuring credit risk on all lending exposures, commensurate with the size, complexity and risk profile specific to the Company.

The Company has completed Ind AS implementation, hence, it already has in place, the ECL policy and methodology, and its impact has already been captured in the Financial Statements/ Results of the respective period post implementation of Ind AS by the Company for the financial years. This document serves the purpose of codification of a formal policy and for continuing guidance.

This policy covers the guiding principles for computation of ECL.

Purpose of policy

The purpose of this policy is to provide a model for calculation of the ECL for the credit impairment of its financial instruments. The implementation of the IND-AS as per the aforesaid circular of MCA requires changes in the methodology of calculating the credit impairment apart from the other changes in the accounting of any entity. Under IGAP, company was following fix percentage-based model directed by RBI through its master directions from time to time, however with the introduction of IND-AS, it will change to Expected Credit Loss (ECL) based model. ECL based credit impairment model is considered pragmatic and include many factors which make model widely accepted. This policy describes the basis of ECL model and its key consideration while calculating the credit impairment for the company

Scope of policy

The Policy covers the following:

a. Approach of the Company for computation of ECL.
b. Segmentation of loan portfolio.
c. Mechanics of the computation of ECL – including the assumptions of deriving various

factors for computing ECL.

d. Changes in the assumptions by the management.
e. Prudential floor for provisioning against assets as per the applicable regulatory framework.

Approval Authority

This Policy is guided by the RBI Circular and Ind AS 109 Financial Instruments. The policy document has been approved by the Board of Directors of the Company on 16.05.2024.

Overview of Expected Credit Loss

Ind AS 109: Financial Instruments ('Ind AS 109') requires financial assets to be classified and measured into one of the three bases below:

- Amortized Cost ('AC')
- Fair Value through Other Comprehensive Income ('FVOCI')
- Fair Value through Profit and Loss account ('FVTPL')

Approach

Ind AS 109 does not prescribe any specific method to estimate ECL.

The Company shall measure the amount of ECL on a financial instrument in a way that reflects an unbiased and probability-weighted amount. The Company considers its historical loss experience and adjusts the same for current observable data. The key inputs into the measurement of ECL are the probability of default, loss given default and exposure at default. These parameters shall be derived from the Company's internally developed statistical models and historical data. In addition, the Company shall use reasonable and supportable information on future economic conditions including macroeconomic factors. Since incorporating forward looking information increases the judgment as to how the changes in the macroeconomic factor will affect ECL, the methodology and assumptions are reviewed regularly.

Segmentation

The impairment approach under Ind AS 109 requires financial entities to segment their portfolio based on their risk profiles. Accordingly, entire loan portfolio shall be segmented into different segments/ products on the basis of homogeneous borrowers since their risk profiles are similar.

Above segmentation may change from time-to-time on the basis of changes in business model andassociated risk, portfolio performance, change in risk profile etc.

Exposure at Default and its Staging

The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation. The Company determines EADs by modelling the range of possible exposure outcomes at various points in time, corresponding to multiple scenarios. Ind AS 109 requires financial instruments to be categorized into 3 different stages on the basis of degree of risk. The staging prescribed by the standard is as follows:

ECL is recognized on loans based on the general approach wherein lifetime ECL is to be recognized if there is a significant increase in credit risk since origination. For assets which have not undergone a significant increase, a 12-month ECL shall be recognized.
Assets are classified under three stages based on the evaluation of the following criteria:

- Stage 1 – Loans with low credit risk and where there is no significant increase in credit risk i.e accounts with no default.

- Stage 2 – Loans with significant increase in credit risk i.e accounts more than 90 days of default.

- Stage 3 – Credit impaired loans i.e accounts with more than 365 days default.

Assessment is made for each asset at borrowers' level to understand if the credit risk is significantly increased or the asset is credit impaired ECL is provided based on the categorization of each of the outstanding loan considering performance during the year and future outlook. As a matter of policy, ECL shall be applied on respective categories of Assets as per following process.

- Loans with low credit risk and where there is no significant increase in credit risk- -0.40%

- Loans with significant increase in credit risk- 25%

- Credit impaired loans- 100%

Net ECL amount is charged / credited to Profit & Loss account in the relevant financial year.

Probability of Default

The Probability of Default (PD) is the likelihood that the borrower will default in future.

Analysis of historical data regarding days past due (DPD) or delinquency of loans is the primary input into the determination of the term structure of PD for exposures. The Company shall look at performance and default information about its credit risk exposures analyzed by type of product or borrower as well as by DPD.

Forward looking information

In its ECL models, the Company relies on a broad range of forward-looking information as macro-economic inputs. As required by Ind AS 109, Macro Economic (ME) overlays are required to be factored in ECL Models and accordingly, Company shall use relevant ME variable. Overtime, new ME variable may emerge to have a better correlation and may replace the previous ME being used.

Loss Given Default

Loss given default (LGD) is defined as the expected amount of the credit that is lost by a financial institution when a borrower defaults. The Company uses collection details on previously defaulted cases for calculating the estimated recoveries and consequently the LGD, and further deducts estimated direct cost of collection from default cases. Appropriate discounting rates are applied to calculate present value of future estimated collection net of direct collection cost. LGD thus calculated is used for all stages, i.e., Stage 1, Stage 2 and Stage 3.

ECL computation

ECL shall be computed at each reporting period under different scenarios with weightages decided by management from time-to-time.

Expected Credit Loss = Exposure at default x Probability of default x Loss given default x Discounting Factor

Discounting Factor (Df) will be EIR of the respective portfolio.

The parameters such as PD and LGD shall be refreshed periodically.

Management Overlay

Any overrides to components like PD, LGD, and EAD shall be documented with rationale and such overrides are subject to approval of Audit Committee. Also, the criteria for reversal of the overrides shall be aligned at the time of application of the overrides.

Further, the Management, if it so desires, may provide for higher losses than that arrived at based on the manner discussed above.

Changes in the ECL model, parameters and key assumptions

The parameters and assumptions considered as well as their sensitivity to the ECL output shall be documented. No change in the parameters, assumptions and other aspects of ECL model shall

be made merely for the purposes of profit smoothening. The rationale and justification for any change in the ECL model shall be documented and approved by the Audit Committee. Similarly, any adjustments to the model output (i.e. a management overlay) should be approved by the Audit Committee of the Board (ACB) and its rationale and basis should be clearly documented.

Prudential Floor

Company shall hold impairment allowances as required by Ind AS.

In parallel Company shall also maintain the asset classification and compute provisions as per extant prudential norms on Income Recognition, Asset Classification and Provisioning (IRACP) including borrower/beneficiary wise classification, provisioning for standard as well as restructured assets, NPA ageing, etc.

If the impairment allowance under Ind AS 109 is lower than the provisioning required under IRACP (including standard asset provisioning), Company shall appropriate the difference from its net profit or loss after tax. Endeavor shall be made to make adequate provision through impairment allowance itself. Further, this comparison shall be done at Legal Entity level.

The difference appropriated against net profit or loss after tax shall be transferred to “Impairment Reserve”, the withdrawal from which shall be possible only with the permission of the RBI, or in such manner as may be prescribed by the RBI from time to time.

Disclosures

Appropriate disclosures as required in regulatory guidelines, from time to time, shall be made by the Company by way of notes to financial statement.

Monitoring & Review of the Policy

The Board of Directors shall monitor and review the Policy and can amend this policy to incorporate appropriate changes as and when deemed fit.

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