Pillar III Disclosure

The RBI guideline on 'Basel II Capital Regulation' was issued on July 1, 2008 for implementation in India with effect from March 31, 2008. Suryoday Small Finance Bank Limited (hereinafter referred to as the Bank) is subject to the RBI Master Circular on Basel-II Capital Regulations, July, 2008 and amendments thereto issued on time to time basis by RBI.

The Basel II framework consists of three-mutually reinforcing pillars:
Pillar 1 - Minimum capital requirements for credit risk, market risk and operational risk
Pillar 2 - Supervisory review of capital adequacy
Pillar 3 - Market discipline

Market discipline (Pillar 3) comprises a set of disclosures on the Capital Adequacy and Risk Management framework of the Bank. Pillar 3 disclosures as per RBI master circular on Basel-II Capital Regulations are set out in the following sections for information.

DF-2: Capital Adequacy

Regulatory capital assessment

The Bank is subjected to Capital Adequacy guidelines stipulated by Reserve Bank of India (RBI). In line with RBI guidelines under Basel II, the Bank has adopted Standardized Approach for Credit Risk, Standardized Duration Approach for Market Risk and Basic Indicator Approach for Operational Risk while computing its Capital Adequacy Ratio (CAR).

As per operating guidelines for Small Finance Bank, the Bank is required to maintain a minimum CAR of 15% with minimum Common Equity Tier I (CET I) CAR of 6%.

As on December 31, 2017, total CAR of the Bank stood at 41.64%, well above regulatory minimum requirement of 15%. Tier I ratio of the Bank stood at 38.03% well above regulatory requirement of 6%.

Assessment of adequacy of Capital to support current and future activities

The Bank has a policy on Internal Capital Adequacy Assessment Process (ICAAP) which is approved by the Board of Directors (Board). Under ICAAP, the Bank determines whether it has adequate level of capital to meet regulatory norms, current and future business needs, including stress scenarios. ICAAP evaluates and documents all risks and substantiates appropriate capital allocation for not only risks identified under Pillar 1 (i.e. Credit, Market and Operational Risk) but for the ones identified under Pillar 2 as well.

ICAAP enables the Bank to ensure the adequacy of capital to take care of the future business growth and various other risks that the Bank is exposed to, so that the minimum capital required is maintained on a continuous basis and also at the times of changing economic conditions/economic recession. The Bank takes into account both quantifiable and non-quantifiable risks while assessing capital requirements. The Bank considers the following risks as material and has considered these while assessing its capital requirements:

- Credit Risk
- Market Risk
- Operational Risk
- Interest Rate Risk in banking Book
- Liquidity Risk
- Credit Concentration Risk
- Business Risk
- Strategic Risk
- Compliance Risk
- Reputation Risk

Monitoring and reporting

The Board of Directors of Suryoday Bank maintains an active oversight over the Bank's capital adequacy levels. On a quarterly basis an analysis of the capital adequacy position and the risk weighted assets and an assessment of the various aspects of Basel III on capital and risk management as stipulated by RBI, are reported to the Board.

Capital requirements for various risks

A summary of Bank's capital requirement for credit, market and operational risk on December 31, 2017 is presented below:

		(Rs. In Million)
SN	**Particulars**	**31.12.2017**
(a)	Capital requirements for Credit risk:	
	- Portfolios subject to standardized approach	1713
	- Securitization exposures	-
(b)	Capital requirements for Market risk:	
	Standardized duration approach	
	- Interest rate risk	14
	- Foreign exchange risk (including gold)	-
	- Equity risk	-
(C)	Capital requirements for Operational risk:	
	- Basic indicator approach	287

Common Equity Tier 1, Tier 1 and Total Capital ratios:

Ratios	**31.12.2017**
Capital Adequacy Ratios	
- Total Capital Adequacy Ratio (%)	41.64%
- Tier -1 Capital Adequacy Ratio (%)	38.03%
- Common Equity Tier - 1 Capital Adequacy Ratio (%)	38.03%

DF-3: Credit Risk: General Disclosures

Policy and Strategy for Credit Risk Management

Credit risk is defined as the possibility of losses associated with diminution in the credit quality of borrowers or counterparties. In the Bank's portfolio, losses stem from outright default due to inability or unwillingness of a borrower or counterparty to meet commitments in relation to lending, trading, settlement and other financial transactions.

The Bank has put in place Credit Policy, Collection and Recovery policy, Income Recognition and Asset Classification (IRAC) Policy, Investment Policy and Risk Management Policy duly approved by the Board whereby credit risk can be identified, quantified and managed within the framework that is considered consistent with the scale, size of business and risk appetite of the Bank. These policies prescribe various methods for credit risk identification, measurement, grading, monitoring, reporting, risk control/mitigation techniques and management of problem loans/ credit.

Organizational Structure for Credit Risk Management function

The organizational structure of the Bank for Credit Risk Management function has the Board of Directors at the apex level that maintains overall oversight on the management of risks. The Risk Management Committee of Board (RMCB) assists the Board in relation to the oversight and review of the Bank's risk management principles and policies, strategies, appetite, processes and controls which includes credit risk. RMCB approves/ recommend the Bank's credit policies, prudential exposure limits, business segments, credit assessment and approval system, margin and collateral management, credit documentation, credit pricing framework, credit administration and monitoring system, non-performing assets management policy, credit risk management system etc.

At operational level, Risk Management Committee of the Executives is responsible for overseeing implementation of credit and operational risk management framework across the Bank. The committee reviews status of portfolio management, loan review mechanism, risk monitoring and evaluation, regulatory/legal compliance, adequacy of provision, risk concentrations, industry reviews and suggest corrective measures.

The roles and responsibilities of the key functions are as detailed below:

- Credit Risk Function: The Credit Risk Function, with support from Business Units, is entrusted with the responsibility of implementing processes for credit risk identification, assessment, measurement, monitoring and control. Credit Risk function execute portfolio risk management activities, analyse early warning signals, study the impact of various stress testing scenarios.

- Business Units: Business Units are primarily responsible for day-to day risk management with regard to processing transactions and the establishment of internal controls to treat the risks associated with those transactions. Business units are required to comply with credit risk management policies and processes related to the origination and management of credit risks.

Credit risk measurement, mitigation, monitoring & reporting systems

1. **Credit Origination and Appraisal System**

There are separate Credit Origination and Appraisal Processes for Joint Liability Group (JLG) and Retail segments. Within the Retail segment, 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 JLG segment, on the other hand, relies largely on standardized product programs for credit risk assessment and approvals.

2. **Credit Rating Framework**

The Bank is under process of developing credit scorecards for the assessment of loan applications on a pilot basis for a period of 6-12 months; thereafter, with reviews and updates of the scorecards, the Bank will define the usage of scorecard outputs for credit appraisal.

3. **Credit Documentation**

Collateral / security documents are finalized and registered in consultation with the legal and compliance department. The RM/RO and Credit Operation are jointly responsible for ensuring that proper documentation is obtained as per the check list provided by credit and legal department. The Credit Operation team is responsible for the safe custody of all documentation. Documents from various branches are sent within 15 days of the sanction of the facility.

4. **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. The Bank has also adopted Committee Approach for sanctioning high value credit proposals.

5. **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 main objectives of credit monitoring are:

- To ensure that there is timely recovery of principal and interest from Borrower

- To assess the health of the borrower units at periodic intervals with reference to the key indicators of performance such as stability, activity level etc.

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.

6. Review / Monitoring / Supervision:

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 main objectives of credit monitoring are:

- To ensure that there is timely recovery of principal and interest from Borrower
- To assess the health of the borrower units at periodic intervals with reference to the key indicators of performance such as stability, activity level etc.

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.

7. Security monitoring:

The value of the collateral shall be reassessed at periodic intervals. Collateral valuations shall be updated at a frequency appropriate to the value and nature of the collateral and the ease and costs of valuation.

8. Monitoring Standards – Portfolio level:

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

1. Portfolio origination performance – Number of applications, approval/rejection rate, Priority Sector Lending (PSL) compliant loans, etc.
2. Portfolio asset quality – Delinquencies in various buckets: 1+ days, 30+ days, 60+ days, 90+ days, NPAs, Write-offs, Recoveries, Non-starters and early delinquencies (30+ in less than 6 months or 60+ in less than 12 months, etc.)
3. Portfolio concentration limits – Concentration across tenor, collateral type, single borrower, group borrower level, geography, product, etc.

The Credit risk unit is responsible for conducting portfolio level monitoring and publishing relevant MIS reports.

9. 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.

Quality & control review primarily focus on the following key aspects:

- Loan Approval process
- Adherence to internal policies and procedures and applicable laws/Regulations
- Compliance with loan covenants
- Post Disbursal Documentation (PDD) compliance
- Sufficiency of loan documentation

10. Recovery Policy:

- The Bank has a Recovery and collection policy. This policy is formulated within the framework of various regulatory requirements and was approved by Board of Directors on 23rd Jan 2017.
- The recovery process is required to be started as soon as a borrower account shows symptoms of weakness / default and the Bank does not wait till the borrower account is classified as NPA.
- The Bank is documenting the efforts made for the recovery of dues and the copies of communication sent to customers, if any, shall be kept on record.
- The repayment record of borrowers shall be monitored both with regard to payment of interest and repayment of principal. The mode of recovery shall be decided after conducting a root cause analysis of the reason for default.
- Whenever a borrower defaults or is likely to default, rigorous follow-up shall be made for the collection of dues / arrears. When default occurs, oral and written communications shall be sent to the borrower to regularise their accounts within a specified period.
- In case the loan is secured by a guarantee (personal or corporate), steps shall be taken to recover dues from the guarantor.
- Suryoday shall use any of the following broad methods for management of problem accounts:
  - Restructuring, rephasement and rehabilitation
  - Exit strategy
  - Settlements / compromise
  - Sell down Asset Reconstruction Company (ARC) / other entities
  - Invocation of SARFAESI
  - Legal Action & recovery

Definition and classification of Non-performing Assets (NPAs)

An asset, including a leased asset, becomes non-performing when it ceases to generate income for the Bank. A "Non-performing Asset" (NPA) is a loan or an advance where:

- Interest and/or instalment of principal remain overdue for a period of more than 90 days in respect of a Term Loan,
- The account remains ‘out of order’, in respect of an Overdraft/Cash Credit (OD/CC),
- The amount of liquidity facility remains outstanding for more than 90 days, in respect of a Securitisation transaction undertaken in terms of the RBI guidelines on securitisation dated February 1, 2006.

- Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.
- An account may also be classified as NPA if the interest charged during any quarter is not serviced fully within 90 days from the date of debit / due date.

Credit risk exposures

Credit risk exposures (excluding specific risk on available-for-sale and held-for-trading portfolio) include all credit exposures as per RBI guidelines on exposure norms and investments in the held-to-maturity category. Exposures to regulatory capital instruments of subsidiaries that are deducted from the capital funds have been excluded.

Quantitative Disclosures

1. Total gross credit risk exposures*, Fund based and Non-fund based separately:**

(Rs. In Million)

Category	31.12.2017
Fund Based	
Gross Advances	13,499
Investment #	-
All other Assets	2,095
Non - Fund Based	28
Total	**15,622**

*Represents book value as on 31th December 2017
** Credit Equivalent Amount
# Investment includes Government Securities – Rs. 2154 Million, State Government Securities – Rs. 872 Million, Certificate of Deposits and Commercial Papers – Rs. 249 Million.

2. Geographic distribution of exposure*, Fund based & Non- fund based separately**

(Rs. In Million)

Category	31.12.2017		
	Domestic	Overseas	Total
Fund Based	15,594	-	15,594
Non - Fund Based	28	-	28
Total	**15,622**	-	**15,622**

*Represents book value as on 31th December 2017
** Credit Equivalent Amount

3. Residual contractual maturity breakdown of assets as on

(Rs. In Million)

Maturity bucket	Cash, balances with RBI and other banks	Investments	Advances	Other assets including fixed assets
Day - 1	535	887	10	33
2-7 Days	151	9	159	49
8-14 Days	4	33	275	58
15-30 Days	27	276	268	71
31 Days and upto 2 months	78	12	745	15
More than 2 months and upto 3 months	42	42	761	16
More than 3 Months and upto 6 months	183	41	2,208	18
More than 6 Months and upto 1 year	87	174	3,780	-
More than 1 Year and upto 3 years	474	1,485	4,021	54
More than 3 Years and upto 5 years	35	315	135	17
More than 5 years	3	-	707	312
Total	**1,618**	**3,275**	**13,069**	**642**

5.Asset Quality

- NPA Ratios

Particulars	**31.12.2017**
Gross NPAs to gross advances	7.19%
Net NPAs to net advances	3.66%

- Net NPAs

(Rs. In Million)

Particulars	**31.12.2017**
Gross NPAs	971
Less: Provisions	(430)
Less: Floating Provisions	(63)
Net NPAs	**478**

- Classification of gross NPAs

(Rs. In Million)

Particulars	**31.12.2017**
Sub-standard	935
Doubtful	
▪ Doubtful 1	36
▪ Doubtful 2	Nil
▪ Doubtful 3	Nil
Loss	Nil
Total Gross NPAs	**971**

- Movement of Gross NPAs

(Rs. In Million)

Particulars	31.12.2017
Opening balance as on 01.04.2017	513
Additions during the year	488
Reductions	30
Closing balance	971

- Movement of Provisions for NPAs

(Rs. In Million)

Particulars	31.12.2017
Opening balance as on 01.04.2017	139
Provisions made during the year	299
Write-Off	-
Any other adjustment, including transfer between provisions	-
Write-back of excess provisions	7
Closing balance	**430**

6. Non-performing Investment

(Rs. In Million)

Particulars	31.12.2017
Gross Non-Performing Investment	Nil
Less: Provisions	Nil
Net Non-performing Investment	Nil

- Provision for depreciation on Investment

(Rs. In Million)

Particulars	31.12.2017
Opening balance as on 01.04.2017	Nil
Provisions made during the year	Nil
Write-Off	Nil
Any other adjustment, including transfer between provisions	Nil
Write-back of excess provisions	Nil
Closing balance	Nil

- Provision for Standard Asset

(Rs. In Million)

Particulars	31.12.2017
Opening balance as on 01.04.2017	20
Provisions made/reversed during the year	12
Any other adjustment, including transfer between provisions	-
Closing balance	32

- Geographic Distribution

(Rs. In Million)

Category	31.12.2017		
	Domestic	Overseas	Total
Gross NPA	971	-	971
Provision for NPA	430	-	430
Provision for Standard Assets	32	-	32

DF-4: Credit Risk: Disclosures for Portfolios Subject to the Standardized Approach

Ratings used under Standardized Approach:

The Bank reckons external ratings for risk weighting purposes, if the external rating assessment complies with the guidelines stipulated by RBI.

The Bank uses ratings assigned by RBI approved Eligible Credit Assessment Institutions (ECAI) for domestic counterparties.

Quantitative Disclosures

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

(Rs. In Million)

Particulars	31.12.2017
- At 0% risk weight	2,464
- Below 100% risk weight	10,133
- 100% risk weight	4606
- More than 100% risk weight	35
- Deducted (Intangible Assets and Deferred Tax Assets)	166

Treatment of undrawn exposures

As required by regulatory norms, the Bank holds capital even for the undrawn portion of credit facilities which are not unconditionally cancellable without prior notice by the Bank, by converting such exposures into a credit exposure equivalent based on the applicable Credit Conversion Factor ("CCF")

DF 18: Leverage Ratio Disclosure

- Leverage ratio common disclosure as of December 31, 2017

The leverage ratio acts as a credible supplementary measure to the risk based capital requirement. The Bank is required to maintain a minimum leverage ratio of 4.5%. The Bank's leverage ratio calculated in accordance with RBI guidelines under consolidated framework is as follows:

(Rs. In Million)

Tier-1 capital (A)	5107
Exposure measure (B)	18,466
Leverage ratio (A/B)	**27.66%**