



# **Edel Finance Company Limited**

## **Internal Capital Adequacy Assessment Process (ICAAP) Policy**

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<b>Previous versions and dates of approval</b>	<table border="1"><tr><th><b>Version No.</b></th><th><b>Date of Approval</b></th></tr><tr><td><b>1</b></td><td><b>November 8, 2022</b></td></tr></table>		<b>Version No.</b>	<b>Date of Approval</b>	<b>1</b>	<b>November 8, 2022</b>
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## 1. Background

RBI has issued "Scale Based Regulation (SBR)" for the NBFC sector in India vide their circular RBI/2021-22/112 DOR.CRE.REC. No.60/03.10.001/2021-22 dated 22 October, 2021 which is effective from 01 October, 2022.

NBFC's shall now be categorized in four layers -Base Layer (NBFC-BL), Middle Layer (NBFC- ML), Upper Layer (NBFC-UL) and Top Layer (NBFC-TL). Categorization will be done based on their size, activity, and perceived riskiness. The Top Layer is ideally expected to be empty unless the Reserve Bank is of the opinion that there is a substantial increase in the potential systemic risk from specific NBFCs in the Upper Layer and those will then be moved to Top Layer.

The top ten eligible NBFCs in terms of their asset size shall always reside in the upper layer, irrespective of any other factor. Also, NBFC-D, CIC, IFC and HFC will be included in Middle Layer or the Upper Layer (and not in the Base layer), as the case may be. SPD and IDF-NBFC will always remain in the Middle Layer.

Under the Regulatory changes stated by RBI under the SBR applicable to NBFC-ML and NBFC- UL, NBFC's are required to have an ICAAP (Internal Capital Adequacy Assessment Policy) in place. NBFCs are required to make a thorough internal assessment of the need for capital, commensurate with the risks in their business. The methodology for internal assessment of capital shall be proportionate to the scale and complexity of operations as per their Board approved policy. The objective of ICAAP is to ensure availability of adequate capital to support all risks in business as also to encourage NBFCs to develop and use better internal risk management techniques for monitoring and managing their risks. The circular also suggests that the internal assessment shall be on similar lines as ICAAP prescribed for commercial banks under Pillar 2 (Master Circular – Basel III Capital Regulations dated July 01, 2015).

RBI in its communication dated 30 September 2022, has identified the NBFCs which will be categorized under Upper Layer. Edel Finance Company Limited (henceforth referred as 'EFCL' or 'the Company') has not been identified as an Upper Layer NBFC by RBI.

RBI wide its Notification No. RBI/2022-23/129 DOR.CRE.REC.No.78/03.10.001/2022-23 dated 11 October 2022, has stated that NBFCs that are part of a common Group or are floated by a common set of promoters shall not be viewed on a standalone basis for classification in Middle Layer. The total assets of all the NBFCs in a Group shall be consolidated to determine the threshold for their classification in the Middle Layer.

As EFCL (NBFC-CIC-ND-SI) is a CIC having greater than INR 1,000 crores as asset size, it will be classified in NBFC-ML category. Hence EFCL is required to implement ICAAP.

This document explains possible procedures and methods to assist the Company in the implementation of ICAAP. This document needs to be reviewed annually.

## **2. ICAAP Principles**

The ICAAP is an important component of Pillar 2 requirements for Basel III regulations. The following aspects have been considered while preparing this document.

- It envisages the establishment of suitable risk management system in the Company and their review by supervisory authority.
- Under Pillar 2, the Company shall implement the process for assessing their capital adequacy in relation to their risk profiles as well as a strategy for maintaining their capital levels – i.e. Internal Capital Adequacy Assessment Process (ICAAP) in addition to the capital specified under Pillar 1 of Basel Accord.
- The main aspects to be addressed under the ICAAP, includes:
  - ✓ the risks that are not fully captured by the minimum capital adequacy ratio prescribed under Pillar 1;
  - ✓ the risks that are not at all considered by Pillar 1; and
  - ✓ the factors external to the Company.
- It is a forward-looking and risk-based process.
- It envisages stress testing procedures, scenarios for sensitivity and impact analysis, results of this exercise and impending implications on entity's business / risk profile.

## **3. Scope and Objectives of ICAAP**

### **3.1. Scope and Objectives of ICAAP**

- This policy and all associated components of ICAAP are developed considering the requirements of the SBR.
- EFCL is required to have Board-approved ICAAP policy.

The objective of this policy is to provide the framework for conducting the Internal Capital Adequacy Assessment Process (ICAAP) at Edel Finance Company Limited. The policy for ICAAP aims to achieve the following objectives:

- To broadly describe the process for identification, assessment, measurement, and aggregation of the risks inherent in its business and operations.
- To lay down the basic framework and design the approach for conducting stress tests to assess the impact on its earnings and capital.
- To integrate ICAAP into its capital planning and forecasting process.
- To assess availability of capital commensurate with its risk profile.
- To ensure that there is clear assignment of roles and responsibilities for facilitating ICAAP.
- To ensure ICAAP be an integral part of management decision making and organizational culture.

### **3.2. Regulatory Compliance**

This policy is prepared in compliance with following key guidelines by RBI / Basle Committee on Banking Supervision (BCBS):

- “Scale Based Regulation (SBR)” vide circular no: RBI/2021-22/112 DOR.CRE.REC. No.60/03.10.001/2021-22 dated 22 October 2021, as may be amended from time to time.
- Circular no. ‘RBI/2022-23/129 DOR.CRE.REC.No.78/03.10.001/2022-23’ dated 11 October 2022 regarding classification of multiple NBFCs in a Group in Middle Layer
- “Master Circular – Basel III Capital Regulations” vide circular no. RBI/2015-16/58 DBR.No.BP.BC.1/21.06.201/2015-16
- “Master Direction - Core Investment Companies (Reserve Bank) Directions” vide circular no: RBI/DoR(NBFC)/2016-17/39

## **4. Contents of ICAAP Document**

The ICAAP Document shall consist of following sections:

- a. Executive Summary
- b. About the Company
- c. Risk Management Framework
- d. Summary of Current and Projected Financial and Capital Position
- e. Capital Adequacy
- f. Stress Testing
- g. Testing and adoption of ICAAP
- h. Use of ICAAP within the Company
- i. Aggregation and diversification
- j. Management action
- k. Findings of ICAAP

### **4.1 Review of ICAAP Document**

EFCL’s management shall prepare the ICAAP document and shall assess capital requirement against various risks to which EFCL is exposed.

Group Risk Management Committee (GRMC) shall review the ICAAP Document regularly to evaluate the sensitivity of key assumptions and to assess validity of the Company’s estimated future capital requirements.

The ICAAP Document shall be prepared by EFCL’s management and presented to the Board of Directors for their approval on an annual basis, containing the analysis and results of the year, to assess and document whether the processes relating to ICAAP implemented by the Company have been successfully achieved.

The written record of internal assessment of the Company's capital adequacy (ICAAP Policy and document) shall include the risks identified, the manner in which those risks are monitored and managed, details of stress tests/scenario analysis conducted and the resultant capital requirements. The reports shall be sufficiently detailed to allow the Board of Directors to evaluate the level and trend of material risk exposures, whether the Company maintains adequate capital against the risk exposures and in case of additional capital being needed, the plan for augmenting capital. The Board of Directors shall be expected to make timely adjustments to the strategic plan, as necessary.

The ICAAP Policy shall be reviewed by Board of Directors on an annual basis or on a shorter frequency on occurrence of some material changes / developments warranting a review of the policy.

#### **4.2 Submission of the outcome of the ICAAP Document to RBI**

As the ICAAP is an ongoing process, a written record of ICAAP policy and the ICAAP Document, approved by the Board, shall be submitted to RBI at a frequency as may be requested by RBI.

### **5. Business Overview**

- Edel Finance Company Limited ('EFCL') is a public limited company domiciled and incorporated under the provisions applicable in India under the Companies Act, 1956. EFCL was incorporated on October 16, 1989. EFCL is wholly owned subsidiary of Edelweiss Financial Services Limited.
- EFCL was primarily engaged in the business of lending and investment and is registered with the Reserve Bank of India ('RBI') as a Systematically Important Non-Deposit taking Non-Banking Financial Company (NBFCND-SI). EFCL got converted to Core Investment Company ('CIC') as NBFC-CIC-ND-SI on 09 October, 2018.
- EFCL has one wholly owned subsidiary i.e. Edelweiss Rural and Corporate Services Limited (ERCSL) and one step down subsidiary i.e. Allium Finance Private Limited.

The ICAAP Document shall present following details in this section:

- Details about the Company: This section shall mention the details of the Company viz. list of subsidiaries, nature of business, products offered etc.
- A brief of the corporate governance structure of the Company.
- Summary of the key financial indicators of the Company as discussed in Annexure II.

## 6. ICAAP Governance Structure

Following is the governance structure for ICAAP purpose:

Figure 1- ICAAP Governance Structure



### 6.1 Roles and Responsibilities with respect to ICAAP

#### 6.1.1 Ownership

The ICAAP Document shall be prepared by Finance Head and reviewed by CFO and Group Risk Management Committee at regular intervals.

#### 6.1.2 Board of Directors/Audit Committee

Board of Directors have the overall responsibility of designing and implementing the ICAAP. The key responsibilities are as below:

- Review and approve risk management framework and ICAAP policy;
- Periodic review and approval of ICAAP Document to ensure that the ICAAP forms an integral part of the risk management process and decision-making culture of the Company;
- Approve the risk limits set by Group Risk Management Committee by assessing Company's risk and risk-bearing capacity;
- Review and approve the capital plan, detailing the Company's capital needs, its anticipated capital utilization, its desired level of capital, limits related to capital and a general contingency plan for dealing with divergences and unexpected events;
- Understand the risk run of the Company and ensuring that the risks are appropriately managed;
- Review and approve the risk management strategies and make timely adjustments to the strategic plan, as necessary;

- Review the risk management policies and system periodically;
- Ensure that Company maintains adequate capital commensurate with its risk profile;
- Implement strong internal controls throughout the Company and review controls and issue areas to ensure that system of internal controls is adequate to ensure well-ordered and prudent conduct of business.

#### **6.1.3 Group Risk Management Committee**

The Group Risk Management Committee (GRMC) will play a key role in the implementation of ICAAP. In the context of ICAAP, the GRMC shall undertake the following responsibilities, emphasizing the committee's role in the process:

- Review and approve risk management framework and related policies to ensure that all material risks are appropriately identified, measured, monitored and controlled and are commensurate with the Company's size, nature and complexities;
- Ensure that Company maintains adequate capital commensurate with its risk profile;
- Set the risk limits by assessing Company's risk and risk-bearing capacity;
- Identify and assess all material risks, including Stress Testing in coordination with various departments;
- Devise appropriate methodologies for measurement of risks considering the nature, size, and complexity of the Company so as to measure the risk capital;
- Ensure that detailed documentation of methodologies, assumptions, procedures, and minutes of meeting etc. is available for all the processes of ICAAP and is communicated to the relevant stakeholders and appropriate authority and responsibilities have been allocated;
- Review the level and trend of material risks on an ongoing basis and their effect on capital levels. Allocation of capital based on the business plan and risk profile.
- Supervise and review of implementation of ICAAP including ICAAP Policy and ICAAP Document.

#### **6.1.4 Chief Financial Officer (CFO)**

Below are the key responsibilities of CFO:

- Ensure the preparation, review, implementation, and approval of ICAAP Document as per timelines, commensurate with the risk profile of the Company and as per guidance issued by the Board and ensure that objectives as envisaged for ICAAP are achieved;
- Evaluate on a regular basis the relevance and appropriateness of key assumptions, assess the validity of the Company's estimated future capital requirements, review the performance of the ICAAP related processes vis-à-vis the objectives and strategy set by the Board;
- Review the ICAAP Document prepared by the Finance Head.

#### **6.1.5 Finance Head**

Below are the key responsibilities of Finance Head:

- Review and implementation of ICAAP Policy;
- Identify and assess all the material Pillar 1 and Pillar 2 risks including their quantifications as applicable to the Company for the purpose of ICAAP documentation;
- Define the assessment technique for Pillar II non-quantifiable risk;
- Develop the stress testing templates and assess its impact on Risk Weighted Asset (RWA) computation;
- Computation of Minimum Regulatory Capital with respect to ICAAP in Normal and Stressed scenarios;
- Evaluate on a regular basis the relevance and appropriateness of key assumptions, assess the validity of the Company's estimated future capital requirements, review the performance of the ICAAP related processes vis-à-vis the objectives and strategy set by the Board;
- Based on regular assessments, the Finance Head shall ensure incorporation of appropriate changes in the ICAAP policy / document to ensure that the underlying objectives are achieved effectively;
- Review the regulatory inspection report with respect to ICAAP policy compliance;
- Assessment of internal controls and risk management system with respect to ICAAP policy;
- Ensure that there is an independent review of ICAAP Document conducted on an annual basis.

#### **6.1.6 Asset Liability Management Committee (ALCO)**

ALCO takes on the following responsibilities with reference to ICAAP:

- ALCO shall share the risk monitoring reports with Finance Head and provide remediation strategies for breach (if any) for ratios mentioned as per the ALM policy.

#### **6.1.7 Finance & Accounts Department**

The Finance & Accounts Department shall carry out the following activities in the ICAAP process:

- Providing information to Finance Head for ICAAP on periodic and timely basis;
- Coordinating for the preparation of budgeted and financial projection for the next three / five years based on the approved strategy in coordination with various departments;
- Performing capital planning and budgeting.

#### **6.1.8 Other Departments**

- Support the preparation of ICAAP by responding to the risk questionnaires, providing other relevant information as requested by Finance Head in a timely manner;
- Co-ordinate with Finance Department by providing necessary data for business projections.

#### **6.1.9 Internal Audit Function**

Below are the roles & responsibilities of Internal Audit Function:

- Review ICAAP Document and ensure that they are compliant with ICAAP policy for

EFCL. Internal audit process should also encompass the review of risk assessments carried out for preparation of ICAAP Document.

- Ensure existence of appropriate and effective internal control structures, particularly with regard to the risk management processes followed by EFCL to comply with regulatory requirements.

## **7. Summary of Current and Projected Financial and Capital Position**

This section presents the templates for the capital position summary and the capital planning results of the Company.

### **7.1 Current Financial Position of the Company**

The ICAAP Document shall present the current financial position of the Company. This is discussed in Annexure III.

### **7.2 Capital Management**

Capital is the amount held or required to be held to protect the Company against losses. The capital requirement is affected by the economic environment, the regulatory requirement and the risks arising from Company's activities. Every Systematically Important Non-Deposit taking CIC (NBFC-CIC- ND-SI) shall maintain a minimum capital adequacy ratio i.e. Adjusted net worth not to be less than 30% of its aggregate Risk Weighted Assets and Risk adjusted value of off-balance sheet items as at last audited balance sheet date. Adjusted Net Worth shall be as per RBI circular RBI/2010-11/168 DNBS (PD) CC.No. 197/03.10.001/2010-11 dated August 12, 2010 and as per RBI guidelines issued from time to time.

#### **7.2.1 Projected Financial Position of the Company**

The ICAAP Document shall present a summary of the capital plan of the Company. The finance department shall carry out the capital planning exercise and prepare a capital plan. Capital Plan shall be put up to the Board of Directors for their approval. Assumptions used for preparing projected financial position including a summary of capital plan will be documented and updated in the ICAAP Document on an ongoing basis.

The purpose of capital planning shall be to ensure the adequacy of capital at the times of changing economic conditions, even at times of economic recession. In capital planning process the Company shall review:

- i. Current capital requirement of the Company;
- ii. The targeted and sustainable capital considering business strategy and risk appetite
- iii. Margin of safety maintained over the regulatory capital requirement;
- iv. The future capital planning will be done on a minimum three-year outlook

The projected financial position of the Company shall be presented in the ICAAP Document in the format annexed in Annexure IV.

### **7.2.2 Capital Adequacy Projections**

EFCL computes the Risk Weighted Assets (RWA) for credit risk using regulatory risk weights assigned for each asset class as per the current regulatory framework applicable to NBFC-CIC's. The value of each asset / item is multiplied by the relevant risk weights to arrive at risk adjusted value of assets.

The Company will put in place a process for assessing its overall capital adequacy in relation to its risk profile and strategy for maintaining its capital levels above the regulatory capital adequacy ratios.

Wherever possible, EFCL shall quantify the risks and accordingly calculate capital required under Pillar II/ICAAP. For risks which cannot be quantified, the EFCL shall use qualitative criteria/scorecards to monitor the risk.

### **7.3 Contingency Funding Plan**

Recent volatility in the markets has highlighted the importance of sound liquidity risk management practices. As a result, management's ability to adequately meet daily and emergency liquidity needs while controlling liquidity risk through risk identification, monitoring, and controls is receiving increasingly intense regulatory scrutiny.

The Company has a formal contingency plan in the form of policies and procedures to use as a blueprint to manage adequate liquidity in the scenario of financial stress which might affect the Company's ability to run the business activities in a timely manner and at a reasonable cost.

## **8. Risk Management**

This section details the risk appetite, risk identification and materiality assessment and capital planning processes of the Company.

### **8.1 Risk Appetite Statement**

Risk appetite is defined as the amount and type of risks that the Company is willing to take within the context of its business strategy and sets the outer boundaries for risk taking and forms an input to the business and capital planning process. The risk appetite links risk strategy to business strategy through a set of comprehensive indicators. The risk appetite is defined in quantitative or qualitative terms and subjected to annual review and approval by the Board.

The Risk Appetite Statement (RAS) at EFCL will satisfy following key elements:

- The articulation in written form of the aggregate level and types of risk that EFCL is willing to accept in the pursuit of its strategic objectives and business;
- Quantification of risk limits in terms of earnings (earnings perspective);
- The limits and thresholds for monitoring the risk appetite of EFCL
- The qualitative statements for non-quantifiable risks.

The limits, trigger points, actionable and responsibilities of various departments are covered in the RAS of the Company. RAS limits and compliance status at the time of assessment shall form a part of the ICAAP Document.

## 8.2 Risk Identification Process

The Material Risk Identification Framework is designed to provide the Board and Senior Management relevant information pertaining to the risk profile of EFCL in a timely and concise manner. This framework enables EFCL's management to have a single top-down view of all the material risks impacting EFCL.

The following includes the overall objectives that EFCL would achieve through this framework:

- Define a process for identification of all the risks that EFCL faces;
- Define an approach to identify risks that materially impact EFCL's earnings, capital, reputation, or people;
- Incorporate material risks as identified above in Internal Capital Adequacy Assessment Process and quantify capital requirement for material risks as per qualitative or quantitative methodology.

The identified risks are classified as material based on materiality assessment, as described in the next section.

## 8.3 Materiality Assessment Framework

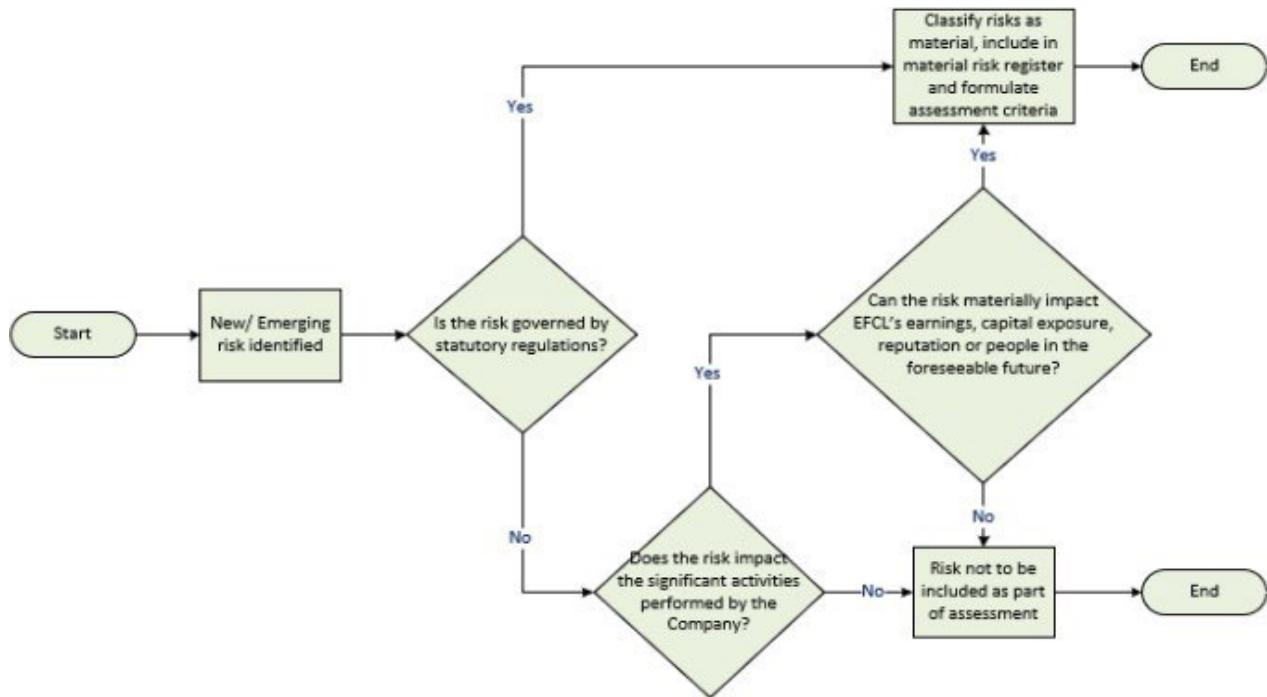
Following parameters are utilized to assess materiality of risks and their potential impact on the Company.

1. **Earnings:** Potential impact on operating earnings which include net interest income and non- interest income. Focus should be on potential earnings impact in next 12-months and historical loss trend should be leveraged.
2. **Capital:** Impact of adverse events on regulatory capital requirements.
3. **People:** Potential impact of different risks on the staff including, staff morale, performance management, training and development, balancing business requirements with personal goals of employees, etc.
4. **Reputation:** Potential loss of goodwill, franchise value, or future business potential loss arising from failed risk management, corporate governance, environmental, social and ethical performance, compliance, financial performance or any other factor that destroys long-term shareholder value. Example: failure to comply with KYC / AML norms may result in significant loss of reputation.
5. **Regulation:** Potential impact of risk in meeting the regulatory requirements.

Every department that faces new / emerging risk would appraise the Finance Head on the potential impact of new / emerging risks on the above parameters' basis their internal

assessment and identify the risks that may materially impact the earnings, capital, people, regulation or reputation. The exercise would be performed annually or as and when required in extreme cases, subsequent to which the risk universe will be updated. The process flow of identification of material risks is given below.

*Figure 2 - Materiality Assessment Framework*



#### 8.4 Risk Profile Assessment

The Company will assess the following risks under ICAAP involving quantitative assessment of quantifiable risks and qualitative assessment of non-quantifiable risks. For qualitative assessment, qualitative methods viz. scorecard approach, prescribing controls etc. will be used to monitor the risks.

Sr. No.	Risk Area	Risk Definition
1.	Liquidity risk	Risk of not being able to raise funds or monetize an asset within a reasonable timeframe at a fair price, leading to an inability to meet financial obligations / requirements.
2.	Operational risk	Risk of loss resulting from inadequate or failed processes, system controls or human negligence.

3.	Market risk	Risk of loss resulting from adverse movements in market variables & instruments.
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4.	Interest rate risk	Risk where changes in market interest rates might adversely affect EFCL's financial condition.
5.	Information security Risk	Risk of loss resulting from breach / attacks on information systems.
6.	Credit risk	Risk of loss due to inability or unwillingness of a counterparty or borrower to meet financial / contractual obligations, incorrect due diligence/assessment and adverse developments.
7.	Strategic risk	Current or prospective risk to earnings and capital arising from changes in the business environment, faulty planning/ budgeting, adverse business decisions, improper implementation of decisions, lack of responsiveness to changes in the business environment etc.
8.	Reputational risk	Risk arising from negative perception about the organization on the part of stakeholders that can adversely affect an organization's ability to maintain existing or establish new business relationships.
9.	Compliance risk	Risk arising from failure to abide by the rules and regulation laid out by various regulators which may lead to penalties.

## 9. Stress Testing

As part of the ICAAP exercise, stress test will be carried out in respect of the Company's material risk exposures, in order to evaluate the potential vulnerability of the Company. The stress testing exercise will provide a better understanding of the adverse impact on the Company's capital and profitability mostly from certain unlikely but plausible events or movements in the market conditions.

### 9.1 Stress Testing Framework

As part of ICAAP, EFCL shall conduct relevant stress tests across material risk dimensions to evaluate its vulnerability to unlikely but plausible events or movements in the market conditions that could have an adverse impact on its business operations and overall capital adequacy.

EFCL shall use stress testing framework to:

- Assist the Board / GRMC / senior management in risk identification and control, complementing other risk management tools, improving capital and liquidity planning and facilitate in business decision-making
- Alert the management against adverse unexpected outcomes related to its material risks and provide an indication for additional capital that might be needed to absorb losses; should severe shocks occur
- Seek to provide forward-looking assessments to its risks and facilitate monitoring

- Assess the ability to withstand stressed situations resulting from unexpected losses in terms of profitability, liquidity, and capital adequacy
- Facilitate the development of risk mitigation or contingency plans across a range of stressed conditions

Stress testing framework shall be designed at par with the nature and scale of business. As part of ICAAP implementation, EFCL shall focus on establishing a robust stress testing framework and ensure coverage across all material risk dimensions. The stress testing framework shall meet regulatory requirements as well as be an integrated part of risk management and business decision-making.

## 9.2 Stress Testing Process & Analysis

Stress scenarios, based on the severity of change in the risk drivers, would be classified as having low, medium, or high impact and that would be assessed in terms of additional capital requirement, and profitability. Finally, impact of all the material risks under different stress scenarios would be aggregated and would be translated in terms of its impact on capital adequacy ratios.

## 9.3 Stress Testing Methodology

EFCL shall define a set of stress scenarios, assumptions, and risk factors at par with the complexity of its nature of business, risk management objectives, and recommendation of regulators.

Each iteration of stress testing shall begin by determining the risks to which the process will be applied. The identification of such risks shall be largely based on EFCL's portfolio composition, while analysing the impact of external economic factors that may affect its capital position. Post identification of material risks to be stress tested, relevant factors shall be further identified within each risk category.

## 9.4 Types of Stress Tests

This section provides an indicative list of stress tests that EFCL may adopt that should be subject to stress testing. These drivers include:

Type of Risk	Indicative stress scenarios
Credit Risk	Deterioration in asset quality (i.e. transfer from stage 1 to stage 2 and stage 2 to stage 3/NPA)
	Increase in provisioning rates
Interest Rate Risk	Changes / increased volatility in interest rates
Liquidity Risk	Increase in Funding Costs
	Premature withdrawal of debentures/ borrowings
	Increased haircuts on investments

EFCL's Finance Head shall review and update the stress scenarios periodically, while assessing the relevance / materiality of risks faced by the Company. New scenarios / risks may be introduced for stress testing, as required, post approval from the GRMC. Incremental changes to EFCL's stress testing universe shall be duly documented in subsequent versions of this policy.

### **9.5 Uses of Stress Testing**

EFCL shall use stress testing for assessment of its capital adequacy, liquidity, and key profitability ratios. Results from stress testing analysis shall be utilized to impact decision making, regarding business strategies and day-to-day operations, at appropriate managerial levels.

### **9.6 Frequency of Stress Testing**

EFCL aims to determine the frequency of stress testing in conjunction with the complexity of the nature and size of its business. As part of prudent risk management practice, stress testing exercise will be carried out on an annual basis. However, the frequency shall be increased during times of financial distress, or as per the discretion of Group Risk Management Committee and Board of Directors.

### **9.7 Remediation of Adverse Results**

Board of Directors and GRMC shall direct EFCL's Finance Head to take remedial measures considering the level of risk exposures, as revealed by results of stress tests.

Remedial actions shall include:

- Reviewing exposure limits
- Reconsidering the funding policy
- Activating contingency funding plan
- Building up on additional buffer of capital.

## **10. ICAAP Implementation**

The Risks Management Framework is managed by the various committees set up by the Board.

The ICAAP exercise shall involve Senior Management and Board of Directors with responsibilities for its design and implementation, as stipulated by RBI. Further, as ICAAP is a firm-wide risk assessment, it shall involve various departments of the organization and shall encompass activities right from collecting data to finalization of reports.

Respective departments will provide data for assessment of various risks under Pillar II. Quantitative and qualitative assessment of those risks will be carried out in consultation with the concerned department and accordingly ICAAP Document will be finalized.

## **11. Testing and Adoption of ICAAP**

The ICAAP is a Board driven function. All the risk policies, procedures and processes are cleared by the GRMC of the Board. The management actions are basically top down. The

corporate plan, capital planning and other strategic decisions are set by the top management for the ensuing year.

In the stress testing exercise the impact of various scenarios on the Capital Adequacy Ratio of the Company are appraised to the Top Management.

In addition to current internal audit scope, the reviews with respect to ICAAP regulatory requirements should also be covered as part of internal audit plan. Areas of review shall include:

- Review ICAAP Document and ensure that they are compliant with ICAAP policy for EFCL. Internal audit process should also encompass the review of risk assessments carried out for preparation of ICAAP Document.
- Ensure existence of appropriate and effective internal control structures, particularly with regard to the risk management processes followed by EFCL to comply with regulatory requirements.

Refer Annexure I of this document for an illustrative outline for the ICAAP Document as per RBI requirements.

## **12. Use of the ICAAP within the Company**

Use of ICAAP in the Company is an area of great regulatory interest. The regulator desires that CICs should not only define an ICAAP suitable to their size and complexity but also integrate it substantially in their day-to-day management of business, short term and long term decision makings of the Company. The ICAAP process should include participations across the Company departments and should not be restricted only to be a risk management device. The overall responsibility for the ICAAP shall be assigned to Company's Board, which shall ensure that the Company's risk-bearing capacity is secured and that all material risks are measured and limited.

## **13. Aggregation and diversification**

Company's overall capital requirement is thus the summation of the capital required for each of the individual material risks identified. Company has adopted a conservative approach currently and not claimed any benefit of diversification. Company intends to take a view on the benefits of diversification while enhancing its risk management capabilities.

## **14. Management Action**

In case of such adverse situation, the Company will take the following remedial measures:

1. Company will explore to have a line of credit.
2. Company will request additional infusion of capital from the Parent
3. Any other action as suitable

The management actions undertaken in the current year will be reported in the ICAAP Document.

## 15. Conclusion

### Adequacy of the risk management processes

The Company has a risk management process that actively identifies, assesses and manages its risks. The Company also has a holistic assessment and management of its risks.

As part of ICAAP exercise, capital adequacy needs to be assessed in context of capital planning exercise as well. Adequate monitoring framework shall be in place to trigger capital raising initiative if there is a shortfall in the capital adequacy level. This trigger should also be sensitive to significant revisions in business growth, changes in delinquency levels, macro-economic environment, and corporate actions of competitors. Expected changes in the business profile/ environment, projected business plans and financial position, and the requirement of capital arising thereby shall be considered under ICAAP.

While consolidating its current practice of capital planning under ICAAP assessment, EFCL shall assess its capital requirement for various risks that it is exposed to and will accordingly compute the capital adequacy ratio. It shall need to forecast its capital adequacy ratio under stressed scenarios to ensure that it has sufficient capital to meet the regulatory requirements. In case the capital adequacy ratio falls below a certain threshold defined by the management and approved by the Board, the Company shall actively initiate the fund-raising process.

EFCL shall strive to monitor its risks periodically and shall maintain the target capital levels on an ongoing basis.

*Table 1- ICAAP Summary*

Parameter	As per ICAAP of last year	Actual for current year	Difference
Advances			
Borrowings			
PAT			
Capital			
RWA			
<b>Capital Adequacy Ratio (Adjusted Net Worth / RWA)</b>			

## **16. Policy Administration**

### **Applicability, Review and Approval of the Policy**

This policy comes into effect immediately on approval by the Board of Directors of the Company. This policy will be approved by the Board of Directors through GRMC, on an annual basis or more frequently, as deemed necessary due to changes in business, regulatory or market conditions.

### **Policy Adoption**

Group Risk Management Committee is responsible for owning and maintaining this policy. GRMC will engage with relevant departments to make necessary updates to the policy. Any enquiries related to this policy or request for addition / deletion of any provision shall be addressed to GRMC which will evaluate such requests and if considered necessary, additions and / or amendments will be made and notified to all the departments concerned.

### **Policy Non-compliance Issues**

Each department is required to self-evaluate its own procedures to ensure compliance with the requirements of this policy. All requests for policy exceptions must have an action plan and time frame for compliance with this policy, or must have expiration or review date.

Exclusion of any function / department from the scope of this policy is to be approved by the Board and reported to GRMC with reasons recorded in writing based on the explanation given by the respective function / department.

Group Risk Management Committee is to maintain a list of all approved exceptions, and must notify the Board, of material policy exceptions along with any material policy non-compliance issue.

## Annexure I

An illustrative outline of ICAAP Document is as follows:

### 1. What is an ICAAP Document?

The ICAAP Document would be a comprehensive report furnishing detailed information on the ongoing assessment of EFCL's entire spectrum of risks, how it intends to mitigate those risks and what amount of current and future capital is necessary, reckoning other mitigating factors. The purpose of the ICAAP Document is to apprise the Board of Directors on these aspects, and to explain EFCL's internal capital adequacy assessment process and approach towards capital management, to the RBI.

### 2. Contents

The ICAAP Document shall contain the following sections:

- I. **Executive Summary** includes purpose of the report, main findings of ICAAP analysis, brief descriptions of the capital raising and dividend plan, and commentary on material risks faced by EFCL
- II. **Introduction:** includes discussion on EFCL's organizational and business background
- III. **Business Background** includes discussion on EFCL's present financial position, expected changes in business profile, projected financial position, and future planned sources of capital
- IV. **Internal Governance** includes discussion on EFCL's risk governance structure - roles and responsibilities across hierarchy of officials / business verticals
- V. **Material Risk Assessment** includes discussion on identification, assessment, and management of EFCL's material risks - based on its risk appetite and overall risk profile
- VI. **ICAAP Methodology** includes description of EFCL's approach towards ICAAP assessment
- VII. **Stress Testing** includes commentary on stress testing procedures, scenarios for sensitivity and impact analysis, results of this exercise and impending implications on EFCL's business / risk profile
- VIII. **Capital Planning and Allocation** includes EFCL's current practices regarding capital planning, in alignment with current and expected business profiles
- IX. **Adoption and Communication** includes discussion on procedures for ongoing adoption of ICAAP analysis in EFCL's business operations, and communication of the same thereof.

## Annexure II

The Company shall report the relevant key financial indicators in the ICAAP Document using the below format:

*Table 2- Key Financial Indicators*

Parameter	Last year	Current Year	Growth
Advances			
Total Borrowings			
Gross NPA			
Net NPA			
Net Profit			
Yield on advances			
Net Interest Margin			
Return on Average Assets			
Total Capital			
Risk Weighted Assets			
Capital Adequacy Ratio (Adjusted Net worth/ Risk Weighted Assets)			
Leverage Ratio (Times) (outside liabilities/ Adjusted Net worth)			
Investments in equity shares and compulsorily convertible instruments of group companies as a proportion of net assets			
Investments & loans to group companies as a proportion of Net Assets			

### Annexure III

The ICAAP document shall present the current financial position of the Company in the below format:

*Table 3- Balance Sheet as on the last financial year end*

Particulars	Amount (INR Cr)
<b>Assets</b>	
<b>Financial Assets</b>	
Cash and cash equivalents	
Bank balances other than cash and cash equivalents	
Loans	
Investments	
Other financial assets	
<b>Non-Financial Assets</b>	
Current tax assets (net)	
Deferred tax assets (net)	
Property, plant and equipment	
Other non-financial assets	
<b>Total Assets</b>	
<b>Liabilities and Equity</b>	
<b>Liabilities</b>	
<b>Financial Liabilities</b>	
Trade Payables	
Debt securities	
Borrowings (other than debt securities)	
Subordinated liabilities	
Other financial liabilities	
<b>Non-Financial Liabilities</b>	
Current tax liabilities (net)	
Provisions	
Other non-financial liabilities	
<b>Equity</b>	
Equity share capital	
Other equity	
<b>Total liabilities and equity</b>	

Table 4- Profit & Loss Statement as on the last financial year end

Particulars	Amount (INR Cr)
<b>Revenue from operations</b>	
Interest income	
Fees and commission income	
Net gain on fair value changes	
<b>Total revenue from operations</b>	
Other Income	
<b>Total Income</b>	
<b>Expenses</b>	
Finance costs	
Impairment on financial instruments	
Employee benefits expense	
Depreciation and amortisation expenses	
Other expenses	
<b>Total expenses</b>	
<b>Profit/(loss) before tax</b>	
Tax expense	
<b>16.1 <u>Current Tax</u></b>	
<b>16.2 <u>Deferred Tax</u></b>	
<b>Profit/(loss) after tax</b>	
<b>Other comprehensive income (OCI)</b>	
Items that will not be reclassified to profit or loss:	
Items that will be reclassified to profit or loss in subsequent:	
<b>Total other comprehensive income for the year (net of tax)</b>	
<b>Total comprehensive income for the year</b>	

## Annexure IV

Format of projected financial position is as follows:

*Table 5- Projected Balance Sheet of EFCL*

<b>Edel Finance Company Limited</b>				
<b>(INR Cr)</b>	<b>Current Year(A)</b>	<b>Year 1 (E)</b>	<b>Year 2 (E)</b>	<b>Year 3 (E)</b>
<b>Assets</b>				
<b>Financial Assets</b>				
Cash and cash equivalents				
Bank balances other than cash and cash equivalents				
Loans				
Investments				
Other financial assets				
<b>Non-Financial Assets</b>				
Current tax assets (net)				
Deferred tax assets (net)				
Property, plant and equipment				
Other non-financial assets				
<b>Total Assets</b>				
<b>Liabilities &amp; Equity</b>				
<b>Liabilities</b>				
<b>Financial Liabilities</b>				
<b>Edel Finance Company Limited</b>				

(INR Cr)	Current Year(A)	Year 1 (E)	Year 2 (E)	Year 3 (E)
Trade Payables				
Debt securities				
Borrowings (other than debt securities)				
Subordinated liabilities				
Other financial liabilities				
<b>Non-Financial Liabilities</b>				
Current tax liabilities (net)				
Provisions				
Other non-financial liabilities				
<b>Equity</b>				
Equity share capital				
Other equity				
<b>Total Liabilities and equities</b>				

Table 6- Project Profit and Loss Statement of EFCL

<b>Edel Finance Company Limited</b>				
(INR Cr)	Current Year(A)	Year 1 (E)	Year 2 (E)	Year 3 (E)
<b>Revenue from operations</b>				
Interest income				
Fees and commission income				
<b>Edel Finance Company Limited</b>				
(INR Cr)	Current Year(A)	Year 1 (E)	Year 2 (E)	Year 3 (E)
Net gain on fair value changes				
<b>Total revenue from operations</b>				
Other Income				
<b>Total Income</b>				
<b>Expenses</b>				
Finance costs				
Impairment on financial instruments				
Employee benefits expense				
Depreciation and amortisation expenses				
Other expenses				
<b>Total expenses</b>				
<b>Profile/(loss) before tax</b>				
Tax expense				
a. Current tax				
b. Deferred tax				
<b>Profit/(loss) After Tax</b>				

<b>Other comprehensive income (OCI)</b>				
Items that will not be reclassified to profit or loss:				
Items that will be reclassified to profit or loss in subsequent:				
<b>Total other comprehensive income for the year (net of tax)</b>				
<b>Total comprehensive income for the year</b>				