

## PROVISIONING POLICY

### DOCUMENT CONTROL

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### **Statement of Confidentiality**

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**CHANGES MADE IN THE CURRENT VERSION SINCE THE LAST APPROVED POLICY**

<b>SI No</b>	<b>Change</b>	<b>Section</b>	<b>Reference Page No</b>
<b>1.</b>	Added - loans are classified into appropriate cohorts based on homogeneous risk attributes for PD and LGD calculation	-	8 and 10

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## **1. Introduction**

### **1.1 Background**

Ind AS 109 is the new accounting standard that requires impairment of financial assets to be based on expected loss calculations. Globally, IFRS 9 replaced the IAS 39 incurred loss model with an expected credit loss (ECL) methodology from 1<sup>st</sup> January 2018. Under this methodology, impairment loss on financial assets must be recognized from the date of origination depending on the credit quality of the asset.

### **1.2 Scope**

This policy intends to address the governance standards, models and coverage of impairment process of Satin Finserv Limited ('the company').

### **1.3 Policy Ownership**

This policy is developed by the Finance and Accounts Department. Any enquiries related to this policy or requests for additions/deletions of any points should be addressed to the Finance and Accounts Department. The department will evaluate such requests and if deemed necessary, additions/amendments will be issued after taking the requisite approval.

### **1.4 Reference Documents**

For adherence to regulation, guidelines published by the Ministry of Corporate Affairs (MCA) and the Reserve Bank of India (RBI) have been referred to in this policy. All the technical references made in this policy are derived from the Institute of Chartered Accountants of India (ICAI) and applicable guidance within Ind AS 109. Basel papers issued on this matter have been considered where applicable and consistent with the requirements of Ind AS 109. These sources of references are aimed to assist the company in implementation and transition.

The impairment requirements apply to financial assets measured at amortized cost and Fair Value Through Other Comprehensive Income (FVOCI). Equity instruments (subsequently measured either at Fair Value Through Profit or Loss (FVTPL) or designated as FVOCI) are excluded for the purpose of impairment.

## **2. Governance Framework**

This section specifies the summary of roles and responsibilities to the extent of this policy.

### **a) Board of Directors**

One of the major responsibilities of the Board pertaining to Ind AS 109 impairment includes the approval of the Ind AS 109 impairment framework, policy and further delegating responsibilities for key decision making and controls to appropriate personnel, units or committees.

### **b) Audit Committee of the Board**

The main roles and responsibilities of the Audit Committee of the Board (hereby referred to as 'ACB') will be as follows:

- (i) Ensure that RBI regulations are adequately reflected in policies, procedures and

guidelines.

- (ii) Review and confirm the final ECL submitted is properly and adequately reflecting the guidelines.
- (iii) Review and approve any overrides made to the ECL models. Competent authorities may consider overrides in a situation where, for a data input, there are anomalies or incomplete data. Also, the company may consider overriding based on management experience.

**c) Chief Financial Officer**

The Chief Financial Officer (CFO) has been entrusted with the responsibility of recommending and setting the IFRS 9 Impairment guidelines and thereafter of monitoring them periodically to ensure that recommended requirements are adhered to. The specific responsibility includes:

- (i) Review and approve, or ratify the methodology, measures, targets, and tolerances associated with the Ind AS 109, such that the established strategic objectives are achieved.
- (ii) Review the amendments made to ensure compliance to the recommendations/observations of the auditors.
- (iii) Review and sign-off on the ECL numbers.

The CFO along with the Credit & Risk department and Finance & Accounts department shall meet on regular intervals, at least quarterly, in order to assess and take a decision on the provisioning requirements.

**3. Disclosures and Reporting**

The company will disclose information related to ECL in the annual report. The Finance and Accounts department is responsible to ensure compliance with the MCA and RBI mandated rules.

The ECL computed every quarter will be reviewed and the results/ reports will be shared with the relevant stakeholders. This valuation will help management to analyze the various portfolio movements and stressed assets and take suitable actions.

**4. Segmentation of Portfolio for ECL Measurement**

Adaptation of the Expected Credit Loss (ECL) requires the groupings of the financial assets of the company into segments and sub-segments wherever applicable. The company shall segment its portfolio to ensure that each segment has homogenous characteristics and are captured by respective models. This is done to account for the differences in risk between segments and sub-segments.

Segments shall be updated in below situation:

- (i) If a new portfolio is introduced by the company; or
- (ii) If a current portfolio is discontinued by the company

In addition to the above, in case of change in risk characteristics of any of the portfolios or change in business model of the company, it shall amend the current portfolio segments. The same shall require requisite approvals of the Board, upon its complete satisfaction regarding the reasons for the amendment in the segments.

**5. Staging and Significant Increase in Credit Risk (SICR)**

The process of Expected Credit Loss calculation broadly encompasses the following steps to derive the loss:

- Staging and Segmentation
- Expected Credit Loss computation which is a product of the following:
  - PD - Probability of Default (12-month or lifetime)
  - LGD - Loss Given Default (derived from company's data or as per regulatory guidelines)
  - EAD - Exposure at Default

The Staging and Segmentation process and the ECL calculation (including understanding and computation of PD, LGD and EAD) is described individually in further sections.

## 5.1 Definition of Default and SICR

### **Default definition as per Ind-AS 109**

The term default is not defined in Ind AS 109. SFL, as per Ind AS 109, considers facilities with days past due greater than 90 to have defaulted.

### **Significant increase in credit risk (SICR) Ind AS 109**

The term significant increase has not been defined in Ind AS 109. The assessment of SICR is required for staging the portfolio and basis the staging, the calculation of the one year or Lifetime ECL is determined. Assessment of whether there has been a significant increase in credit risk is required to be carried out at each reporting date.

### **Current approach for SICR**

SFL, as per Ind AS 109, considers facilities with days past due greater than 30 days to have undergone a significant increase in credit risk.

## 5.2 Staging Assessment

Ind AS109, the standard outlines a 'three-stage' model ('general model') for impairment based on changes in credit quality since initial recognition.

### **Stage 1:**

If an exposure's credit risk has not increased significantly since initial recognition ('Stage 1'), then the company recognizes only 12-month ECL as a loss allowance. For financial instrument, as soon as it is originated or purchased, 12-month expected credit losses are recognized in profit or loss statement and a loss allowance is established. For financial assets, interest revenue is calculated on the gross carrying amount (i.e. without adjustment for expected credit losses).

$$PD * LGD * EAD * D_f$$

$D_f$ : Discounting Factor

### **Stage 2:**

If the exposure has suffered a significant increase in credit risk (SICR), then the company recognizes a loss allowance equal to lifetime ECLs. Therefore, the assessment – especially for longer dated portfolios – can have a significant impact on reported earnings and equity. If

the credit risk increases significantly and the resulting credit quality is not considered to be low credit risk, full lifetime expected credit losses are recognized. For financial assets under this category, interest revenue is calculated on the gross carrying amount (i.e. without adjustment for expected credit losses). The PD applied to Stage-2 are the marginal PDs (MPD) for the respective periods.

$$\sum_{k=1}^M MPD(k) * EAD(k) * LGD * Df$$

**Stage 3:**

If the credit risk of a financial asset increases to the point that it is considered credit-impaired then same is included in Stage 3. Financial assets in this stage are individually or collectively assessed. Lifetime expected credit losses are still recognized on these financial assets.

**Current Approach for Staging:**

The company has considered days past due as staging criteria for each portfolio. The staging definition is as under:

**Stage 1:** The loans with low credit risk, using a quantitative trigger of 0-30 days past due loans.

**Stage 2:** The loans with significant increase in credit risk, using a quantitative trigger of 31-90 days past due loans.

**Stage 3:** Credit impaired loans, using a quantitative trigger of 90+ days past due loans.

**5.3 ECL Computation Methodology**

Ind AS 109 does not prescribe a single method to measure expected credit losses. The method used could vary based on the type of financial asset and information available.

The Expected Credit Loss (ECL) is calculated separately for each portfolio segment as:

$$ECL = PD * EAD * LGD * Df$$

**12-month expected credit losses**

12-month expected credit losses are all cash shortfalls that will result if a default occurs in the 12 months after the reporting date or a shorter period as if expected life of a financial instrument is less than 12 months weighted by the probability of that default occurring.

On initial recognition of a financial asset in scope, the company recognizes expected credit loss using 12 month expected credit losses i.e. probability of default over the period comprising 12 months from the reporting date.

**Life-time expected credit losses**

Lifetime expected credit losses are those that result from all possible default events over the expected life of the financial instrument.

The term default is not defined in Ind AS 109. Accordingly, default will have to be defined in a manner consistent with that used for internal credit risk management purposes.

For example:

- a. It may be appropriate to consider assets to be in default if a contractual payment is not made when it is due,
- b. Default may occur if a borrower breaches a loan covenant, which may occur before any contractual payment is missed.

### **Macro-Economic Variable**

- By testing the statistical significance of the portfolio, macro-economic variables are selected for forecasting the PDs for the company. The macro-economic data published by EIU or any other similar organisation is taken.
- The future estimates of the variables are stressed in both positive direction (best-case scenario) and in the negative direction (worst-case scenario). Based on the economic scenario, stress applied in the positive direction will be 5-10% and in the negative direction will be 10%-25%.
- An average and standard deviation of the historical values of the variable is computed. Based on the same, a z-value is computed for the estimated/ forecasted values of the variable by standardizing the estimated variable value with the average and standard deviation of the historical values. These z-values are computed for each scenario (best and worst) and these act as an input for estimating forward-looking PD as mentioned in the PD section. The final factor is arrived by applying the weights on the individual z-factors.

While forecasts for the macro-economic variables is available on EIU, in case the maturity period of the portfolio is more than the period for which estimates are available, mean reversion will be used for estimating the value of macro-variable for further years.

### **Probability of Default**

The PD defines the probability that the borrower will default in the future. PD used for ECL shall reflect management's current view of the future and should be unbiased (i.e. it shall not include any conservatism or optimism).

Two types of PDs are used for calculating ECLs:

- **12-month PDs** – This is the estimated probability of default occurring within the next 12 months (or over the remaining life of the financial instrument if that is less than 12 months). This is used to calculate 12-month ECL for 'Stage 1' exposures.
- **Lifetime PDs** – This is the estimated probability of a default occurring over the remaining life of the financial instrument. This is used to calculate lifetime ECL for 'Stage 2' exposures.

### **Computation Methodology**

#### **Data Availability**

For the purpose of PD computation, the Company classifies loans into appropriate cohorts based on homogeneous risk attributes.

The company considers month-on-month outstanding balances across different DPD buckets considering the below:

- The outstanding balances include balances for portfolio for last 5-years.
- In the loan balances, the company considered the impact of moratorium provided as part

of COVID 19 guidelines issued by RBI for the period of March 2020 to Aug 2020.

**Historical PD – Net Flow Rate approach**

Historical PD is computed using the net flow rate approach. Flow Rates are the count of outstanding balances that go from being current or moderately past due to significantly past due. Individual accounts are not tracked, only the volume against a particular bucket is tracked. This approach has been captured in the following three steps given below:

- **Step 1:** Capturing the total outstanding within each delinquency bucket on a month on month basis for last 5 years.
- **Step 2:** Computation of the average observed flow rate for each bucket. The average observed flow rate is computed as the percentage of outstanding in a delinquency bucket that has transitioned forward to the next worse delinquency bucket in the next month. This flow rate is computed for every month for all the DPD buckets and an average across all the months is taken to generate a single flow rate for the DPD bucket. This computation is repeated for all the delinquency buckets before default. For the period of Mar’20-Aug’20, the flow rates have been forced to 0 as it was the moratorium period and no DPD movements were there.
- **Step 3:** Computation of the delinquency bucket wise PD. The PD for each delinquency bucket is computed as the product of the average flow rates until the bucket of default is reached.

$$PD \text{ in Bucket} = \text{Average Flow rate } (B_i \text{ to } B_{i+1}) \times \text{Average Flow rate } (B_{i+1} \text{ to } B_{i+2}) \times \dots \times \text{Average Flow rate } (B_{i+k-1} \text{ to } B_{i+k})$$

where  $B_{i+k}$  is the last bucket before default.

**Forward Looking PD**

The above calculated PDs are used as historical PDs. Vasicek single factor approach is used for computation of forward-looking PD. The detailed methodology of the same is explained below:

**Vasicek approach**

- Historical PDs are computed using the net flow rate approach as per the approach mentioned in the above section.
- Macro Variable considered for this portfolio is ‘Consumer Prices’ and ‘Real GDP (% change p.a.)’ as sourced from Economist Intelligence Unit (EIU). The weights assigned to the variables are 50% each as per the management’s assessment of the applicability of the variables in the portfolio.
- The Point in Time (PIT) PDs for future years are estimated based on the Vasicek methodology by establishing a link between TTC PD and the selected macro-economic variable as per the below formula:

$$NORM.S.DIST ((NORM.S.INV (TTC PD) - SQRT (AC) * X \%) / (SQRT (1 - AC)))$$

where,

- TTC PD: Through the Cycle PD
- Asset correlation (AC):  $0.12 * (1 - EXP(-50 * TTC PD)) / (1 - EXP(-50)) + 0.24 * (1 - (1 - EXP(-50 * TTC PD)) / (1 - EXP(-50)))$

- X: z-value of the macro-economic variable selected.
- The PIT PDs estimated above are referred to as ‘Base’ case estimates. ‘Best’ case and ‘Worst’ case PIT PDs are estimated by considering z-value of the stressed macro-economic variable.
- Marginal PDs for future years are computed for each scenario (base, best and worst) from the estimated PIT-PDs using the below formula:

$$\text{Marginal PD (Y1)} = \text{PD(Y1)}$$

$$\text{Marginal PD (Yi)} = 1 - (\text{MPD Y1} + \dots + \text{MPD Yi-1}) \times \text{PD Yi}$$

### **Loss Given Default**

The LGD is computed on the historical recovery data for the company for each portfolio. In case of secured portfolio, as collateral is also available, the same is also considered in addition to the historical recovery data.

As the company does not have sufficient data on recovery given the low vintage of portfolio, the company will use LGD reference data given by the RBI or any other external agencies.

### **Computation Methodology**

For the purpose of LGD computation, the Company classifies loans into appropriate cohorts based on homogeneous risk attributes.

Details of all the accounts present in the book as on the computation date are considered for LGD computation.

- Values corresponding to the POS, portfolio type and collateral values are used for computation.
- Below haircuts will be applied on the collaterals:
  - Property – 50%
  - Book Debt- 70%
  - Cash Margin – 0%
- The values after haircuts for Book Debt and Cash Margin are subtracted from the POS in order to arrive at the unsecured portion.
- For accounts where the collateral is a residential property, the LGD is computed based on the unsecured portion. LGD of 65% is applied on the unsecured portion of the account and based on the overall collateral coverage, the final LGD is computed. The minimum LGD of 20% is kept for all the accounts.
- For accounts other than above, the LGD is computed based on collateral coverage by property. The minimum LGD for these cases will be 50% and the maximum LGD is 65% based on the collateral coverage.
- Cases where FLDG is available, the final unsecured amount is adjusted in order to calculate the final loss amount in case of default.

### **Final LGD**

- Final LGD is computed by taking a weighted average of the account wise LGD and the Principal outstanding amount.

**Exposure at Default**

EAD is seen as an estimation of the extent to which a financial institution may be exposed to a counterparty in the event of, and at the time of, that counterparty’s default. The EAD is taken as per the stage of the exposure as appended below:

- **Stage 1:** For stage-1 exposure (0-30DPD), as only 12-month ECL is computed, the outstanding values as on the reporting date is used as EAD.
- **Stage 2:** For stage-2 exposure (31-90DPD), as lifetime ECL is computed, the outstanding values throughout the life of the accounts are used for ECL computation.
- **Stage 3:** For Stage-3 exposures (90+ DPD), as 100% PD is applied, outstanding values as on the reporting date is used as EAD.

**Discounting Factor**

Discounting factor (*Df*) is computed using the estimated Effective Interest Rate (EIR) of the portfolio and is used as a component in the ECL computation to arrive at the present value of future expected loss. The company is using the EIR for the respective portfolios to arrive at the discounted ECL.

**ECL and probability-weighted scenarios**

Expected Credit Loss measurement under IndAS-109 requires the company to model their ECL number as per the forward-looking scenarios considering the possibility of good and bad economic conditions.

Hence, the ECL numbers will be a probability-based outcome from the three scenarios i.e. Base Case, Best Case and Worst Case.

Computation Methodology:

- For all portfolios, ECL is computed using the below formula:

$$ECL = PD * EAD * LGD * Df$$

The best and worst cases have been assigned probabilities (weights) as below:

Case	Probabilities (Weights)
Base	65%
Best	10%
Worst	25%

The weights have been assigned by taking into consideration the stress given to macro factors and the current economic scenario. The company may change these weights as and when required based on the macro economic environment.

The final probability weighted ECL is calculated as a weighted average using the above weights as per the formula below:

$$\text{Probability Weighted ECL} = W_{\text{Base}} * ECL_{\text{Base}} + W_{\text{Best}} * ECL_{\text{Best}} + W_{\text{Worst}} * ECL_{\text{Worst}}$$

**Management Overlay**

The company believes that the complexity and limitations of ECL model may not fully capture all relevant credit risks and hence, management may apply overlay to address these gaps. Any overlay, if applied will be placed before the Audit Committee of the Board for approval.

**6. RBI Guidelines on provisioning**

The below is as per the RBI’s extant prudential norms on Income Recognition, Asset Classification and Provisioning (IRACP).

**a) Standard asset provisioning**

The company shall make provisions for standard assets at 0.40 percent of the outstanding, which shall not be reckoned for arriving at net NPAs. The provision towards standard assets need not be netted from gross advances but shall be shown separately as ‘Contingent Provisions against Standard Assets’ in the balance sheet.

**b) Doubtful and Loss Asset**

The company, after taking into account the time lag between an account becoming non-performing, its recognition as such, the realisation of the security and the erosion over time in the value of security charged, make provision against sub-standard assets, doubtful assets and loss assets as provided hereunder

- I. **Loss Asset** - The entire asset shall be written off. If the assets are permitted to remain in the books for any reason, 100% of the outstanding shall be provided for.
- II. **Doubtful Assets** - (a) 100% provision to the extent to which the advance is not covered by the realisable value of the security to which the company has a valid recourse shall be made. The realisable value is to be estimated on a realistic basis; (b) In addition to item (a) above, depending upon the period for which the asset has remained doubtful, provision to the extent of 20% to 50% of the secured portion (i.e. estimated realisable value of the outstanding) shall be made on the following basis:

Period for which the asset is considered as doubtful	% of provision
Up to one year	20
One to three years	30
More than three years	50

- III. **Sub-standard assets** - A general provision of 10% of total outstanding shall be made.

All loan asset are classified into secured and unsecured for calculation of provision. Post the classification, based on the performance of the portfolio, provision are created as follows.

Particulars	Months Past due	Provisioning Required	
		Unsecured	Secured
Standard Asset	0-3 Months	0.40%	0.40%
NPA	overdue >3 Months		
Substandard Asset	>3-12 Months	10%	10%
Doubtful Asset	>12 - 24 Months	100%	20%
	>24 - 51 Months		30%
	>51 Months		50%
Loss Asset			Write off/100% Provisioning

## 7. Prudential Floor for ECL

The company shall hold impairment allowances as required by Ind AS. In parallel, the company will also maintain the asset classification and compute provisions as per RBI's extant prudential norms on Income Recognition, Asset Classification and Provisioning (IRACP). A comparison between provisions required under IRACP and impairment allowances made under Ind AS 109 will be disclosed by the company in the notes to its financial statements as specified in Appendix II-A of the Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023, to provide a benchmark on the adequacy of provisioning for credit losses.

Where impairment allowance under Ind AS 109 is lower than the provisioning required under IRACP, the company shall appropriate the difference from its net profit or loss after tax to a separate 'Impairment Reserve'. The balance in this reserve will not be reckoned for regulatory capital.

## 8. Policy Review and Adoption

This policy will be reviewed at least annually and as and when the competent authority issues new guidelines or notifications related to impairment calculation. The changes will be approved by the Board of the company.