

## **Basel - Pillar 3 Disclosures at December 31, 2016**

IDFC Bank Limited (hereinafter referred as the “Bank” or “IDFC Bank”) was incorporated on October 21, 2014 as a Company under the Companies Act, 2013. Further to the grant of the banking license by the RBI on July 23, 2015 and approval of the Scheme of Arrangement between IDFC Limited and IDFC Bank Limited and their respective shareholders and creditors, IDFC Bank Limited commenced its Banking operations on October 1, 2015. As per the Scheme of Arrangement, the entire financial undertaking of IDFC Limited was transferred to IDFC Bank Limited with effect from October 1, 2015.

IDFC Bank Limited being a newly launched bank has to abide by the directions of RBI on Guidelines for Licensing of New Banks in the Private Sector dated February 22, 2013. As per the guidelines the Bank is required to maintain a minimum capital adequacy ratio of 13 per cent of its risk weighted assets (RWA) for a minimum period of three years after commencement of its operations, subject to any higher percentage as may be prescribed by RBI from time to time. This document covers the Capital Adequacy Status for IDFC Bank. It also describes the Risk Process and Governance at the Bank to effectively on-board, monitor and report risk.

### **I. Scope of Application**

The Basel III Capital Regulation (“Basel III”) is applicable to IDFC Bank. The bank aims to operate within an effective risk management framework to actively manage all the material risks faced by the Bank, in a manner consistent with the Bank’s risk appetite.

The Bank has acquired 100% equity share capital of Grama Vidiyal Microfinance Limited, a non-banking finance company - microfinance institution (NBFC-MFI). On receipt of final approval from RBI and satisfaction of all the conditions, Grama Vidiyal Microfinance Limited has become a wholly owned subsidiary of the Bank with effect from October 13, 2016. All the disclosures pertain to IDFC Bank as a standalone Entity.

### **II. Capital Adequacy**

IDFC Bank has developed a strong risk management framework to assess and monitor its credit, market and operational risk that is inclusive of its risk culture, risk governance, policies & procedures and risk technology. The Pillar I RWA Calculation covers the following risks

- 1) Credit Risk in Banking Book (Using Standardized Approach)
- 2) Market Risk in Trading Book (Using Standardized Approach)
- 3) Operational Risk across the Bank (Using Basic Indicator Approach)

IDFC currently maintains a Common Equity Tier 1 (CET1) Ratio of **17.98%** and a Capital to Risk Weighted Assets (CRAR) ratio of **18.39 %**.

In INR Crores

Particulars	Amount
<b>Risk Weighted Asset for Credit Risk</b>	<b>53,851</b>
- <i>On-Balance Sheet Items</i>	43,969
- <i>Non-Market Related Off-Balance Sheet Items</i>	7,011
- <i>Market Related Off-Balance Sheet Items</i>	2,146
- <i>Exposure to QCCP</i>	725
<b>Risk Weighted Asset for Market Risk</b>	<b>18,091</b>
- <i>Interest Rate Risk</i>	12,729
- <i>Equity Risk</i>	4,772
- <i>Foreign Exchange Risk</i>	590
<b>Risk Weighted Asset for Operational Risk</b>	<b>4,761</b>
<b>Total Risk Weighted Asset (RWA)</b>	<b>76,703</b>
Tier 1 Capital	13,792
Tier 2 Capital	313
<b>CET1 Ratio</b>	<b>17.98%</b>
<b>CRAR</b>	<b>18.39%</b>

In addition to the calculation of minimum regulatory capital as per Pillar I, the Bank has also developed an Internal Capital Adequacy Assessment Process (ICAAP) governance model to cover risks over and beyond what is envisaged under Pillar 1. This includes an assessment of capital for risks identified under Pillar II and a stress testing framework to cover stressed scenarios the economy and the Indian banking system might face. The risks covered under Pillar II include

1. Interest Rate Risk in the Banking Book
2. Credit Concentration Risk
3. Liquidity risk
4. Settlement Risk
5. Reputation Risk
6. Business and Strategic Risk
7. Risk of underestimation of credit risk under the standardized approach
8. Internal Rating Model Risk
9. Risk of weakness in credit risk mitigants
10. Information Technology and Information Security Risk

The ICAAP serves as a key guiding tool towards capital management in the Bank. The Bank recognizes that it is still evolving in a new environment and the ICAAP will serve as a vital document for the evaluation of management strategies. The bank intends to conduct back testing when there is sufficient history of data with the Bank. The ICAAP document is prepared on an annual basis and subject to approval by the Board of Directors.

The ICAAP is subject to regular and independent review by Internal Audit Department separately from the SREP conducted by the RBI, to ensure that the ICAAP is comprehensive and proportionate to the nature, scope, scale and level of complexity of the bank's activities and accurately reflects the material risks that the bank is exposed to.

Areas of review include:

- Integrity, accuracy, and reasonableness of the processes
- Appropriateness of the bank's capital assessment process based on the nature, scope, scale and complexity of the bank's activities
- Timely identification of any concentration risk
- Accuracy and completeness of any data inputs into the bank's capital assessment process
- Reasonableness and validity of any assumptions and scenarios used in the capital assessment process
- Conduct of appropriate stress testing

Stress Testing forms an integral part of the ICAAP process and assesses the extent of capital required under various stress scenarios and sensitivity tests envisaged by the Bank. Stress Testing Framework demonstrates how Stress Testing is used to evaluate the impact of various stress situations on the Bank's capital adequacy. The Bank has a Board approved Stress Testing Policy in place that is in line with extant RBI guidelines on stress testing.

### **III. Risk Management at IDFC**

#### **A. Risk Culture**

The Bank promotes a strong risk culture throughout the organisation. A strong risk culture is designed to help reinforce the Bank's resilience by encouraging a holistic approach to management of risk & return and an effective management of risk, capital and reputational profile. The Bank actively takes risks in connection with its businesses. The following principles underpin the risk culture at IDFC Bank:

- 1) Risk taken is approved within the risk management framework
- 2) Risk taken is within a defined risk appetite
- 3) Risk taken is adequately compensated
- 4) Risk is continuously monitored and managed

Employees at all levels are responsible for management and escalation of risks. The Bank expects employees to exhibit behaviour that supports a strong risk culture. The following aspects support the risk culture of the Bank:

**Tone at the top:** Tone at the top refers to communication of risk appetite statements, risk limits and risk strategy and leveraging on the same to identify and prioritise appropriate risk behaviour that is required for building the desired risk culture.

**Accountability:** Accountability refers to clear and transparent communication of roles and responsibilities to committees and staff members across the three lines of defence (LOD) essential for effective risk governance, viz. front office functions, risk management & oversight and assurance roles are played by functions independent of one another with clearly defined responsibilities.

## **B. Risk Infrastructure**

IDFC Bank has developed a comprehensive infrastructure of policies, procedures, people and technology to actively measure, monitor and report risk to the senior management and to the Board. This risk infrastructure is reviewed on periodic basis for completeness, appropriateness to business and alignment to changing risk within the economy and the business.

### **Policies**

A board approved Risk Appetite Framework lays down the risk appetite & boundary for target market, onboarding criteria, portfolio mix including tenor /product mix and other concentration risk parameters. The key policies for IDFC Bank are approved by the Board. In addition to these, several Management Policies and operational manuals have been developed to manage risk. The Board level policies are reviewed on an annual basis by the RMCB while the Management Level policies and manuals are to be reviewed annually by Senior Management.

The Board Policies include Risk Management Policy, Credit (Lending) Policy, Credit Risk Management Policy, Market Risk Management Policy, Operational Risk Management Policy, Fraud Risk Management Policy, ICAAP Policy, ALM Policy, Investment Policy, Forex & Derivative Policy and Portfolio Acquisition Policy.

In addition to the above Policies, the Credit Operations Manuals lays down the detailed processes to be carried out for loan sanction/approval, documentation & credit administration and post disbursement monitoring activities. The Bank maintains a process for identifying Watchlist accounts.

## C. Risk Governance

The Chief Risk Officer manages execution of the Risk Governance Framework at IDFC Bank. The Chief Financial Officer enables assessment and deployment of Capital to various businesses based on the Risk Strategy and the Risk Appetite approved by the Board.

The Bank has set up a robust risk governance framework based on the following key principles:

- While the Board is responsible for the overall governance and the oversight of core risk management, execution strategy is delegated to risk subcommittee of the Board.
- Segregation of duties across the three-lines of defence model whereby front office functions, risk management & oversight and assurance roles are played by functions independent of one another.
- Risk strategy is approved by the Board on an annual basis and is defined based on the –Bank’s Risk Appetite in order to align risk, capital and performance targets.
- All major risk classes are managed via risk management processes including: credit risk, market risk, operational risk, liquidity risk, business risk and reputational risk.
- Policies, processes and systems are in place to enable the risk management capability.
- Risk Management has the appropriate representation on management committees of the Bank and its respective businesses, and other governance forums as appropriate. At these forums, Risk Management’s approval is required for decisions impacting bank’s risk profile.
- Risk monitoring, stress testing tools and escalation processes have been established to monitor the performance against approved risk appetite.

## D. Governance Committees

The Board has delegated authority to the Risk Management Committee of the Board (RMCB) for oversight and review of risk management in the Bank. The RMCB maintains active supervision of the Bank’s exposure, asset quality and risk strategy. Additionally the RMCB reviews the policies, strategies and associated frameworks for risk management, assures independence of Risk Management and constructively challenges the management’s proposals and decisions on all aspects of risk management arising from the Bank’s activities. The RMCB is supported by the following sub-committees to facilitate effective execution of the above responsibilities.

### **Credit & Market Risk Management Committee (CMRC)**

The key purpose of the Credit & Market Risk Management Committee is to oversee implementation of credit risk management framework and market risk management frameworks across the Bank, monitor risk on the Investment portfolio and provide recommendations to the RMCB. The Committee also ensures implementation of the credit risk management policy approved by the Board, formulation, review and

implementation of credit risk appetite, monitor credit risks on a bank wide basis and ensure compliance with the board approved risk parameters/prudential limits and monitor risk concentrations and review 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 Committee is also responsible for Identification, assessment, monitoring, reporting and analysis of market risk associated with Financial Markets Group, formulation of policies, setting of risk parameters and overseeing compliance.

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

The purpose of the Asset Liability Management Committee is to act as a decision making unit responsible for integrated balance sheet risk management from risk-return perspective including strategic management of interest rate and liquidity risks. ALCO reviews asset liability profile of the Bank, assesses liquidity risk and Interest Rate Risk from the ALM perspective and give directives for managing the funding and capital planning including issuance of capital and borrowing instruments. ALCO also approves the methodology for computing the base rate, pricing of assets and liabilities and desired maturity profile of the incremental assets and liabilities.

#### **Operational Risk & InfoSec Risk Management Committee**

The purpose of the Operational and Information Security Risk Management Committee is to oversee implementation of operational risk management framework including fraud risk management across the Bank and provide recommendations to the RMCB. It also helps to identify, assess, monitor and evaluate significant Information Security risk exposure of IDFC Bank and assess management actions to mitigate the bank's exposure in a timely manner

#### **Product and Process Approval Committee**

The Committee is formed to ensure that introduction of new products and processes within the Bank are undertaken in a structured manner, meeting the regulatory requirements for risk assessment.

#### **Audit Committee**

The Committee is constituted to ensure review of MIS related to Compliance and Compliance controls, Internal Audit & Product and Process Approvals on a periodic basis before they are taken up to the Board and/or the Committees of the Board.

#### **Other Management Committees Include**

- IT Governance & Infrastructure Committee
- Business Planning and Strategic Initiatives Committees
- Premises & Outsourcing Committee

- Training, Recruitment and Compensation Committee
- Branding, Culture and Communication Committee

## IV. Credit Risk - General disclosures

### A. Credit Risk Management

Credit risk is the possibility of losses associated with diminution in the credit quality of borrowers or counterparties. In a 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.

As part of Credit risk management, the Bank has

- Established governance framework to ensure an effective oversight, segregation of duties, monitoring and management of credit risks in the Bank.
- Established standards to facilitate effective identification and assessment of credit risk.
- Established standards for effective measurement (measurement of credit risk capital requirements in line with Basel III requirements) and monitoring of credit risk.
- Established principles for portfolio risk management and stress testing.

The Bank provides customized financial solutions to corporates, individuals, small and micro-enterprises, entrepreneurs, financial institutions and the government. With best-in-class corporate governance, rigorous risk management, experienced management and a diversified team, IDFC Bank is uniquely positioned to meet the aspirations of its customers and stakeholders.

### Credit Approval Process

The Banks Credit Policies & Operations Manual forms the core to controlling credit risk in various activities and products.

Wholesale Bank<sup>1</sup>: Credit Risk Unit with support from Business unit and Credit Administration Department (CAD), is entrusted with the responsibility of implementing processes for credit risk identification, assessment, measurement, monitoring and control. Business unit has the responsibility to originate the proposals and prepare the credit approval notes. Risk unit performs an independent appraisal of these notes including highlighting key risks, reviewing and finalising the credit rating, and then submits these notes approval. Credit approvals are done as per the board approved Delegation of Authority. CAD is responsible for managing the credit administration activities, credit documentation and independently

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<sup>1</sup> Wholesale Bank includes Large Corporates, Government Business, Financial Institutions, Middle Market and Financial Markets Group.

monitoring the compliance to sanction terms and conditions. The Credit Operations manual lays down specific responsibilities of each unit – Business, Risk & CAD.

In addition to the above there are also other units like Early Warning Signals (EWS) unit which is responsible for implementing the EWS framework including reporting of EWS, Portfolio Analytics unit which is responsible for execution of portfolio risk management activities including concentration risk monitoring and stress testing as well as supporting the underwriting unit for any portfolio / industry related data inputs and Environment Risk Group (ERG) which is responsible for implementing processes for environmental and social risk identification, assessment, monitoring and review of new transactions and existing portfolio.

**Bharat Plus:**

**SME & Business Banking:** Credit Risk Unit with support from Business unit and Credit Administration Department (CAD) / Operations, is entrusted with the responsibility of implementing processes for credit risk identification, assessment, measurement, monitoring and control. Business unit has the responsibility to originate the proposals and Risk unit performs an independent appraisal & preparation of credit approval notes including highlighting key risks, reviewing and finalizing the credit rating / scoring, and then submits these notes for approval. Credit approvals are done as per the board approved Delegation of Authority.

CAD / Operations is responsible for managing the credit administration activities, credit documentation and independently monitoring the compliance to sanction terms and conditions. The Credit Operations manual lays down specific responsibilities of each unit – Business, Risk & CAD / Operations

In addition to the above there are also other units like Early Warning Signals (EWS) unit which is responsible for implementing the EWS framework including reporting of EWS, Portfolio Analytics unit which is responsible for execution of portfolio risk management activities including concentration risk monitoring and stress testing as well as supporting the underwriting unit for any portfolio / industry related data inputs and Environment Risk Group (ERG) which is responsible for implementing processes for environmental and social risk identification, assessment, monitoring and review of new transactions and existing portfolio. \_

**Secured/Unsecured Products:** Credit risk is approved within the Product Program lending framework. In such programs, the Bank approves maximum levels of credit exposure to a set of customers with similar characteristics and profiles, under clearly defined standard terms and conditions. Such product programs once duly approved basis Delegation of Authority, are implemented for a large set of homogeneous customers within standard operating procedures and underwriting guidelines. Credit Bureaus, Scorecards, verification of customer antecedents through engagement with third party agencies and due diligence on collateral - if applicable, are extensively used for underwriting individual customers basis the approved



Risk appetite. Individual approvals are done as per the approved Delegation of Authority and Risk Based Approval Matrix.

### **Bharat Banking:**

The challenge of credit risk management in Bharat Banking is absence of documented financial statements and lack of collateral to mitigate the credit risk. Therefore, an alternate credit assessment methodology has been adopted supplemented by strong portfolio monitoring. Credit granting process has been defined in Product Programs, and is mainly inclusive of pre-defined customer selection criteria's covering age, income and stability norms. Credit underwriting is performed at branch level after conducting due-diligence of the customer through Residence/business premises visit, reference checks and Bureau Checks. Individual approvals are done as per the approved Delegation of Authority and deviation approval matrix. The accountability of collection has been entrusted with Business team to ensure the quality of the portfolio being sourced.

The portfolio monitoring for both Personal, Business and Bharat Banking portfolios is done at a high level of granularity and segmentation. Remedial strategies are implemented if a loan is identified as an adversely labelled credit, or if there are incipient signs of stress, using credit bureaus as the primary source of information.

### **Risk Monitoring and Reporting**

Credit risk monitoring for the Bank is broadly done at two levels – Account level and Portfolio level. While account monitoring aims to identify weak accounts at an incipient stage to facilitate corrective actions whereas, portfolio monitoring aims towards managing risk concentrations in the portfolio as well identifying stress in certain sectors / industries.

The Bank has also established an Early Warning System (EWS) to identify and act on signs of early sickness in the loan accounts and take necessary corrective actions. Such accounts, where potential distress has been identified, will be included and maintained in a Watchlist and reviewed on a periodic basis by the business and underwriting units so that suitable steps may be taken for mitigation of the risk. The Bank also actively monitors its credit portfolio on non-stress related factors, such as concentration risk, program limits, rating migrations and industry risk analysis.

## **B. Definition of Non-Performing Assets**

IDFC Bank defines an asset as NPA if that asset, including a leased asset, ceases to generate income. IDFC Bank classifies non-performing assets further into the following three categories based on the period for which the asset has remained non-performing:

- i. Substandard Assets
- ii. Doubtful Assets
- iii. Loss Assets

#### Substandard Assets

A substandard asset is one that has remained NPA for a period less than or equal to 12 months. These assets exhibit well defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.

#### Doubtful Assets

An asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, – on the basis of currently known facts, conditions and values – highly questionable and improbable.

#### Loss Assets

A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

### **Criteria for treatment of Account as NPA**

A loan or an advance is identified as a non-performing asset where;

- Interest and / or instalment of principal remains overdue for a period of more than 90 days in the case of a term loan,
- The account remains 'out of order' in the case of an Overdraft / Cash Credit (OD / CC),
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- Interest and / or instalment of principal remains overdue for two crop seasons in the case of short duration crops and one crop season in the case of long duration crops,
- The amount of liquidity facility remains outstanding for more than 90 days, in the case of an undertaken securitisation transaction,
- With respect to derivative transactions, if the overdue receivables, that represent a positive mark-to-market value of a derivative contract, remain unpaid for a period of 90 days from the specified payment due date.

- In case of Interest payments, classify an account as NPA only if the interest charged during any quarter is not serviced fully within 90 days from the end of the quarter.

## **Provisions/write off on loans and other credit facilities**

### **a) On legacy advances- loans acquired on demerger of Financing Undertaking of IDFC Limited**

In addition to the minimum provisioning level prescribed by RBI, IDFC Limited on a prudent basis made provisions on specific advances in infrastructure sector that are not NPAs ('identified advances') but had reason to believe risk of possible slippages on the basis of the extant environment or specific information or current pattern of servicing. These provisions being specific in nature are netted off from gross advances.

At each balance sheet date, these provisions are reviewed and reassessed to determine their adequacy.

### **b) On loans & other credit facilities disbursed after commencement of banking operations**

The bank makes general provisions on all standard advances based on the rates under each category of advance as prescribed by the RBI. The provision on standard asset is not reckoned for arriving at net NPAs. The provisions towards standard advance is not netted from gross advance.

Specific loan loss provisions in respect of non-performing advances are made based on management's assessment of the degree of impairment of wholesale and retail advances, subject to the minimum provisioning level prescribed by the RBI.

In case of corporate loans, provision is made for substandard and doubtful assets at the rates prescribed by the RBI. Loss assets and the unsecured portion of doubtful assets are provided/written off as per the extant RBI guidelines or higher as approved by the management. Provision on retail loans and advances, subject to the minimum provisioning requirement of the RBI are assessed at borrower level, on the basis of ageing of loans based on internal provisioning policy of the Bank.

The Bank considers an account as restructured where the Bank for economic or legal reasons relating to the borrower's financial difficulty, grants to the borrower concessions that the Bank would not otherwise consider. Restructuring would normally involve modification of terms of the advance/securities, which would generally include, among others, alteration of repayment period/ repayable amount/ the amount of instalments/ rate of interest (due to reasons other than competitive reasons). Necessary provision for diminution in the fair value of a restructured account is made in accordance with the RBI guidelines.

### C. Exposure Summary

The following section provides details of all risk exposures held at IDFC Bank.

#### By Facility Type

In INR Crores

Category	Credit Exposure
Fund Based Facilities*	67,181
Non-Fund Based Facilities**	12,861
<b>Total</b>	<b>80,042</b>

\* Fund Based Facilities include Loans & Advances (Net), investments in debentures & bonds, commercial papers, equity shares, preference shares. It excludes fixed and other assets and government securities.

\*\* Non-Fund Based Facilities include exposure through issuance of Letter of Credit, Bank Guarantee and other Off-Balance sheet products to customers. This also includes the Exposure through Foreign Exchange and Derivative Transactions at the Bank.

#### By Geographic Distribution

In INR Crores

Category	Fund Based	Non-Fund Based
Domestic	67,181	12,861
Overseas	-	-
<b>Total</b>	<b>67,181</b>	<b>12,861</b>

## By Industry

In INR Crores

CATEGORY	Fund Based O/S	Non-Fund Based O/S
Energy	17,532	1,247
Transport	9,200	718
Banks & Financial Institutions*	5,580	3,876
Telecom	5,130	2,545
Services	2,062	762
Real Estate	1,478	-
Construction	888	1,685
Food & Agriculture	1,341	77
Education	501	-
Retail Outlets	551	-
Metal & Steel	539	117
Healthcare	500	-
Water & Sanitation	458	3
Automobile	400	21
Paper and Paper Products	299	3
Cement	294	170
Hospital	288	-
Logistic Services	195	353
Chemicals	162	141
Pharma	134	30
IT & Computers	119	19
Engineering	112	290
Oil & Gas	-	261
Other Retail Assets**	1,472	-
Other Industries#	1,168	544
Other Securities###	16,778	-
<b>Grand Total</b>	<b>67,181</b>	<b>12,861</b>

\* Banks & Financial Institution exposure includes exposure to Banks, NBFC incl trade exposure, balance with banks and money at call and short notice.

\*\* Other Retail Assets include loans to individuals including Portfolio Buyouts.

# Other Industries include loans to Tourism, Glass, Rubber, Wood & wood, E-Commerce, Textile, Fertilizer, Leather, Jewellery and Paper where exposure to each of these sectors is less than 200 Cr each.

### Other Securities include debentures & bonds, commercial papers, equity shares, preference shares, venture capital funds, investments in subsidiary.

**Exposures to industries (other than retail assets not elsewhere classified) in excess of 5% of total exposure**

In INR Crores

Industry	Fund-based	Non-fund based
Energy	17,532	1,247
Transport	9,200	718
Banks & Financial Institution	5,580	3,876
Telecom	5,130	2,545
<b>TOTAL</b>	<b>37,442</b>	<b>8,386</b>

**Maturity Pattern**

In INR Crores

	Cash & Balance with RBI	Balances with banks & Money at call and short notice	Investments	Loans & Advances	Fixed Assets	Other Assets
1 Days	580	37	549	99	-	45
2 – 7 Days	334	1,383	22,769	370	-	269
8 – 14 Days	62	-	4,368	396	-	314
15 – 30 Days	58	-	482	879	-	2,430
31Days - 2Months	194	2,000	1,292	728	-	-
2 - 3Months	137	-	1,228	652	-	1,296
3 - 6Months	150	-	1,268	2,016	-	38
6Months- 1Year	250	-	2,339	2,890	-	-
1 - 3Years	290	-	5,321	11,600	-	2,410
3 - 5Years	216	-	3,375	8,530	-	-
> 5 Years	721	-	11,600	18,823	786	-
<b>TOTAL</b>	<b>2,993</b>	<b>3,420</b>	<b>54,592</b>	<b>46,983</b>	<b>786</b>	<b>6,803</b>

**Restructured and NPA Accounts**

In INR Crores

Category	Amount
Gross Standard Restructured Assets	2,134
Gross NPA	3,587
Gross NPA to Gross Advances %	7.03%
Net NPA to Net Advances %	2.57%

**Classification of NPA**

In INR Crores

Category	Gross NPA	Net NPA
Sub-Standard	842	398
Doubtful	2,745	852
- Doubtful 1	1,895	612
- Doubtful 2	850	240
<b>Total</b>	<b>3,587</b>	<b>1,250</b>

**Movement of NPA**

In INR Crores

Category	Gross NPA
Opening Balance April 1,2016	3,058
Additions during the Year	620
Reductions during the year	(91)
- Upgradation	-
- Transfer due to conversion of loans into investments	-
- Recoveries (excluding recoveries made from upgraded account)	(91)
- Technical / prudential write-offs	-
- Write-offs other than technical / prudential write-offs	-
<b>NPA Balance at December 31, 2016</b>	<b>3,587</b>

**Movement of NPA Provision**

In INR Crores

Category	Specific Provision
Opening balance at April 1,2016	1,919
Additions during the year	451
- Provisions debited to Profit and Loss Account	248
- Provisions on downgrade of restructured advances to sub-standard/Doubtful	13
- Specific provisions on identified advances	190
- Provisions transfer to non-performing investments on conversion	-
Reductions	(33)
- Transfer to Restructured on upgradation	-
- Write-back on recovery / upgradation	(33)
<b>Provision Balance at December 31, 2016</b>	<b>2,337</b>

**Movement of Restructured Provision**

In INR Crores

Particulars	Amount
Opening balance April 1,2016	1,105
Additions during the year	(225)
- Additions during the year	
- Upgradations to restructured standard category during the year	(194)
- Increase / (decrease) in provisions of existing restructured cases	(13)
Down gradations of restructured accounts during the year	
Recoveries during the FY	(18)
Write-offs of restructured accounts during the FY	
<b>Provision Balance at December 31, 2016</b>	<b>880</b>

**Movement of Specific Provision**

In INR Crores

Particulars	Amount
Opening balance April 1,2016	1,267
Additions during the year	39
Reductions during the year	(190)
<b>Provision Balance at December 31, 2016</b>	<b>1,116</b>



**Amount of non-performing investments (NPIs)**

In INR Crores

Particulars	Amount
Gross non-performing investments	412
Less: Provisions	(412)
<b>Net non-performing investments</b>	<b>0.00</b>

**Movement of provisions for non-performing investments (NPI)**

In INR Crores

Particulars	Amount
Opening balance April 1,2016	412
Additions during the year	-
- Transfer due to conversion of loans into investment	-
- Write-off	-
- Write-back of excess provisions	-
<b>Closing balance at December 31, 2016</b>	<b>412</b>

**By major industry or counterparty type:**

In INR Crores

Industry	Gross NPAs	Specific Provision
Energy	2,803	1,853
Construction	337	171
Food & Agriculture	193	29
Telecom	183	127
Transport	64	64
Education	5	5
Other Retail Assets	1	1
<b>Total</b>	<b>3,587</b>	<b>2,337</b>

## V. CREDIT RISK - Disclosures under the Standardised Approach

### A. External Credit Rating

Under the Standardised Approach, the rating assigned by the eligible external credit rating agencies will largely support the measure of credit risk. The Bank relies upon the ratings assigned by eligible external credit rating agencies, as defined by RBI, for assigning risk weights for credit risk capital computation. The Reserve Bank has identified the external credit rating agencies that meet the eligibility criteria specified under the revised Framework. Ratings given by the following credit rating agencies are used by the Bank for the purpose of risk weighting their claims:

- Credit Analysis and Research Limited;
- CRISIL Limited;
- India Ratings and Research Private Limited (India Ratings);
- ICRA Limited; C
- Brickworks Rating India Pvt. Limited (Brickwork); and
- SMERA Ratings Ltd. (SMERA)

The Ratings applied are the solicited ratings provided by the Rating Agencies for the Credit facilities to which IDFC Bank is a Lender.

Bank would also use the ratings of the following international credit rating agencies for assigning risk weights to claims for capital adequacy purposes where the exposure can be specified as international exposure:

- Fitch;
- Moody's and
- Standard & Poor's

Some Key Principles:

- Bank uses the chosen credit rating agencies and their ratings consistently for each type of claim, for both risk weighting and risk management purposes.
- For assets which have a contractual maturity of more than one year, long term ratings accorded by the chosen credit rating agencies is used.
- If there are two ratings accorded by chosen credit rating agencies then the lower of the two ratings is applied. If there are three or more ratings accorded by chosen credit rating agencies, then the better of the two lowest ratings is applied.
- To be eligible, the rating agency should have reviewed the rating at least once during the previous 15 months.

The following Capital Ratios are applied, as prescribed by RBI in the Master Circular – Basel III Capital Regulations.

Claims on Domestic Sovereigns

Both fund based and non-fund based claims on the central government attract a zero risk weight. Central Government guaranteed claims attract a zero risk weight.

Claims on Public Sector Entities (PSEs)

Claims on domestic public sector entities are risk weighted in a manner similar to claims on Corporates.

Claims on Foreign Banks

The claims on foreign banks are risk weighted as under as per the ratings assigned by international rating agencies

S &P / Fitch ratings	Moody's ratings	Risk weight (%)
AAA to AA	Aaa to Aa	20
A	A	50
BBB	Baa	50
BB to B	Ba to B	100
Below B	Below B	150
Unrated	Unrated	50

Claims on Corporates, AFCs and NBFC-IFCs

Claims on corporates, exposures on Asset Finance Companies (AFCs) and Non-Banking Finance Companies-Infrastructure Finance Companies (NBFC-IFC), are risk weighted as per the ratings assigned by the rating agencies registered with the SEBI and accredited by the Reserve Bank of India. The following table indicates the risk weight applicable to claims on corporates, AFCs and NBFC-IFCs.

Domestic rating agencies	Risk weight (%)
AAA	20
AA	30
A	50
BBB	100
BB & below	150
Unrated	100

### Claims on Restructured Assets

With a view to reflect a higher element of inherent risk which may be latent in entities whose obligations have been subjected to re-structuring / re-scheduling either by banks on their own or along with other bankers / creditors, the unrated standard / performing claims on these entities are assigned a higher risk weight until satisfactory performance under the revised payment schedule has been established for one year from the date when the first payment of interest / principal falls due under the revised schedule. The risk weights applied is 125 per cent.

### Claims Classified as Commercial Real Estate Exposure

Claims on Commercial Real Estate is applied a risk weight of 100 per cent.

### Non-Performing Assets (NPA)

The unsecured portion of NPA, net of specific provisions (including partial write-offs), is risk-weighted as follows:

- 150 per cent risk weight when specific provisions are less than 20 per cent of the outstanding amount of the NPA ;
- 100 per cent risk weight when specific provisions are at least 20 per cent of the outstanding amount of the NPA ;
- 50 per cent risk weight when specific provisions are at least 50 per cent of the outstanding amount of the NPA

### Claims on Advances classified as Capital Market Exposure

Advances classified as 'Capital market exposures' attract a 125 per cent risk weight or risk weight warranted by external rating (or lack of it) of the counterparty, whichever is higher.

### Off-Balance Sheet Exposures

The risk weighted off-balance sheet credit exposure is calculated as the sum of the risk-weighted amount of the market related and non-market related off-balance sheet items. The risk-weighted amount of an off-balance sheet item that gives rise to credit exposure is calculated by means of a two-step process:

(a) The notional amount of the transaction is converted into a credit equivalent amount, by multiplying the amount by the specified credit conversion factor or by applying the current exposure method; and

(b) The resulting credit equivalent amount is multiplied by the risk weight applicable to the counterparty or to the purpose for which the bank has extended finance or the type of asset, whichever is higher.

Unhedged Foreign Currency Exposure

Currency induced credit risk is related to the position of the customer’s Unhedged Foreign Currency Exposure (UFCE). The Bank currently measures, monitors and applies incremental risk weight as defined below.

Likely Loss/EBID (%)	Incremental Capital Needed
Less than 75 percent	0 percent
75 percent and above	25 percent increase in risk weight

**B. Credit Risk Mitigants**

The Adjusted exposure to a counterparty has to take account of the effects of that collateral.

The Bank currently holds physical collateral for credit risk mitigation purposes, but does not have significant holdings in eligible financial collateral.

Eligible financial collateral for recognition in the comprehensive approach to credit risk mitigation include:

1. Cash (as well as certificates of deposit or comparable instruments, including fixed deposit receipts, issued by the lending bank)
2. Gold – both bullion and jewellery
3. Securities – issued by central and state governments
4. Kisan Vikas Patra and NSC certificates with no lock in
5. Life Insurance Policies with a declared surrender value by a regulated insurer
6. Externally Rated Debt Securities attracting lower than 100% risk weight
7. Externally unrated debt securities in respect of which the bank is sufficiently confident about market liquidity
8. Units of Mutual funds regulated by the securities regulator of the jurisdiction of the bank’s operations.

**C. Internal Credit Rating**

In addition to actively pursuing an external rating on the facility, the bank has also developed a robust internal ratings framework.

Some key features of this rating framework are:

- Internal credit rating is a core element of IDFC Bank’s risk management framework. To determine an internal credit rating, an objective assessment of the counterparty’s default probability is done based on present characteristics and assumptions. This rating also reflects the credit view for the next 12 months.
- No credit limit is approved without an approved internal credit rating except as may be specifically provided in this policy. In case of exceptions, necessary approvals are obtained as per the Delegation of Authority.
- Assessment of internal credit rating are based on any one of the approved credit rating models as maybe applicable basis the industry and business segments.
- Internal Rating or Obligor rating (OR) is on a 14 point scale starting from iAAA to iD.

Additional Risk weight is taken on certain assets that were grandfathered through IDFC Limited as per the directive of RBI.

**Credit Exposure by Risk Weight**

In INR Crores

Category	Amount
Below 100% Risk Weight	42,345
100% Risk Weight	34,211
More than 100% Risk Weight	3,486
<b>Total</b>	<b>80,042</b>

## VI. Market Risk in Trading Book

### A. Market Risk Management

The Bank has set up robust Market Risk management process which sets out the broad guidelines for managing Market Risk that the Bank is exposed to. Management of market risk encompasses risk identification, measurement, setting up of limits and triggers, monitoring, control, reporting and taking corrective actions, where warranted. The Market Risk management process at the Bank ensures that the Treasury dealings in the product that are exposed to market risk are within the risk appetite of the Bank. The Board approved risk appetite is handed down as limits to Financial Markets Group. The prescribed limits are monitored by the Market Risk and reported as per the guidelines laid down from time to time. The market risk objective, framework and architecture along with the functions of market risk are detailed in the Board approved Market Risk Management Policy.

#### **Bank monitors and measures market risk on the following positions:**

- Trading book positions in interest rate sensitive securities, including interest rate derivatives
- Open positions in foreign exchange, including foreign exchange derivatives
- Trading book positions in equity securities
- Position exposed to market risk, undertaken as part of the non-trading activities (part of Banking Book)

#### **Market Risk Management Governance Framework:**

The governance framework for market risk management is as follows:

- Board of Directors (BoD)
- Risk Management Committee of Board (RMCB)
- Market Risk Committee (MRC)
- Market Risk Department

The Bank has ensured segregation of duties in terms of independent Front Office, Back Office and Market risk department.

**Market Risk Department** of the bank provides periodic reviews and analysis to BoD, RMCB, ALCO and MRC. It is responsible for preparation and review of the Policy and Limits with regard to market risk post discussion with Financial Markets Group, reviews valuation methodologies, reviews risk computation methodologies like VAR, sensitivities, conducts stress testing, conducts hedge effectiveness testing as per the frequency detailed in the hedge strategy documents etc.

Bank has an **independent team** within Market Risk function that monitor limits as laid down in the Limit Management Framework (LMF) and report breaches and exceptions, if any. The department's main responsibilities also includes review of market data, computation and dissemination of Front office P&L, risk and position statements, monitor stop loss triggers as per the Stop Loss Monitoring framework & performs rate scan.

#### **Classification of Books:**

Market Risk governance framework involves classification of books into Trading Book and Banking Book.

The Bank's trading book consists of securities held in held for trading (HFT) and Available for Sale (AFS). All foreign exchange (FX) and derivatives transactions, other than classified as hedging or funding deals are considered as trading book. The Bank's banking book consists of positions which are not included in the Bank's trading book.

#### **Management of Market Risk in the Trading Book**

The Market Risk Committee has the responsibility of reviewing and advising the market risk limits to be adhered for the trading book. MRC reviews compliance of limits, exceptions observed and approval status and provide necessary directions on the same on a periodic basis.

#### **Management of Market Risk in the Banking Book**

The ALCO also has the responsibility of ensuring adherence to the limits set by the Board as well as formulation of balance sheet strategy for the Bank as a whole. This includes broad direction for management of the market risk in the banking book as stipulated in the Bank's Asset Liability Management (ALM) Policy. The ALM Policy also prescribes stipulations on management of liquidity risk and interest rate risk in the banking book.

#### **Market Risk Monitoring Parameters:**

- Risk on fixed income portfolio is measured through PV01 and VaR.
- Foreign exchange exposure is measured through MTM, Net overnight open position (NOOP), Aggregate Gap limits, Pv01 and VaR.
- Risk on Derivatives portfolio is measured through MTM, PV01, greeks (Delta, Gamma and Vega) and VaR.

Bank has implemented advanced methodology of estimating potential future exposure on a counterparty arising out of Fx and Derivative deals done with the counterparty. The methodology estimates future exposure using simulated market factors and market scenarios.



## VII. Operational Risk

### A. Operational Risk Management

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It is inherent in all activities arising out of Bank's business and operations and could result in financial losses, litigation, regulatory fines or other damage to the Bank. The severity of impact on the bank, its employee and customers is dependent on the efficacy with which operational risk is managed by the Bank. The goal is to keep operational risk at appropriate levels, in light of the Bank's financial strength, the characteristics of its businesses, the markets in which it operates, and the competitive and regulatory environment in which it operates.

#### **Governance and organization structure for managing operational risk**

Risk Management Committee of the Board has the primary responsibility of oversight and review of risk management in the Bank. Board has approved the Operational risk management policy to achieve below objectives:

- Provide comprehensive view of operational risks across Business/ Shared Service Units for proactively assessing key risks and initiating mitigating measures.
- Reduce 'Impact' and 'Probability' of risk events through introduction of sound practices for operational risk, embedding right sized controls in a proactive manner to minimize losses from operational failures.
- Create awareness by developing a common understanding and taxonomy of risks across Bank and embed risk ownership by Business/Shared Service Units.
- Manage Capital optimally by moving to more advanced approaches.

The Bank has put in place Board approved governance and organisational structure that specifies roles and responsibilities of employees, Business and Shared service Units, Operational Risk Management Department and other stakeholders towards operational risk management.

#### **Risk identification, measurement, monitoring and reporting**

Responsibility of identification and management of operational risk on day –to-day basis lies with Business and Shared Service Units. ORMD is responsible for designing and implementing framework and tools that help identify, manage operational risk and for assessing the design and operating effectiveness of controls. Internal Audit validates and assures stakeholders on efficacy of governance, risk management and internal controls. Key initiatives taken by Bank to ensure timely identification and management of risks include–

- All new Products are rolled out post mitigation of assessed critical risks basis approval from Product/Process Approval Committee (PAC).

- Risk and Controls Self-Assessment methodology that supports identification and mitigation of key risks using bottoms-up approach. Every process is reviewed for identifying 'Inherent risks' basis probability of occurrence & severity of impact, related controls assessed for design efficiency and control effectiveness to arrive at 'Residual risk'. Depending on the severity of residual risks, risk acceptances are obtained from appropriate authorities.
- Internal Control Testing Framework that helps assess design & operating effectiveness of controls.
- Framework for on-going monitoring of risks through Key Risk Indicators. This will include defining and monitoring Bank level KRIs followed by process level KRIs.
- Operational risk Incident reporting process that involves detailed risk analysis for material incidents to learn from errors for strengthening controls through Loss and Near miss data.
- Tracking of Actions for timely closure of Open Issues from RCSAs, Control Testing, Risk incidents and Audit.
- Periodic reporting of material risk exposures to Senior Management to facilitate timely mitigation.
- Roll out of mandatory e-learning training modules for Basic Operational risk, Fraud risk and Information security risk management for all employees to build a strong risk culture through continuous training and awareness.
- Governance over outsourcing of financial services activities through the Outsourcing Committee.

## **B. Information Technology and Information Security Risk**

Information security group (ISG) is an independent group that oversees risks related to information technology. The group is headed by a senior executive of the bank and is designated as Chief Information Security Officer (CISO), who reports to the Chief Risk Officer with a dotted line reporting to Chief Operating Officer. This group operates under information security management system framework (ISMS) framework and cyber security framework that is aligned with RBI guidelines and the ISO 27001 standard. In the Bank, this group guides and supports implementation of strong information security principles in the areas of technology solutions, the related processes and people.

## **C. Business Continuity Management**

IDFC Bank is committed to providing the best possible experience to its customers and the best possible relationships with employees, shareholders and suppliers. However, IDFC Bank is exposed to potential risks that could disrupt or destroy critical business functions and/or the production and delivery of the IDFC Bank's services. To ensure consistent availability and delivery of its products and services, IDFC Bank has developed the following business continuity policy in support of a comprehensive program for business continuity and overall business survivability. The policy highlights IDFC Bank's strategy for uninterrupted business in the event of an incident by ensuring safety and security of all employees; and continuing critical business functions, production and delivery of products and services from predefined alternatives / sites.