INDEL MONEY LIMITED(IML)

ICAAP Policy and Framework for Assessment

1. Background

The ICAAP policy is prepared and put in place in compliance with the requirements of Reserve Bank of India (the "RBI") Guidelines issued vide its Notification no. RBI/2021-22/112 DOR.CRE.REC.No.60/03.10.001/2021-22 on **"Scale Based Regulation (SBR): A Revised Regulatory Framework for NBFCs" (the "Regulations")** dated October 22, 2021 and RBI Master Circular RBI/2022-23/12 on DOR.CAP.REC.3/21.06.201/2022-23 on **"Basel III Capital Regulations" (the "Master Circular")**. The structure of the ICAAP and this policy is basis the requirements of these Regulation and Circular.

In simple words, ICAAP refers to an analysis which assists the financial institution like NBFCs to determine whether the regulatory capital maintained by them is adequate to absorb relevant risk poised due to their operations.

Since introduction of Basel guidelines, Banks have been subjected to advanced level of capita assessment process based on their risk. NBFCs are not subjected to ICAAP based capital charging practices so far by RBI. However, given the growing systemic importance of NBFCs, RBI through its Revised Regulatory Framework for NBFCs (Scale Based Regulations – SBR) has made applicable ICAAP requirements in the lines of banks for estimating their capital requirements.

Accordingly, IML have to follow ICAAP to comply with the RBI directives. Brief details of the RBI stipulations as per circular number DOR.CRE.REC No. 60/03.10.0001/2021-22 dt October 22, 2021 are as below:

Quote
Regulatory changes under SBR applicable to NBFC-ML and NBFC-UL
Internal Capital Adequacy Assessment Process (ICAAP) - NBFCs are required to make a thorough internal assessment of the need for capital, commensurate with the risks in their business. This 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). While Pillar 2 capital will not be insisted upon, NBFCs are required to make a realistic assessment of risks. Internal capital assessment shall factor in credit risk, market risk, operational risk and all other residual risks as per methodology to be determined internally. 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. This will facilitate an active dialogue between the supervisors and NBFCs on the assessment of risks and monitoring as well as mitigation of the same.

Unquote

RBI subsequent to its circular of 15 July 2015, issued a Master circular titled Basle III regulations ref No RBI/2022-23/12 DOR.CAP.REC.3/21.06.201/2022-23 on 1 April 2022 combining various circulars published after 15th July 2015. RBI has indicated in the SBR that the process for NBFCs will be in line with its directive of July 2015 applicable to Banks. However, given that RBI has issued a subsequent directive on 1 April 2022 consolidating all the previous versions, we consider ICAAP process for NBFCs will be guided by the broad framework provided in the Master Circular – Basel III Capital Regulations dated April 1 2022 meant for Banks, including small finance banks and payment banks, till specific directions applicable for NBFCs are issued.

Accordingly, we propose to put in place the "ICAAP policy", the "Assessment Model for computation for ICAAP driven capital estimate and the format for "ICAAP document" in compliance with the RBI directions contained in the Circular dated 22 October 2021 and din alignment with the Basel III Master Circular dated 1 April 2022.

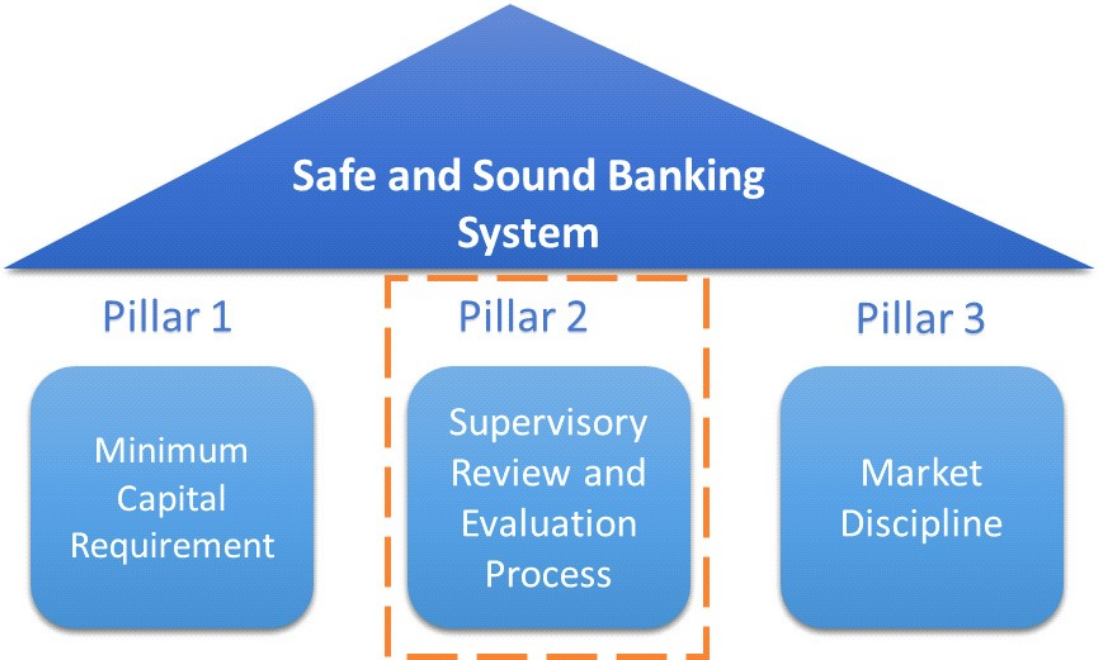
2. Internal Capital Adequacy Assessment Process (ICAAP)

2.1 Background

The principle of ICAAP for the purpose of Capital charging was proposed by Bank for International settlement (BIS) known as Basel II approach. It was intended for Banks across all members of BIS. Brief details of the same are given below

2.2 Basel II Framework

Basel II, published in 2006, lays out a three-pillar approach to risk and capital management (Mainly for Banks) as depicted below:



2.2.1 Pillar 1: Capital Adequacy Requirements: Pillar 1 provided improvement on the policies of Basel I by taking into consideration operational risks in addition to credit risks associated with risk-weighted assets (RWA). It requires banks to maintain a minimum capital adequacy requirement of its RWA. Basel II also provides banks with more informed approaches to calculate capital requirements based on credit risk, while taking into account each type of asset's risk profile and specific characteristics in alignment with the specific features of the product and counterparty.

As per the current capital adequacy guideline IML need maintain minimum capital ratio consisting of Tier I and Tier II which shall be not less than 15% of its aggregate risk weighed assets on-balance sheet and of risk adjusted value of off-balance sheet items. As a lender primarily engaged in lending against gold jewellery, shall maintain a minimum Tier I Capital of 12%.

The risk weighed assets – on balance sheet items and the applicable percentage of weight for capital adequacy purposes are given below:

Weighted risk assets - On-Balance Sheet items	**Percentage weight**
(i) Cash and bank balances including fixed deposits and certificates of deposits with banks	0
(ii) Investments	
(a) Approved securities [Except at (c) below]	0
(b) Bonds of public sector banks	20

(c) Fixed deposits/certificates of deposits/bonds of public financial institutions	100
(d) Shares of all companies and debentures / bonds/commercial papers of all companies and units of all mutual funds	100
(e) All assets covering PPP and post commercial operations date (COD) infrastructure projects in existence over a year of commercial operation.	50
(iii) Current assets	
(a) Stock on hire (net book value)	100
(b) Inter-corporate loans/deposits	100
(c) Loans and advances fully secured against deposits held	0
(d) Loans to staff	0
(e) Other secured loans and advances considered good [Except at (vi) below]	100
(f) Bills purchased/ discounted	100
(g) Others (To be specified)	100
(iv) Fixed Assets (net of depreciation)	
(a) Assets leased out (net book value)	100
(b) Premises	100
(c) Furniture & Fixtures	100
(v) Other assets	
(a) Income tax deducted at source (net of provision)	0
(b) Advance tax paid (net of provision)	0
(c) Interest due on Government securities	0
(d) Others (to be specified)	100
(vi) Domestic Sovereign	
(a) fund-based claims on the Central Government	0
(b) Direct loan/ credit/ overdraft exposure and investment in State Government securities	0
(c) Central Government guaranteed claims	0
(d) State Government guaranteed claims, which have not remained in default/ which are in default for a period not more than 90 days	20
(e) State Government guaranteed claims, which have remained in default for a period of more than 90 days	100

Off- balance sheet items

Sl. No.	Instruments	Credit Conversion Factor
i.	Financial & other guarantees	100
ii.	Share/debenture underwriting obligations	50
iii.	Partly-paid shares/debentures	100
iv.	Bills discounted/rediscounted	100
v.	Lease contracts entered into but yet to be executed	100
vi.	Sale and repurchase agreement and asset sales with recourse, where the credit risk remains with the applicable NBFC.	100
vii.	Forward asset purchases, forward deposits and partly paid shares and securities, which represent commitments with certain draw down.	100
viii.	Lending of NBFC securities or posting of securities as collateral by the applicable NBFC, including instances where these arise out of repo style transactions	100
ix.	Other commitments (e.g., formal standby facilities and credit lines) with an original maturity of up to one year over one year	20 50
x.	Similar commitments that are unconditionally cancellable at any time by the applicable NBFC without prior notice or that effectively provide for automatic cancellation due to deterioration in a borrower's credit worthiness	0
xi.	Take-out Finance in the books of taking-over institution	
	(i) Unconditional take-out finance	100
	(ii) Conditional take-out finance	50
		Note: As the counter-party exposure will determine the risk weight, it will be 100 per cent in respect of all borrowers or zero percent if covered by Government guarantee.
xii.	Commitment to provide liquidity facility for securitization of standard asset transactions	100

xiii.	Second loss credit enhancement for securitization of standard asset transactions provided by third party	100
xiv.	Other contingent liabilities (To be specified)	50

Current regulations do not prescribe to distinguish between the exposures based on the credit worthiness of the counter parties or their credit rating. Further, as per the current regulations, capital for market risks and operations risks need not be separately computed as NBFCs need carry higher capital adequacy of 15% against the capital adequacy requirements of 9% to banks.

2.2.2 Pillar 2: Supervisory Review added owing to the necessity of efficient supervision and lack thereof in Basel I, pertaining to the assessment of a bank's internal capital adequacy. Under Pillar 2, banks are obligated to assess the internal capital adequacy for covering all risks they can potentially face in the course of their operations. The supervisor (Regulator) is responsible for ascertaining whether the bank uses appropriate assessment approaches and covers all risks associated including the risk embedded and overflown from the Pillar 1 analysis but are not considered for charging capital under Pillar 1.

Internal Capital Adequacy Assessment Process (ICAAP): A bank must conduct periodic internal capital adequacy assessments in accordance with their risk profile and determine a strategy for maintaining the necessary capital level.

Supervisory Review and Evaluation Process (SREP): Supervisors are obligated to review and evaluate the internal capital adequacy assessments and strategies of banks, as well as their ability to monitor their compliance with the regulatory capital ratios.

Capital above the minimum level: One of the added features of the framework Basel II is the requirement of supervisors to ensure banks maintain their capital structure above the minimum level defined by Pillar 1.

Supervisor's interventions: Supervisors must seek to intervene in the daily decision-making process in order to prevent capital from falling below the minimum level.

2.3 Risk Appetite – Framework and Procedures

The global financial crisis has demonstrated clearly that many financial institutions lacked a proper understanding of their true risk profile and realized too late that it was not in line with their desired risk profile. The key lesson learned from this crisis is that financial institutions need to have a comprehensive risk appetite framework in place to enable better understanding and management of their risks by translating risk metrics and methods into strategic decisions, reporting, and day-to-day business decisions.

2.3.1 Scope and Objective

The scope and objectives of the Risk Appetite in IML are as follows:

- To encourage risk management and not risk aversion, wherein risk management is not purely the Risk Function's responsibility, but one that is shared across the organization.
- Clear articulation of enterprise risk appetite and risk tolerance limits which may directly guide and enhance strategic planning and budgeting thereby facilitating consistency in the process.
- Consistent measurement and monitoring of risk to facilitate enhanced understanding of the risks and undertake only value generating risks within the risk tolerance limits.

Risk Capacity is the maximum level of risk IML can assume given its level of resources.

Risk Tolerance is boundary of risk taking, outside of which IML is not prepared to venture in pursuit of its long-term objective.

Risk Appetite is the amount of risk a Financial Institution is willing to accept and is an expression of the risks; the aggregate level and types of risk that an institution is willing to accept, or to avoid, in order to achieve its business objectives.

At present, IML has set the tolerance limit for each parameter and trigger levels for remedial measures. IML will endeavor to differentiate the tolerance limit and appetite limit for materials risks in a time bound manner.

A report on the present Risk capacity and trend in Risk tolerance limits shall be furnished in the ICAAP document on quarterly basis to Top Management and RMC.

2.3.2 Risk Metrics and tolerance limits

Risk metrics is the extent to which a Bank chooses to express its risk tolerance at business unit level, product or functional level depending on the desired level strategic objectives and its risk category definitions.

The risk metrics and tolerance limits adopted by IML at corporate level are follows**:**

Risk Metric	Tolerance Level	Remedial Actions
Adherence to Regulatory Capital Ratios	Minimum overall CRAR at 25%	IML shall undertake such capital optimization measures which may enhance the capital ratios. These measures would include • Enhance recovery in Non- Performing Assets to restrict incremental provisioning requirements. • Issuance of equity shares and/or Innovative Perpetual Debt to raise the required shortfall in capital.

		• Issuance of debt instruments eligible to be classified under Tier II Capital.
ROE	Minimum 14%	• Reduce operating cost. • Repricing of products. • Give more focus on high yielding products.
ROA	Minimum 4%	
Regulatory	0 Tolerance	
Statutory	0 Tolerance	
Business growth.	Maximum deviations from budget – 15%	• Review Business strategies.
NPA in gold loan.	Maximum deviations from budget: 0.5%.	• Accelerate auction process
NPA in other verticals	Maximum 3%	• Accelerate collection efforts
Breach of internal exposure ceilings	Zero tolerance	• Check vulnerabilities in controls and rectify the issues. • Review the ceilings and modify the ceilings based on the business requirements after evaluating risks.

2.4 Pillar 3: Market Discipline: Pillar 3 aims to ensure market discipline by making it mandatory to disclose relevant market information. This is done to make sure that the users of financial information receive the relevant information to make informed trading decisions and ensure market discipline.

2.5 Basel III Framework

Basel II framework was announced in 2017 and implemented in January 2022. While maintaining the 3 Pillar approach Basel III aims to strengthen the requirements in the Basel II regulatory standards for banks.

In addition to increasing capital requirements, it introduces requirements on liquid asset holdings and funding stability etc. and also has given more granular definitions on the capital. Basel III norms are under implementation for Indian Banks. Brief details on the pillars and coverage are given in the illustration below

Basel III – 3 Pillar Framework – Salient features		
Pillar 1	Pillar 2	Pillar 3
Minimum capital requirement	Supervisory review process	Market Discipline
• Additional/Refined capital requirement	• Supervision driven	• Additional/Enhanced Disclosures

• Liquidity Coverage Ratios • Net stable funding indicators • OTC/Derivative instruments charges • Quality and level of capital (More granular definition of capital) • Leverage ratio • Capital conservation buffers • Countercyclical buffers • Enhanced Loss absorption clause	• Firm wide Corporate Governance • Concentration risk management • Alignment with long term incentives • Sound compensation practices • Additional capital (ICAAP) • Firm wide Risk management practices • Valuation practices, stress test practices • Supervisory Review Evaluation process (SREP)- capital and Governance standards	• Risk Management -Credit -Market -Operational • Regulatory capital components • Reconciliation of capital • Regulatory capital ratios • Securitization exposures

3. ICAAP for NBFCs

While the aforesaid details are applicable to Banks, in compliance with the RBI directive quoted above we propose the ICAAP policy, the model for assessment and the "ICAAP document" template in line with the Master circular April 1 2022 (issued consolidating the all previous directive on the subject including the July 1 circular) as detailed in this document;

4. ICAAP Policy

The following policy is proposed to commensurate with the size, level of complexity, risk profile and scope of operations to be in place.

5. Objectives of ICAAP

The objective of ICAAP is as detailed Basel III Circular, which state that:
"The main aspects to be addressed under the Supervisory Review process (SRP rule 4) and will cover the following;

- risks that are not fully captured by the minimum capital ratio prescribed under Pillar 1;
- the risks that are not at all taken into account by the Pillar 1; and
- the factors external to the institution.

Since the capital adequacy ratio prescribed by the RBI under the Pillar 1 of the Framework is only the regulatory minimum level, addressing basically the three risks (viz., credit, market and operational risks), holding additional capital may be necessary

for IML on account of both – the possibility of some under-estimation of risks under the Pillar 1 and the actual risk exposure vis-à-vis the quality of its risk management architecture.

While the RBI circular on SBR has not directed NBFCs to charge additional capital based on ICAAP, we believe that as a measure of best practice it would be appropriate for IML to have a head room always kept available to the extent of the ICAAP driven capital.

The regulatory capital is maintained against the risk weighted assets. The risk weights prescribed are based on the general experience of the regulators with respect to the respective asset classes. However, risks associated with the assets also depend on the credit underwriting qualities of the originator, the geography in which it operates etc. Hence, often the risk weights assigned as per the regulatory framework turn out to be unrealistic. The ICAAP bridges the gap, if the assets pose a higher risk, that reflects on the end result of the ICAAP process.

ICAAP is therefore an analysis that helps IML to determine whether the regulatory capital maintained is enough to absorb relevant risk faced consequent to its operations.

As per the RBI circular no. DOR.CAP.REC.No.21/21.06.201/2022-23 dt. April 19, 2022 NBFC shall maintain on an ongoing basis Common Equity Tier I (CET1) capital atleast 9% of the risk weighted assets. Elements of Common Equity Tier I capital comprise the following:

a. Paid up equity capital.
b. Share premium.
c. Capital reserves representing surplus arising out of sale proceeds of assets.
d. Statutory reserves.

As on 31.03.2023 our Tier I capital is Rs. 151.41 cr and our Common Equity Tier I Capital is 16.55 %, much superior to the regulatory prescribed CET1 of 9% for NBFC - ML. IML's capital position is much higher than the minimum prescribed by the regulator and also at a very comfortable level to absorb expected and unexpected losses.

The outcome of the ICAAP in respect of those risks already covered and followed under Pillar 1 may be higher or lower than the regulatory capital requirements. It will then be required to maintain *whichever is higher in the event of the RBI directive stipulates capital charging also based on ICAAP in future.*

The Risk Management Committee will lay down judicious buffers calibrated in extreme stress scenarios including Black Swan events like pandemic.

6. IML's responsibilities under ICAAP

IML has the following responsibilities.

- To put in place a process for assessing its overall capital adequacy in relation to the risk profile and a strategy for maintaining capital levels
- To operate above the minimum regulatory capital ratios

Accordingly, IML is required to have a procedure for identification and measurement of risk, maintain an appropriate level of internal capital in relation to the risk profile and engage in further development of suitable risk management systems.

The SREP consists of a review and evaluation process adopted by the supervisor, which covers all the processes and measures defined in the principles listed above. Essentially, these include the review and evaluation of IML's ICAAP, conducting an independent assessment of the risk profile, and if necessary, taking appropriate prudential measures and other supervisory actions.

7. Principles of ICAAP/Practices

A sound ICAAP relies on the following concepts:

Forward-looking Process: The ICAAP is a forward looking in nature, and thus, shall take into account the expected / estimated future developments such as strategic plans, macro-economic factors, etc., including the likely future constraints in the availability and use of capital.

Board and Management to develop and maintain an appropriate strategy that would ensure that it has adequate capital commensurate with the nature, scope, scale, complexity and risks inherent in the on-balance-sheet and off-balance-sheet activities, and should demonstrate as to how the strategy is able to follows the macro-economic factors.

Availability of a Board-approved capital plan which should spell out the institution's objectives in regard to level of capital, the time horizon for achieving those objectives, and in broad terms, the capital planning process and the allocated responsibilities for that process.
ICAAP is Risk-based Process: Adequacy of capital is a function of the risk profile. It is therefore important to set capital targets consistent with the risk profile and operating environment in which the Company operates. A sound ICAAP should include all material risk exposures that the company is exposed to. There are some types of risks (such as reputation risk and strategic risk) which are less readily quantifiable; for such risks, the focus of the ICAAP should be more on qualitative assessment, risk management and mitigation than on quantification of such risks. To the extent possible it would be ideal to

indicate for which risks a quantitative measure is considered warranted, and for which risks a qualitative measure is considered to be the correct approach.

ICAAP to Include Stress Tests and Scenario Analyses: As part of the ICAAP it is necessary to conduct periodic and relevant stress tests, particularly in respect of material risk exposures, in order to evaluate the potential vulnerability to some unlikely but plausible events or movements in the market conditions that could have an adverse impact.

Stress testing, besides focusing on the risk posed to an entity in different stress scenarios should also assesses the entity's capability to effectively deal with the same, primarily stress testing may consist of;

- ✓ Simulation (sensitivity) analysis, intended to capture as to how target variable is affected by change in other variables
- ✓ Scenario analysis – Being the process of estimating the expected values of the particular output considering different sets of inputs.
- ✓ Use of capital models for ICAAP –The Basel III Circular states that, RBI does not expect the use of complex and sophisticated econometric models for internal assessment of their capital requirements, and there is no RBI-mandated requirement for adopting such models however model should include:
- ✓ Well documented model specifications, including the methodology / mechanics and the assumptions underpinning the working of the model.
- ✓ The extent of reliance on the historical data in the model and the system of back testing to be carried out to assess the validity of the outputs of the model vis-à vis the actual outcomes.
- ✓ A robust system for independent validation of the model inputs and outputs.
- ✓ A system of stress testing the model to establish that the model remains valid even under extreme conditions / assumptions.
- ✓ The level of confidence assigned to the model outputs and its linkage to the business strategy.
- ✓ The adequacy of the requisite skills and resources within the entity to operate, maintain and develop the model.

For detailed guidance the following RBI Directives applicable to Banks may be referred to. *DBOD.No.BP.BC.101/21.04.103/2006-07 and DBOD.BP.BC.No.75/21.04.103/2013-14 dated June 26, 2007 and December 2, 2013, respectively on stress testing.*

8. Requirement under ICAAP

In the Basel III Circular intended for Banks which in fact is being followed by us for guidance, RBI has "recognized that there is no one single approach for conducting the ICAAP and the market consensus in regard to the best practice for undertaking ICAAP is yet to emerge. The methodologies and techniques are still evolving particularly in regard to measurement of non-quantifiable risks, such as reputational and strategic risks. These

guidelines, therefore, seek to provide only broad principles to be followed in developing their ICAAP".

9. Board's responsibility

Ultimate responsibility for the ICAAP will be with the Board. Accordingly, Board shall define strategy and approach for ICAAP, at the same time monitor the same, making relevant changes as and when necessary. The broad responsibilities of the board shall include:

- Setting up of the risk tolerance levels;
- Ensure that the senior management:
  - establishes a risk framework in order to assess and appropriately manage the various risk exposures;
  - develops a system to monitor the risk exposures and to relate them to the capital and reserve funds;
  - establishes a method to monitor the compliance with internal policies, particularly in regard to risk management;
  - effectively communicates all relevant policies and procedures;
- Adopt and support strong internal controls;
- Appropriate written policies and procedures should be put in place;
- Ensure that there is an appropriate strategic plan in place, which, as a minimum, shall duly outline
  - current and future capital needs;
  - anticipated capital expenditure; and
  - desired level of capital.

The board may also be required to define the role that ICAAP would play in the decision-making function of the Company.

10. Structural details of ICAAP proposed for IML

10.1 ICAAP to encompass firm-wide risk profile

IML Management recognizes that ICAAP is an integrated, firm-wide perspective of the Company's risk exposure, in order to support its ability to identify and react to emerging and growing risks in a timely and effective manner and is mindful of the need to enhance firm-wide oversight, risk management and controls around the Company's activities involving all its activities.

10.2 Need for a sound Risk Management system

IML already has a sound risk management system with the following features

- Active board and senior management oversight;
- Appropriate policies, procedures and limits;
- Comprehensive and timely identification, measurement, mitigation, controlling, monitoring and reporting of risks;
- Appropriate management information systems (MIS) at the business and firm-wide level;
- Comprehensive internal controls.

10.3 Board and Senior Management Oversight

IML recognizes that the ultimate responsibility for designing and implementation of the ICAAP lies with the board of directors of the Company and the Board and management have an understanding of risk exposures on a firm-wide basis and confirms the following in relation to the risk management and associated practices in place.

- The Company's risk appetite through tolerance limits already put in place
- The risk management framework in place includes detailed policies with specific firm-wide prudential limits on the Company's activities consistent with its risk-taking appetite and capacity.
- That the Senior management bring together the perspectives of the key business and control functions and associated risks on an integrated basis and endeavors always to overcome organizational silos between business lines to share information on market developments, risks and risk mitigation techniques.
- That the risk management practices are not limited to credit, market, liquidity and operational risks, but incorporates all material risks including reputational and strategic risks, as well as risks that do not appear to be significant in isolation, but when combined with other risks could lead to material losses.
- The Board of Directors and senior management possess sufficient knowledge of all major business lines to ensure that appropriate policies, controls and risk monitoring systems are effective.
- Board and Senior management are mindful of the risk capital market related activities such as securitization and off-balance sheet activities – and the associated risks.
- The board and senior management are informed on an on-going basis about these risks as financial markets, risk management practices and the company's activities evolve.
- IML shall not introduce any complex products without understanding the basic assumptions, the business model and risk associated with the same
- Senior management follows a practice to evaluate the potential risk exposure if those assumptions fail. Before embarking on new activities or introducing products new to the institution. The associated risk is also assessed before introducing new products taking into account likely economic stress post introduction including periodic reviews
- The Board ensures that the senior management:

- ✓ establishes a risk framework in order to assess and appropriately manage the various risk exposures of the company;
- ✓ develops a system to monitor the Company's risk exposures and to relate them to the capital and reserve funds;
- ✓ establishes a method to monitor IML's compliance with internal policies, particularly in regard to risk management; and
- ✓ effectively communicates all relevant policies and procedures throughout the Company.

- IML's risk function and the Chief risk officer (CRO) are independent of the individual business lines and report directly to the chief executive officer (CEO)
- The CRO / the risk function provides periodical highlights to senior management and the board risk management concerns, such as risk concentrations and violations of risk appetite limits

10.4 Policies, procedure, Limits and controls

IML already has put in place Firm-wide risk management policies and procedures covering specific firm-wide prudential limits on the principal risks relevant to the company's activities with appropriate guidance, strategies internal risk limits wherever applicable taking into account the overall risk levels that the Company is exposed to including capital and earnings

The policies in place do ensure adequate and timely identification, measurement, monitoring, control and mitigation of the risks posed by the Company's various activities on a firm-wide levels taking into account among other aspects the following;

- The economic substance of the IML's risk exposures, including reputational risk and valuation uncertainty etc.;
- Company's goals and objectives, as well as its overall financial strength;
- Delineating accountability and lines of authority across various business activities, and ensuring clear separation between business lines and the risk function;
- Escalation of breaches of internal limits set;
- Approval and review process for new businesses and products by bringing together all relevant risk management, control and business lines to ensure that the Company is able to manage and control the activity prior to it being initiated;
- Process for reviewing the policies, procedures and limits and for updating them as appropriate

10.5 Identifying, measuring, monitoring and reporting of risk

IML has already put in appropriate systems and procedures for identifying, measuring and reporting risk within the Company and to escalate to Board/committees wherever necessary to ensure that the risk variations and dynamics are understood and addressed appropriately.

10.6 Internal controls

The Company's Risk management processes are frequently monitored and tested by independent internal, as well as external, auditors. The process aims to ensure information on which decisions are based is accurate so that processes fully reflect management policies and that regular reporting, including the reporting of limit breaches and other exception-based reporting, is undertaken effectively. The risk management function and the Internal Audit functions of the company are independent of the business lines ensuring adequate separation and avoiding any conflicts of interest. In addition, the tolerance limits are set by the RMC/ACB/ Board.

11. Outcome of the ICAAP to the Board and the RBI

The ICAAP is an ongoing process and will require a report on the outcome to be prepared and reported to the Board and if sought for to the RBI.

Risk Management Department shall prepare the ***assessment report*** (ICAAP document) covering the risks identified, the manner in which those risks are monitored and managed, the impact of the changing risk profile on the capital position, details of stress tests/s cenario 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 would be expected to make timely adjustments to the strategic plan, as necessary. Model contents for the Report is in Annexure 1, which contains more of Bank specific information's and are not fully relevant for NBFCs. RBI has not stipulated the format for NBFCs yet.

12. Review of the ICAAP Outcomes

The board of directors shall, at least once a year, assess and Assessment document to know whether the processes relating to the ICAAP implemented by IML cover all aspects envisaged is able achieve any specific objectives envisaged by the board. Risk Management and members of the senior management shall also review the reports regularly to evaluate the sensitivity of the key assumptions and to assess the validity of the Company's estimated future capital requirements. In the light of such an assessment, appropriate changes in the ICAAP shall be instituted to ensure that the underlying objectives are met.

13. Making ICAAP part of the Management and Decision-making

IML intends to make ICAAP an important part of the management and decision-making culture of the Company. Going forward and whenever practical it shall consider using the ICAAP to internally allocate capital to various business units to guide diverse decisions

including product pricing, general business decisions and budgets. This would enable the Company to assess, on an ongoing basis, the risks that are inherent to its activities and are material.

14. Regular Independent Review and Validation

The ICAAP shall be subject to regular and independent review through an internal audit process, to ensure that the ICAAP is comprehensive and proportionate to the nature, scope, scale and level of complexity of the Company's activities so that it accurately reflects the major sources of risk that the Company is exposed to**.**

IML has already put in place appropriate and effective internal control structures, particularly in regard to the risk management processes, in order to monitor continued compliance with internal policies and procedures. To ensure the integrity of the ICAAP process shall conduct periodic reviews of its risk management processes to make sure that the;

(a) the integrity, accuracy, and reasonableness of the processes;
(b) the appropriateness of the capital assessment process based on the nature, scope, scale and complexity of the activities;
(c) the timely identification of any concentration risk;
(d) the accuracy and completeness of any data inputs into the ICAAP process**;**
(e) the reasonableness and validity of any assumptions and scenarios used in the capital assessment process; and
(f) that IML will conduct appropriate stress testing.

15. Assessment of ICAAP: Measurement framework proposed

15.1 Quantitative and Qualitative Approaches in ICAAP

All measurements of risk incorporate both quantitative and qualitative elements, but to the extent possible, a quantitative approach should form the foundation of the measurement framework. In some cases, quantitative tools can include the use of large historical databases; when data are more scarce, it is possible to choose to rely more heavily on the use of stress testing and scenario analyses.

Additionally, if risk mitigation techniques are employed it is necessary to understand the risk to be mitigated and the potential effects of that mitigation, reckoning its enforceability and effectiveness, on the risk profile.

15.2 The Principle of Proportionality

RBI in its directive permitted to apply proportionality principle for ICAAP based on the activities and risk management practices as "Simple", "Moderately Complex" and "Complex". While encouraging to migrate to and adopt progressively sophisticated

approaches in designing their ICAAP going forward. RBI expects good degree of sophistication adopted in the ICAAP in regard to risk measurement and management to be commensurate with the nature, scope, scale and the degree of complexity in the business operations.
IML considers that that its activities and risk management practices as simple and accordingly the following practices are allowed to apply for ICAAP

a) identify and consider largest losses over the last 3 to 5 years and whether
b) those losses are likely to recur;
c) prepare a short list of the most significant risks to which the Company is exposed;
d) consider how the Company would act, and the amount of capital that would be absorbed in the event that each of the risks identified were to materialize;
e) consider how the capital requirement might alter under the scenarios in (c) and how its capital requirement might alter in line with its business plans for the next 3 to 5 years; and
f) document the ranges of capital required in the scenarios identified above and form an
g) overall view on the amount and quality of capital as a result of the outcome, ensuring
h) that its senior management is involved in arriving at that view.

IML proposes its methodology broadly in line with the aforesaid, ensuring wherever possible to address all the risk it is exposed to in the process. IML will be able to constantly review the outcome so that gradually be able to have a more robust estimate in the ICAAP process. Accordingly, the following methodology is proposed for ICAAP

16. Identification of Risk and analysis for ICAAP

16.1 Credit risk

IML charges capital of 15% under Pillar 1 which interalia covers credit risk and to some extent other unallocated risk, as against this bank are allowed to charge 9% capital for credit risk with other capital charges as per the outcome of ICAAP. In terms of the intensity of the risk and the residual risk overflown beyond pillar 1 the following observations are made

a) IML's AUM is predominantly driven by Gold loan with Gold jewelry as the underlying collateral. Gold collateral and jewelry collateral are allowed to be netted (after adjusting to 99.99 Purity) for Banks while calculating capital charges for CRAR. Underlying gold collateral is auctioned to realise the value without waiting for any legal proceedings.
b) Residual risk in relation to other business types of loans are not material having charged 15% capital under Pillar 1
c) IML does not undertake any complex transactions with counterparties with diverse risk dimensions driven by the product or the counterparty.

Given the aforesaid factors IML considers that the capital estimated to be charged under ICAAP for credit risk is NIL

16.2 Counterparty credit risk (CCR)

Source of CCR: CCR emerges from transactions like Derivatives and other financial instruments that derive their value from the performance of assets, interest or currency exchange rates, or indexes. They may include structured debt obligations and deposits, swaps, futures, options, caps, floors, collars, and forwards, either singly or in various combinations. The risk will arise if the counterparty for such transactions default before the final settlement of the transaction's cash flows. Besides, an economic loss would occur if the transactions or portfolio of transactions with the counterparty have a positive economic value at the time of default. Unlike a firm's exposure to credit risk through a loan, where the exposure to credit risk is unilateral and only the lending bank faces the risk of loss, CCR creates a bilateral risk of loss: the market value of the transaction can be positive or negative to either counterparty to the transaction. The market value is uncertain and can vary over time with the movement of underlying market factors.

Note:
IML does not enter into any such transactions either on behalf of any of its customers or for the purpose of own account (proprietary) trading. IML enters into such transactions for hedging its balance sheet exposure (like foreign currency loan) with Banks as the counterparty.

Accordingly, IML does not envisage any loss on account of transactions and the ICAAP driven capital estimate for CCR is therefore NIL

16.3 Operational Risk

Operational risks are risks arising from inadequate or failed internal processes, people and systems or external events. As one of the features of our lending operations, IML offer a fast loan approval process and therefore have adopted de-centralised loan approval systems. To control our operational risks, IML has adopted clearly defined loan approval processes and procedures. The internal control includes effective separation of functions, segregation of roles and responsibilities, reliance on the maker-checker concept, joint custody arrangements, monitoring of exceptions, etc. IML also attempt to mitigate operational risk by maintaining a comprehensive system of internal controls, establishing policies and procedures to monitor transactions, maintaining necessary back-up procedures and undertaking contingency planning. IML has adequately insured ornaments pledged against employee and customer frauds, fire, theft and burglary. Besides onsite and offsite security surveillance of our branches, IML conducts risk based internal audits at all our branches to assess the adequacy of and compliance with our internal controls, systems and processes.

The Company operates in an automated environment and makes use of the latest technologies to support various operations, which leads to various operational risks viz business disruption, breaches in data security etc. The Board has adopted various IT and Security related policies to provide a governance framework for information security practices to mitigate information technology-related risks. Besides internal audit, an independent agency also assures the management of information technology-related risks. We have a robust Disaster Recovery plan that is periodically tested to ensure that it can meet any operational contingencies.

The Company achieved the ISO 27001:2013 ISMS certification (ISO 27001:2013) from BSI. BSI Group, also known as the British Standards Institution, is the national standards body of the United Kingdom. BSI produces technical standards, audits and provides certification to companies worldwide who implement management systems standards.

The Board of Directors have also adopted a "Whistle Blower Policy". The vigilance department in the head office oversees the implementation of fraud prevention measures across the organisation. Fraud is fully investigated to identify the root cause and relevant corrective steps are taken to prevent a recurrence.

The first line of defense in operational risk management is provided by the Business Units, which maintain strict internal controls and procedures. Internal audit has adopted a risk-based audit of units, businesses and processes based on various risk alerts. The audit department reviews the effectiveness of governance, risk management and internal controls regularly. Operational Risk incidents are reviewed by the Periodical Review Meeting (PRM) of senior executives. Reports of the internal auditors, as well as the responses, are discussed and reviewed by the Audit Committee of the Board. The Risk Management Committee of the Board also reviews risks in governance and effectiveness of the operational risk management controls.

IML maintains internal loss event data that captures all material activities. The Risk metrics and tolerance levels to minimize gross loss due to internal loss event data shall be the premise for Operational Risk Appetite Framework. They will be as follows:

Risk Metric	Tolerance Level	Remedial Actions
Spurious gold pledged	0.5% of AUM	• Intensify training for the appraisers. • Identify geographies where higher incidence of spurious gold and deploy experienced appraisers.
Losses on account of major frauds	Zero tolerance	Intensify audit and review audit alerts and early warning signals.
Failure of e security monitoring system	3 times in a year	Review the functioning of the e security system and upgrade the system wherever necessary.

Instances of critical IT issues	2 times in a year	Detailed route cause analysis and remedial action.
Instances of system outage		
Instance of disaster recovery failure	Zero tolerance	Detailed route cause analysis and remedial action.
Instances of suspicious transactions	Maximum 120 in a month	Tightening of transaction monitoring and educating field level employees on the PMLA guidelines.
Instance of information security violations and data leakage	Zero tolerance	Detailed route cause analysis and remedial action.

17.3.1 Mitigants in place:

Towards mitigating the risk IML has sound operational risk management policy and procedures overseen by the Risk Management Committee of board which are standard and practiced across all branches and administrative offices. The procedures, inter alia, covers access controls, rotation of duties enforcing 4 eyed principles in operations, training, risk based internal audit etc.

17.3.2 ICAAP assessment for Operational Risk

Notwithstanding the aforesaid, IML recognizes that it will be necessary to provide for ICAAP driven capital estimate for operations risk under ICAAP. For this purpose, we propose to adopt the "Basic indicator approach" as prescribed by Basel and RBI for Banks as detailed below:

17.3.3 The Basic Indicator Approach

Under the Basic Indicator Approach prescribed by BIS under Basel II and III, banks must hold capital for operational risk equal to the average over the previous three years of a fixed percentage (denoted as alpha) of positive annual gross income. Figures for any year in which annual gross income is negative or zero should be excluded from both the numerator and denominator when calculating the average.

The charge may be expressed as follows:

$KBIA = [\sum (GI1...n \times \alpha)]/n$

Where:

KBIA =the capital charge under the Basic Indicator Approach

GI = annual gross income, where positive, over the previous three years

n = number of the previous three years for which gross income is positive

α = 15 per cent, which is set by the BCBS, relating the industry wide level of required capital to the industry wide level of the indicator.

Gross income is defined as "Net interest income" plus "net non-interest income". It is intended that this measure should:

a. *be gross of any provisions (e.g., for unpaid interest) and write-offs made during the year;*
b. *be gross of operating expenses, including fees paid to outsourcing service providers, in addition to fees paid for services that are outsourced, fees received by banks that provide outsourcing services shall be included in the definition of gross income;*
c. *exclude reversal during the year in respect of provisions and write-offs made during the previous year(s);*
d. *exclude income recognized from the disposal of items of movable and immovable property;*
e. *exclude realized profits/losses from the sale of securities in the "held to maturity" category;*
f. *exclude income from legal settlements in favor;*
g. *exclude other extraordinary or irregular items of income and expenditure; and*
h. *exclude income derived from insurance activities (i.e., income derived by writing insurance policies) and insurance claims in favor.*

To summarise, IML shall compute ICAAP capital requirement for operational risk under the Basic Indicator Approach as follows:

a) Average of [Gross Income * alpha(α)] for each of the last three financial years, excluding years of negative or zero gross income as mentioned in paragraph 17.3.3.
b) Gross income = Net profit (+) Provisions & contingencies (+) operating expenses (Schedule 16) (–) items (c) to (h) of paragraph 17.3.3
c) Alpha (α) = 15 per cent

17.4 Market risks

17.4.1 Interest Rate Risk (IRR):

IML's Interest Rate Risk is limited to its on its balance assets and liabilities sourced from Bank and capital markets.

17.4.2 Mitigants in place

a) Characteristics of IMLs, book and its business model, with most of the loans predominantly being with shorter tenor lent on fixed rate and sourced from Banks only having some degree of Interest rate sensitivity

b) Alco closely monitors the IRR on a regular basis
c) Any borrowing other than in INR is hedged on an end-to-end basis with Banks with no residual risk.

17.4.3 ICAAP assessment of IRR

Interest Rate Risk in Banking Book (IRRBB) refers to the current or prospective risk to entity capital and earnings arising from adverse movements in interest rates that affect its banking book positions. When interest rates change, the present value and timing of future cash flows change. These changes in turn affect the underlying value of the entity's rate sensitive assets, liabilities, and off-balance sheet items and, hence, their economic value (EV). Changes in interest rates also affect the entity's earnings by altering interest rate-sensitive income and expenses, affecting their net interest income (NII). Excessive IRRBB can pose a significant risk to the entity's current capital base and/or future earnings if not managed appropriately. RBI Guidelines "Governance, measurement and management of Interest Rate Risk in Banking Book"- dated Feb 17, 2023 have been referred and these guidelines, accordingly, require entity to measure, monitor, and disclose their exposure to IRRBB in terms of potential change in Economic Value of Equity (ΔEVE) and Net Interest Income (ΔNII), computed based on a set of prescribed interest rate shock scenarios.

17.5 Concentration Risk

Concentration risk occurs when there is any single exposure or a group of exposure with the potential to produce losses large enough to threaten a NBFC's health or ability to maintain its core operations.

In other words, it denotes the risk arising from an uneven distribution of assets among counter- parties in credit or across rating grades, sectors or industry, or to a concentration in specific business sectors or geographical regions which is capable of generating losses large enough to jeopardize the banks‟ solvency.

Risk assessment/ management process and capital adequacy consideration

The loan policy and Credit Risk Management Policy of the company stipulates maximum exposure across various industries to mitigate concentration risk. With diversification of portfolio company will be able to address the nonsystematic risk.

The Credit Risk Management policy has also introduced the Large Exposure Framework for Single Borrower Limits and Group of Borrowers. The company is also assessing Single Borrower Limits as per Internal Rating to enhance the existing controls to avoid concentration risk.

Controls/Strategies to avoid concentration risk:

Exposure norms

Fixing Credit Exposure norms is one of the important strategies to reduce Credit Concentration Risk. The exposure limits are set to ensure that IML does not get overexposed to a particular borrower/group of borrowers or in a particular activity or industry.

For this purpose, the limits are fixed in the Credit Risk policy and Loan policy which is as follows:

- Large Exposure Framework limits – Borrower – wise/Group – wise
- Industry and activity wise
- Exposure limits in relation to various activities and industries

In line with RBI directive of Large Exposure framework for NBFC-UL, the exposure norm for single and group borrowers is as under:

Category of Borrower	Ceiling as % to Tier I Capital Funds
Single Party	**20%**
Group	**25%**

As a predominantly retail lender, we have stipulated a low single and group exposure limit of 25 % and 40% respectively of Tier1 capital.

Limits on Capital Market exposure: NIL.

As part of the policy IML's risk management department closely monitors risk limits set for the purpose and periodically reviews credit underwriting and delivery procedures to avoid concentration of exposures to set of individuals and group.

IML does not have any concentration risk in its portfolio, other than a higher exposure to gold loans which are secured by liquid collateral. The shorter maturity of the gold loans mitigates our commodity risks to an extent.

ICAAP driven outcome for Credit Concentration risk

Accordingly, the ICAAP driven capital on account of Credit Concentration risk is near zero. Risk Management Committee may review the price risk in gold loan portfolio and may suggest capital buffer, where necessary.

17.6 Liquidity Risk

IML is aware of the implications of a liquidity risk in its operations. IMLs major funding source are Bank lines from several Banks, through non-convertible debentures from

market and from Multi-lateral agency (IFC). All these are stable funding lines established for a long period of time without any disruptions. In fact, IML's liquidity risk could withstand the long pandemic disruption recently.

17.6.1 Risk Mitigants in place

In compliance with RBI directives IML maintains a strong oversight over the liquidity through ALCO. As required under Regulatory directions liquidity gaps (LCR) and other liquidity ratios are set and monitored including contingency funding plan maintenance of HQLAs at appropriate levels. IML maintains a comfortable level of unencumbered cash/bank balances to address any temporary liquidity stress.

At any point of time the funding pipeline is proactively monitored by ALCO for remedying any likely bottlenecks. IML's Benchmark lending rate is computed by adding a liquidity premium component in addition to other standard components to take care of any cost associated with liquidity tightness.

17.6.2 ICAAP driven outcome for Liquidity risk

Accordingly given the aforesaid details the ICAAP driven capital on account of liquidity risk is NIL

17.7 Off-Balance Sheet Exposures and Securitization Risk

Transactions that are off balance sheet in IML's books are by way of hedging balance sheet items with a perfect hedge model without exposing any risk. Accordingly, the off-balance sheet driven ICAAP outcome is NIL

17.8 Reputation Risk

IML is aware of the reputational risk dimensions and has put in place a reputational risk policy and procedure to mitigate any such risk erupting from diverse origins. IML has identified the following early warning indicators which may affect its Reputation and correction/mitigation plans which may be initiated when these indicators breach a certain "trigger point" identified based on past trends in the warning indicators.

Parameter	Threshold (Tolerance) level
Business growth	Annual growth in major business segments not to lag behind more than 10% of annual sectoral growth of major business segments.
Profitability	ROE shall not be below 14% for IML (Standalone) and 10 to 15% for other verticals. (ROE based on the minimum regulatory prescribed capital).
CRAR	Not to fall below 25%

Dividend	Annual payout ratio not below 10%
NPA	Maximum Gross NPA 1% higher than the reported Gross NPA% of the previous year.
Qualifications impacting financials of the company by the statutory auditors	NIL
Imposition of fines by regulators	Maximum 2 in a year
Share price movement	Downward movement in share prices should not be higher than 25% variation of the peer group or retail lenders index.
Filing of regulatory returns	Within the stipulated time.
Timely payment of statutory dues	Within the stipulated time.
High Risk Internal Audit Observations.	Maximum 5 in a quarter
Departure of Senior Executives	Maximum 1 in a quarter
Employee agitation	Maximum of loss of working days due to strike – 10 days in a year.
Disproportionate disciplinary actions against employees, compared to industry norms.	NIL
Customer complaints	To maintain the ratio of complaints to total customers at the same level of previous year.
Adverse reporting in mainstream media affecting corporate governance.	NIL
Adverse news report on customer / employee fraud.	Maximum 5.
Maintenance of liquidity Coverage Ratio.	Minimum prescribed by regulator. (No breaches)
Compliance to disclosures	There shall be no exceptions
Undisclosed related party transactions.	NIL
System outage	Maximum 1 hour in a quarter (Other than scheduled breaks for maintenance)
Loss on employee fraud	Maximum Rs 10 cr per annum
Major frauds committed by vendors and agents	NIL
Unsatisfied customer complaints unresolved for more than one month.	NIL

Delay / default in servicing loans	NIL
Delay / defaulting interest and principal for NCDs	NIL
Delay / default in payment of vendor bills without adequate reasons.	NIL
Leakage of customer data	NIL
Borrowing cost goes up above peers.	Maximum 1% above the peers.
Delay / omissions for convening statutory meetings	NIL
Suspicious transactions.	Such transaction shall not exceed 100 in a year.
Non observance of mock security alert.	NIL
Defects in functioning of Disaster Recovery system.	NIL

Reputation risk from Implicit support: IML does not extend any implicit support to any counterparties whether for resource raising or for product promotion activities.

Accordingly, the ICAAP driven capital estimate for Reputation risk is NIL.

Exchange Rate risk

Exchange risk arise in the event of any Foreign currency position on account of foreign currency stock, un hedged foreign currency exposure etc. The risk here is NIL

17.9 Talent Risk

Resignation has become an economic trend as people have chosen to pursue new employment while adjusting to a hybrid work environment. Employee retention risk can have many unseen repercussions in the short term. Some of the risks due to employee attrition are given below:

a) Having unfilled key positions can lead to missed targets and disrupt business continuity.
b) High attrition of critical workforce poses obstacles to business growth, raising succession/ transition risk and increasing costs associated with untrained or unprepared talent.
c) Workforces possess critical skills required to maintain a competitive edge in a market where new products and technologies emerge every other day.

d) Industry experience has shown a direct correlation between attrition and employee productivity. Failing to enhance employee productivity can result in unmet business targets, lower profits and higher HR costs.

A lack of appropriate hiring risk controls can lead to employment of suboptimal talent — either overpaying for workers' experience/skills or a misalignment between workforce skills and business requirements.

IML follows attractive HR policies like promotions based on the performance, upskilling through in house and outside training, free education up to post graduate levels in management, accounting, engineering, computer science, law etc.

18 Stress testing of the model and methodology

'Stress testing' refers to various techniques (quantitative and/ or qualitative) used by the IML to gauge its vulnerability to exceptional but plausible events. Stress testing is a risk management technique used to evaluate the potential effects on IML's financial condition of a specific event and/ or movement in a set of financialvariables.

18.4 Purpose - Stress Testing Framework

IML would use stress tests for:

- Understanding its risk profile and communicating the same to the Board/senior management for setting risk limits.
- Allocating capital for various risks.
- Managing risk exposures; and
- Putting in place appropriate contingency plans for meeting the situations thatmay arise under adverse circumstances.

The stress test framework has been devised and implemented in a manner which factors in the Pillar II requirements of RBI and will, thus, serve as an essential aspectof IML's ICAAP.

18.5 Scope of the Stress Testing Framework

The scope of the stress testing framework has the following components:

- ***Proportional to the Size and Complexity of the NBFC:*** IML is a leading NBFC offering standardized Loan products suitable to the certain segment of the Indian population. Generally, IML does not deal incomplex derivative instruments and hence it proposes to rely more on sensitivity tests rather than scenario tests in its overall approach to stresstesting.
- ***Coverage of stress testing:*** The stress testing framework includes all the risks that the IML considers as material. These include-
    - Credit Risk

- Market Risk
- Operational Risk
- Liquidity Risk
- Interest Rate Risk
- Credit Concentration Risk
- Reputational Risk
- Strategic Risk

18.6 Analysis of the Stress Scenarios

Stress scenarios, based on the severity of change in the risk drivers, would be constructed viz. low, medium and high and their impact would be assessed both in terms of additional capital requirement, profitability and anyincrease in the IML's Non-Performing Assets (NPAs). Finally, impact of allthe above risks under different stress scenarios would be aggregated and would be translated in terms of its impact on capital ratios.

18.7 Frequency of Stress Testing

The frequency of stress testing will be based on volatility of risk drivers, complexity of stress tests and subject to significant changes in the external environment and availability of external data for stress testing. Though, various parameters used in assessing various types of risks on standalone basis are usually correlated, however, on portfolio basis, in stress situation the correlation that prevails in ordinary conditions ceases toexist and all risks are likely to move in the same direction though the extent of movement may vary. Keeping this in view, while aggregating the impact of stress scenarios, IML would not consider any diversification benefit.

18.8 ***The different types of stress tests are:*** Based upon the identification of material risks, IML would define material risk drivers that should be subject to stress testing. (Risk definitions are provided in Annexure 2)

19 Preparation of ICAAP document

The process of ICAAP culminates into preparation of a detailed document as specified in the RBI circular (Annexure 15). While this is applicable for Banks with diverse and complex nature of products and services in comparison to IML and requires to be submitted to RBI by Banks. RBI has not stipulated any format for NBFCs yet. However, documenting ICAAP outcome being a natural consequence of the process it is most likely that corresponding directions may be forthcoming. Until then the format may be referred as guidance and to the extent possible IML shall start compiling the report in a simpler version by filling whatever is applicable.

Annexure 1

An illustrative outline of the ICAAP Document

1. What is an ICAAP document?

The ICAAP Document would be a comprehensive Paper furnishing detailed information on the ongoing assessment of the IML's entire spectrum of risks, how IML intends to mitigate those risks and how much current and future capital is necessary for the IML, reckoning other mitigating factors.

2. Contents

The ICAAP Document should contain the following sections:

I. Executive Summary
II. Background
III. Summary of current and projected financial and capital positions
IV. Capital Adequacy
V. Key sensitivities and future scenarios
VI. Aggregation and diversification
VII. Testing and adoption of the ICAAP
VIII. Use of the ICAAP within the Company.

2.1 Executive Summary

The purpose of the Executive Summary is to present an overview of the ICAAP methodology and results. This overview would typically include:

a) the purpose of the report and the regulated entities within a banking group that are covered by the ICAAP;
b) the main findings of the ICAAP analysis:
   (i) how much and what composition of internal capital IML considers it should holds compared with the minimum CRAR requirement (CRAR) under 'Pillar 1' calculation, and
   (ii) the adequacy of the IML's risk management processes;
c) a summary of the financial position of IML, including the strategic position of IML, its balance sheet strength, and future profitability;
d) brief descriptions of the capital raising and dividend plan including how IML intends to manage its capital in the days ahead and for what purposes;
e) commentary on the most material risks to which IML is exposed, why the level of risk is considered acceptable or, if it is not, what mitigating actions are planned;

f) commentary on major issues where further analysis and decisions are required; and
g) who has carried out the assessment, how it has been challenged / validated / stress tested, and who has approved it.

2.2 Background

This section would cover the relevant organizational and historical financial data of IML e.g. group structure (legal and operational), operating profit, profit before tax, profit after tax, dividends, shareholders' funds, capital funds held vis-à-vis the regulatory requirements, total assets, and any conclusions that can be drawn from trends in the data which may have implications for IML's future.

2.2 Summary of current and projected financial and capital positions

This section would explain the present financial position of IML and expected changes to the current business profile, the environment in which it expects to operate, its projected business plans (by appropriate lines of business), projected financial position, and future planned sources of capital.

The starting balance sheet used as reference and date as of which the assessment is carried out should be indicated. The projected financial position could reckon both the projected capital available and projected capital requirements based on envisaged business plans. These might then provide a basis against which adverse scenarios might be compared.

2.4 Capital Adequacy

This section might start with a description of risk appetite, in quantitative terms, as approved by the Board and used in the ICAAP. It would be necessary to clearly spell out in the document whether what is being presented represents the IML's view of the amount of capital required to meet minimum regulatory needs or whether represents the amount of capital that IML believes it would need to meet its business plans. For instance, it should be clearly brought out whether the capital required is based on a particular credit rating desired by IML or includes buffers for strategic purposes or seeks to minimize the chance of breaching regulatory requirements. Where economic capital models are used for internal capital assessment, the confidence level, time horizon, and description of the event to which the confidence level relates, should also be enumerated. Where scenario analyses or other means are used for capital assessment, then the basis / rationale for selecting the chosen severity of scenarios used, should also be included.

The section would then include a detailed review of the capital adequacy of IML. The information provided would include the following elements:

Timing

- the effective date of the ICAAP calculations together with details of any events between this date and the date of submission to the Board / RBI which would materially impact the ICAAP calculations together with their effects; and
- details of, and rationale for, the time period selected for which capital requirement has been assessed.

Risks Analysed

- an identification of the major risks faced by IML in each of the following categories: a) credit risk, b) market risk, c) operational risk, d) liquidity risk, e) concentration risk, f) interest rate risk in the banking book, g) residual risk of securitization, h) strategic risk, i) business risk j) reputation risk, k) group risk, l) pension obligation risk, m) other residual risk and n) any other risks that might have been identified
- for each of these risks, an explanation of how the risk has been assessed and to the extent possible, the quantitative results of that assessment
- where some of these risks have been highlighted in the report of the RBI's on-site inspection, an explanation of how IML has mitigated these;
- where relevant, a comparison of the RBI-assessed CRAR during on-site inspection with the results of the CRAR calculations under the ICAAP;
- a clear articulation of the risk appetite, in quantitative terms, by risk category and the extent of its consistency (its 'fit') with the overall assessment of IML's various risks; and
- where relevant, an explanation of any other methods, apart from capital, used by IML to mitigate the risks.

2.5 Methodology and Assumptions

A description of how assessments for each of the major risks have been approached and the main assumptions made. For instance, IML may choose to base their ICAAP on the results of the CRAR calculation with the capital for additional risks (e.g., concentration risk, interest rate risk in the banking book, etc.) assessed separately and added to the Pillar 1 computations. Alternatively, IML could choose to base their ICAAP on internal models for all risks, including those covered under the CRAR (i.e., Credit, Market and Operational Risks).

The description here would make clear which risks are covered by which modelling or calculation approach. This would include details of the methodology and process used to calculate risks in each of the categories identified and reason for choosing the method used in each case.

Where IML uses an internal model for the quantification of its risks, this section should explain for each of those models:

- the key assumptions and parameters within the capital modelling work and background information on the derivation of any key assumptions;
- how parameters have been chosen, including the historical period used and the calibration process;
- the limitations of the model;
- the sensitivity of the model to changes in those key assumptions or parameters chosen; and
- the validation work undertaken to ensure the continuing adequacy of the model.

Where stress tests or scenario analyses have been used to validate, supplement, or probe the results of other modelling approaches, then this section should provide:

- details of simulations to capture risks not well estimated by the IML's internal capital model (e.g., non-linear products, concentrations, illiquidity and shifts in correlations in a crisis period);
- details of the quantitative results of stress tests and scenario analyses IML carried out and the confidence levels and key assumptions behind those analyses, including, the distribution of outcomes obtained for the main individual risk factors;
- details of the range of combined adverse scenarios which have been applied, how these were derived and the resulting capital requirements; and
- where applicable, details of any additional business-unit-specific or business-plan-specific stress tests selected.

2.6 Capital Transferability

In case of banks with conglomerate structure, details of any restrictions on the management's ability to transfer capital into or out of the banking business(es) arising from, for example, by contractual, commercial, regulatory or statutory constraints that apply, should be furnished. Any restrictions applicable and flexibility available for distribution of dividend by the entities in the Group could also be enumerated. In the case of overseas banking subsidiaries of the banks, the regulatory restrictions would include the minimum regulatory capital level acceptable to the host country regulator of the subsidiary, after declaration of dividend.

2.7 Firm-wide risk oversight and specific aspects of risk management

2.7.1 Risk Management System in IML

This section would describe the risk management infrastructure within along the following lines:

- The oversight of board and senior management
- Policies, Procedures and Limits

- identification, measurement, mitigation, controlling and reporting of risks
- MIS at the firm wide level
- Internal controls

2.7.2 Off-balance Sheet Exposures with a focus on securitization

This section would comprehensively discuss and analyse underlying risks inherent in the off-balance sheet exposures, particularly its investment in structured products. When assessing securitization exposures, IML should thoroughly analyse the credit quality and risk characteristics of the underlying exposures. This section should also comprehensively explain the maturity of the exposures underlying securitisation transactions relative to issued liabilities in order to assess potential maturity mismatches.

2.7.3 Assessment of Reputational Risk and Implicit Support

This section should discuss the possibilities of reputational risk leading to provision of implicit support, which might give rise to credit, market and legal risks. This section should thoroughly discuss potential sources of reputational risk.

2.7.4 Assessment of valuation and Liquidity Risk

This section would describe the governance structures and control processes for valuing exposures for risk management and financial reporting purposes, with a special focus on valuation of illiquid positions. This section will have relevant details leading to the establishment and verification of valuations for instruments and transactions in which it engages.

2.7.5 Stress Testing practices

This section would explain the role of board and senior management in setting stress testing objectives, defining scenarios, discussing the results of stress tests, assessing potential actions and decision making on the basis of results of stress tests. This section would also describe the rigorous and forward-looking stress testing that identifies possible events or changes in market conditions that could adversely impact IML. RBI would assess the effectiveness of IMLs' stress testing programme in identifying relevant vulnerabilities.

2.7.6 Sound compensation practices

This section should describe the compensation practices followed by IML and how far the compensation practices are linked to long-term capital preservation and the financial strength of the firm. The calculation of risk-adjusted performance measure for the employees and its link, if any, with the compensation should clearly be disclosed in this section.

2.8 Key sensitivities and future scenarios

This section would explain how IML would be affected by an economic recession or downswings in the business cycle or markets relevant to its activities. The RBI would like to be apprised as to how IML would manage its business and capital so as to survive a recession while meeting the minimum regulatory standards. The analysis would include future financial projections for, say, three to five years based on business plans and solvency calculations. For the purpose of this analysis, the severity of the recession reckoned should typically be one that occurs only once in a 25 year period. The time horizon would be from the day of the ICAAP calculation to at least the deepest part of the recession envisaged.

Typical scenarios would include:

- how an economic downturn would affect:
- IML's capital funds and future earnings; and
- IML's CRAR taking into account future changes in its projected balance sheet.
- In both cases, it would be helpful if these projections show separately the effects of management actions to change IML's business strategy and the implementation of contingency plans.
- projections of the future CRAR would include the effect of changes in the credit quality of IML's credit risk counterparties (including migration in their ratings during a recession) and IML's capital and its credit risk capital requirement.
- an assessment by IML of any other capital planning actions to enable it to continue to meet its regulatory capital requirements throughout a recession such as new capital injections from related companies or new share issues.
- This section would also explain which key macroeconomic factors are being stressed, and how those have been identified as drivers of IML's earnings. IML would also explain how the macroeconomic factors affect the key parameters of the internal model by demonstrating, for instance, how the relationship between the two has been established.

2.9 Management Actions

This section would elaborate on the management actions assumed in deriving the ICAAP, in particular:

- the quantitative impact of management actions – sensitivity testing of key management actions and revised ICAAP figures with management actions excluded.
- evidence of management actions implemented in the past during similar periods of economic stress.

2.10 Aggregation and Diversification

This section would describe how the results of the various separate risk assessments are brought together and an overall view taken on capital adequacy. At a technical level, this would, therefore, require some method to be used to combine the various risks using some appropriate quantitative techniques. At the broader level, the overall reasonableness of the detailed quantification approaches might be compared with the results of an analysis of capital planning and a view taken by senior management as to the overall level of capital that is considered appropriate.

- In enumerating the process of technical aggregation, the following aspects could be covered:
  i. any allowance made for diversification, including any assumed correlations within risks and between risks and how such correlations have been assessed, including in stressed conditions.
  ii. the justification for any credit taken for diversification benefits between legal entities, and the justification for the free movement of capital, if any assumed, between them in times of financial stress.
  iii. the impact of diversification benefits with management actions excluded. It might be helpful to work out revised ICAAP figures with all correlations set to '1' i.e., no diversification; and similar figures with all correlations set to '0' i.e., assuming all risks are independent i.e., full diversification.

- As regards the overall assessment, this should describe how IML has arrived at its overall assessment of the capital it needs taking into account such matters as:
  i. the inherent uncertainty in any modelling approach;
  ii. weaknesses in IML's risk management procedures, systems or controls;
  iii. the differences between regulatory capital and internal capital; and
  iv. the differing purposes that capital serves: shareholder returns, rating objectives for IML as a whole or for certain debt instruments IML has issued, avoidance of regulatory intervention, protection against uncertain events, depositor protection, working capital, capital held for strategic acquisitions, etc.

2.11 Testing and Adoption of the ICAAP

This section would describe the extent of challenging and testing that the ICAAP has been subjected to. It would thus include the testing and control processes applied to the ICAAP models and calculations. It should also describe the process of review of the test results by the senior management or the Board and the approval of the results by them. A copy of any relevant report placed before the senior management or the Board of IML in this regard, along with their response, could be attached to the ICAAP Document sent to the RBI. Details of the reliance placed on any external service providers or consultants in the testing process, for instance, for generating economic scenarios, could also be detailed

here. In addition, a copy of any report obtained from an external reviewer or internal audit should also be sent to the RBI.

2.12 Use of the ICAAP within IML

This section would contain information to demonstrate the extent to which the concept of capital management is embedded within IML, including the extent and use of capital modelling or scenario analyses and stress testing within IML's capital management policy. For instance, use of ICAAP in setting pricing and charges and the level and nature of future business, could be an indicator in this regard.

This section could also include a statement of IML's actual operating philosophy on capital management and how this fits in to the ICAAP Document submitted. For instance, differences in risk appetite used in preparing the ICAAP Document vis-à-vis that used for business decisions might be discussed.

Lastly, IML may also furnish the details of any anticipated future refinements envisaged in the ICAAP (highlighting those aspects which are work-in-progress) apart from any other information that IML believes would be helpful to the RBI in reviewing the ICAAP Document.

Annexure 2

Risk Definitions

Risk type	Definition
Credit Risk	Credit Risk is defined as the "risk of failure of the counterparty in keeping up its commitments. It can be further described as credit risk is the risk of default on a debt that may arise from a borrower failing to make required payments. In the first resort, the risk is that of the lender and includes lost principal and interest, disruption to cash flows, and increased collection costs.
Market Risk	Market Risk is defined as the risks arising from movements in interest rates and exchange rates, on the overall businesses of the company.
Operational Risk	Operational Risk is the risk of losses arising from failed or inadequate processes, systems, people and due to external events. Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.
Interest Rate Risk in Banking Book (IRRBB)	IRRBB refers to the risk arising on account of adverse interest rate fluctuations on interest rate sensitive assets and interest rate sensitive liabilities, which are held in the banking book. In short term perspective Traditional Gap Analysis (TGA) approach- it is the risk of an adverse impact on net interest income arising from timing differences in re pricing of various items of assets liabilities. In long term perspective Duration Gap Analysis (DGA) approach - it is the risk arising from adverse impact on the Bank's economic value of equity, due to duration gap between assets and liabilities.
Credit Concentration Risk	Concentration risk occurs when there is any single exposure or a group of exposure with the potential to produce losses large enough to threaten a NBFC's health or ability to maintain its core operations. In other words, it denotes the risk arising from an uneven distribution of assets among counterparties in credit or across rating grades, sectors or industry, or to a concentration in specific business sectors or geographical regions which is capable of generating losses large enough to jeopardize the company's solvency.

Liquidity risk	Liquidity" means NBFC's capacity to fund the increase in assets and meet both expected and unexpected cash and collateral obligations at reasonable cost and without incurring unacceptable losses. Liquidity Risk" means the risk of inability of an NBFC to meet such obligations as they become due without adversely affecting the NBFC's financial condition. Effective liquidity risk management ensure an NBFC's ability to meet its obligations as and when they fall due and reduces the probability of an adverse situation developing.
Reputational risk	Reputation risk" means the risk that the Companies reputation is damaged by one or more than one reputation event, as reflected from negative publicity about the Companies business practices, conduct or financial condition. Such risk can emanate from social media postings by individuals directly or using disguised names, groups deliberately targeting the company and by digital news channels by planning and pushing news against the company frivolous or otherwise. Such negative publicity, whether true or not, may impair public confidence in the company, result in costly litigation, or lead to a decline in its customer base, business, or revenue. Although fundamental to the success of an organization, reputation risk falls outside the scope of traditional enterprise risk management – largely because it is hard to neatly package and measure. It is not an operational risk – it could better be described as a strategic risk
Strategic risk	Strategic Risk is the most fundamental of business risks and at its very basic, can be defined as the risk associated with an entity's business model and the way an organization wants to position itself strategically. Strategic risk or business risk means the current and prospective risk to earnings and viability arising from: • Adverse changes in business environment with respect to the economy, political landscape, regulations, technology and actions of competitors. • Adverse business decisions, • Improper implementation of decisions • Lack of responsiveness to changes in the business environment.

Risk of under-estimation of credit risk under the standardized approach	The risk that capital charge specified for credit risk under standardized approach fails to cover losses occurring due to manifestation of credit risk.
Settlement risk	The settlement risk can be defined as the risk of one counter party failing to deliver the terms of contract with us at the time of settlement. The banks encounter settlement risk in foreign exchange transactions and in trade of other financial instruments without central counterparty.
Legal Risk	Legal risk includes, but is not limited to, exposure to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements.
Risk of weakness in the credit-risk mitigants	The risk that Banks' capital funds will be adversely affected due to fall in value of risk mitigants.
Cyber security/IT infrastructure risk	Cybersecurity risks relate to the loss of confidentiality, integrity, or availability of information, data, or information (or control) systems and reflect the potential adverse impacts to organizational operations (i.e., mission, functions, image, or reputation) and assets, individuals, other organizations, and the Nation
Model risk	The Risk of Under-Estimation of Credit Risk under the IRB Approaches
Outsourcing / Vendor Management Risk	Risk of dealing with vendors having bad reputation, adopting illegal or unethical business practices, evasion of taxes, charging exorbitant interest rates, dishonoring commitments etc.
Collateral Risk	The risk of loss arising from errors in the nature, quantity, pricing, or characteristics of collateral securing a transaction with credit risk
Human Capital Risk	Human capital risk refers to the gap between the human capital requirements of a company or organization and the existing human capital of its workforce. This gap can lead a company towards inefficiencies, inability to achieve its goals, a poor reputation, fraud, financial loss, and eventual closure.

Fraud Risk	Fraud risk is the possibility of any unexpected loss, be it financial, reputational, or material, due to fraudulent activity by an internal or external actor. The impact of fraud can be seen in the form of: Financial losses, due to theft, embezzlement, or other types of financial crime.
Climate Risk	Climate risk is the potential for climate change to create adverse consequences for human or ecological systems. This includes impacts on lives, livelihoods, health and wellbeing, economic, social and cultural assets and investments, infrastructure, services provision, ecosystems and species
Political Risk	Political risk is the risk an investment's returns could suffer as a result of political changes or instability in a country. Instability affecting investment returns could stem from a change in government, legislative bodies, other foreign policymakers or military control.
Residual Risk	The residual risk is the amount of risk or danger associated with an action or event remaining after natural or inherent risks have been reduced by risk controls.