EXPECTED CREDIT LOSS POLICY (ECL POLICY)

1. PURPOSE

Premier Ferro Alloys & Securities Limited (PFASL) is a Non- Banking Financial Company registered with the Reserve Bank of India and having its registered office at Emami Tower, 2nd Floor, EM By Pass, Kolkata – 700107, West Bengal. Currently the company is categorized as a Systemically Important Non Deposit taking NBFC (NBFC-ND-SI).

This document is an Integrated Policy (IP) providing norms and disclosure guidance on the subject of provisioning required for Non-performing financial assets (loans) as per the requirement of Indian Accounting Standards ('Ind AS') 109 'Financial Instruments'

The IP lays down a consolidated and integrated framework for timely identification, recognition, monitoring and appropriate classification of non-performing financial assets. This guidance is formulated so as to ensure adequate clarity and pursuit of a uniform approach while complying with the requirement of Ind AS 109.

2. SCOPE

Ind AS 109 introduces the requirement to compute Expected Credit Loss ('ECL') on all financial assets, at the time of origination and at every reporting date. The new impairment requirements are a forward looking framework and is set to replace the existing rule based provisioning norms followed by the company as per the requirements of the RBI guidelines. The provisioning approach has now moved from incurred to expected loss model, which means an entity needs to understand the significance of credit risk and its movement since its initial recognition.

The new credit impairment model as prescribed by Ind AS 109, not only considers historical data but also requires the company to consider the forward looking information. These forward looking information are related to managements own estimate of their customers like expected recovery patterns, probability of default, time of recovery, amount expected to be recovered from collaterals, etc. as well as macro-economic factors like recession, unemployment, etc. Further, judgment is required to decide whether to make the individual assessment or portfolio level assessment for ECL.

3. **What is ECL?**

Credit losses are defined as the difference between the contractual/behavioral cash flow due to the company for a particular facility and cash flow that the company expects to receive. This difference is discounted at the effective interest rate to arrive at the present value of amount of ECL. Ind AS 109 lists down various risk components and its requirements for ECL modelling in order to be compliant with the standard but does not prescribe any fixed or prescribed methodology. RBI through its circular RBI/2019-20/170 DOR (NBFC).CC.PD.No.109/22.10.106/2019-20 dated 13th March 2020 has provided various aspects on ECL provisioning which applicable NBFCs have to follow. Company shall take effect of matters pointed in the aforesaid circular being reproduced below for computation and presentation of ECL provisions in its financial statements.

"NBFCs shall hold impairment allowances as required by Ind AS. In parallel, NBFCs shall also maintain the asset classification and compute provisions as per extant prudential norms on Income Recognition, Asset Classification and Provisioning (IRACP) including borrower/beneficiary wise classification, provisioning for standard as well as restructured assets, NPA ageing, etc.

Where impairment allowance under Ind AS 109 is lower than the provisioning required under IRACP (including standard asset provisioning), NBFCs/ARCs shall appropriate the difference from their net profit or loss after tax to a separate 'Impairment Reserve'. The balance in the 'Impairment Reserve' shall not be reckoned for regulatory capital. Further, no withdrawals shall be permitted from this reserve without prior permission from the Department of Supervision, RBI. (c)The requirement for 'Impairment Reserve' shall be reviewed, going forward."

4. **Business Segments:**

The Company is providing loans to meet the demand of the group companies (the details of which are already taken on record and shared with RBI during its inspection for FY 2018-19) and others on call and demand basis. Thus for the purpose of ECL, the company has divided its loan portfolio in following types of facilities:

a. Loans given to the Group Companies
b. Loans given to the Companies outside the Group

5. The IP aims at early identification and appropriate treatment of non-performing financial loans/ stressed clients/ overdue positions that cease to generate income for the business segment and their timely and appropriate recognition and disclosure in the financial statements.

6. **Staging of Loans:**

Loans are divided into four stages basis the number of days past due (DPD) as detailed below:

Number of Days past dues	Staging
1 to 30 days	Stage 1
31 to 90 days	Stage 2
More than 90 days	Stage 3

7. **12 months ECL versus Life time ECL**

For all stage 1, ECL is calculated based on defaults that are probable in the next 12 months i.e. 12 months ECL. For stage 1 loans it is presumed that there is no significant increase in the credit risk (SICR) from the date of initial recognition.

As per para 5.5.11 of Ind AS 109, regardless of the way in which an entity assesses significant increase in credit risk, there is a rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due (DPD). An entity can rebut this presumption if the entity has reasonable and supportable information that is available without undue cost or effort, that demonstrates that the credit risk has not increased significantly since initial recognition even though the contractual payments are more than 30 days past due.

Thus when the delay in repayment crosses 30 DPD, the company considers that there is no such SICR and provides for 12 months ECL depending upon the past historic data on such loans. This includes all stage 2 loans.

When the delay in repayment crosses 90 DPD, the loans are classified as stage 3 which means that the asset becomes credit impaired and life time ECL provision is made on these assets. This is in line with para B5.5.37 of Ind AS 109, which lays down the rebuttable presumption for default or credit impaired assets. It states, 'However, there is a rebuttable presumption that default does not occur later than when a

financial asset is 90 days past due unless an entity has reasonable and supportable information to demonstrate that a more lagging default criterion is more appropriate. The definition of default used for these purposes shall be applied consistently to all financial instruments unless information becomes available that demonstrates that another default definition is more appropriate for a particular financial instrument'.

To determine if the risk of default of a financial instrument has increased significantly since initial recognition, the current risk of default at the reporting date is compared with the risk of default at initial recognition. To make the assessment, the company considers changes in the risk of default instead of changes in the amount of expected credit losses.

Assessment of whether there has been a significant increase in credit risk is required to be carried out at each reporting date. An asset can move into and out of the lifetime ECLs category based on the fact pattern.

The term 'significant increase' has not been defined in Ind AS 109. Determining if there has been a significant increase in credit risk requires considerable judgement of the company's risk management department and is currently based on the number of days past due and few qualitative aspects discussed later in this IP document.

<u>Reclassification from life time ECL to 12 months ECL:</u>

As per para 5.5.7 of Ind AS 109, the company can reclassify a particular loan balance from life time ECL to 12 months ECL, if on the reporting date the company is of the opinion that there is no significant increase in the credit risk from the date of initial recognition.

8. **Computation of ECL:**

The formula used to compute ECL is:

ECL= PD*LGD*EAD*EIR

✓ **Probability of Default (PD):**

PD is an estimate of the likelihood of a default over a given time horizon.

✓ **Loss given default (LGD):**

LGD is an estimate of the loss from a transaction given that a default occurs. Under Ind AS 109, lifetime LGDs are defined as a collection of LGD estimates applicable to different future periods.

The LGD component of ECL is independent of deterioration of asset quality, and thus applied uniformly across various stages with the applicable PD for stage 1, 2 and 3.

In case of a collateralised portfolio, account level LGD shall be estimated based on the collateral coverage after adjusting the collaterals with worked out haircuts.

✓ **Exposure at default (EAD)**

EAD is one of the key components for ECL computation. EAD is the expected outstanding balance of receivables at the point of default which comprises principal outstanding and principal overdue plus interest accrued up to the date of default. The EAD shall be the actual outstanding of the loan.

9. **Qualitative aspects**

Apart from making template based provision for ECL, the company is also required to undertake a qualitative check on its loan portfolio and accounts which are in stage 1 or 2 but which satisfies certain qualitative parameter documented by the company, which significantly increases the credit risk, are to be treated as credit impaired and accordingly provisioning is done as per stage 3. The illustrative list of qualitative criteria considered by the company are:

1. Default in payment to the banks/ sundry debtors and other statutory bodies, etc., bouncing of the high value cheques
2. Frequent change in the scope of the project to be undertaken by the borrower
3. Dispute on title of the collateral securities
4. Delay observed in payment of outstanding dues
5. Reduction in the stake of promoter / director
6. Resignation of the key personnel and frequent changes in the management

7. Material discrepancies in the annual report, etc.

10. **Accounting for Interest Income**

The company accounts interest income on the outstanding amount of its loan portfolio for all its business lines, i.e., interest is accounted on Gross loan amount before deducting the provision.

11. **Write offs:**

The gross carrying amount of a financial asset is written off (either partly or in full) to the extent that there is no reasonable expectation of recovering the asset in its entirety or a portion thereof. This is generally the case when the Company determines based on defined criteria that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts. However, financial assets that are written off could still be subject to enforcement activities under the Company's recovery procedures with appropriate legal advice. Any recoveries and salvages subsequent to write offs is recognized in the statement of profit and loss.

Exhibit : METHODOLOGY USED FOR ECL COMPUTATION

Line of Business	Computation of ECL
a. **Unsecured Call & Demand Loans given to the Group Companies**	These loans are given on call or demand basis to the Group companies. These are those entities the names of which either appears on the list shared with RBI during its inspection for FY 2018-19 or has been considered within the group due to other reasons. These are basically short term loans which does not have any fixed contractual tenure however, the behavioral tenure considering the past trend of repayments is considered on an average of 6 months to 1 year. Number of past years to be considered for calculation of ECL is 5 years. i.e. for the year ended 31 March 2020, DPD of loans for the financial year 2014-15 to financial year 2019-20 is considered. **Staging**: For all these loans staging is calculated on the basis of days past due (DPD) as on the reporting date. **Calculation of PD:** Based upon historical data there has been no default in loans & interest given to group companies. Thus there has been very lower level of probability of these loans getting default. However, PD for loans given may carry certain risks and thus the PD which is similar to PD for other loans is considered from Discussion Paper on Introduction of Dynamic Loan Loss Provisioning Framework for Banks in India (Being 2.85% for both Stage 1 & Stage 2 loans). However, for loans given to the Group Companies the PD is considered as 25% & 50% of PD of Stage 1 and Stage 2 related to Loans given to the Companies outside the Group. PD for stage 3 is 100%. **Calculation of LGD:** As currently, the company does not have much of historical data of actual losses in its portfolio which can be analysed for establishing Loss Rate trends, the company has considered market-based estimates of LGD from external agencies, industry trends and regulatory publications including RBI publications "Discussion Paper on Introduction of Dynamic Loan Loss Provisioning Framework for Banks in India. On basis of the same the LGD has been considered at 66.23%. **EAD:** The EAD for funded facilities shall be the actual outstanding, comprising the principal and interest accrued.

b. Loans given to the Companies outside the Group

These loans are given on call or demand basis to the companies outside the group. These are those entities the names of which either does not appear on the list shared with RBI during its inspection for FY 2018-19 or those which has not been considered within the group due to other reasons. These are basically short term loans which does not have any fixed contractual tenure however, the behavioral tenure considering the past trend of repayments is considered on an average of 6 months to 1 year.

Number of past years to be considered for calculation of ECL is 5 years. i.e. for the year ended 31 March 2020, DPD of loans for the financial year 2014-15 to financial year 2019-20 is considered.

Staging: For all these loans staging is calculated on the basis of days past due (DPD) as on the reporting date.

Calculation of PD: Loans outside the group may carry certain risks and thus the PD which is similar to PD for other loans are considered from Discussion Paper on Introduction of Dynamic Loan Loss Provisioning Framework for Banks in India (Being 2.85% for both Stage 1 & Stage 2 loans). PD for stage 3 is 100%.

Calculation of LGD: As currently, the company does not have much of historical data of actual losses in its portfolio which can be analysed for establishing Loss Rate trends, the company has considered market-based estimates of LGD from external agencies, industry trends and regulatory publications including RBI publications "Discussion Paper on Introduction of Dynamic Loan Loss Provisioning Framework for Banks in India. On basis of the same the LGD has been considered at 66.23%.

EAD: The EAD for funded facilities shall be the actual outstanding, comprising the principal and interest accrued.

IMPLEMENTATION FRAMEWORK

The Management of the Company has mandated the key responsibility of monitoring and evaluation ECL methodology to the Risk department. The said department shall review the periodical outstanding loan balances and credit facilities. When arriving at a value to determine haircut/impairment, it shall prescribe the documents that outline the decision making process, detailed analysis, application of judgment, the acceptable ECL methodology used in determining the amount of impairment, and other considerations used to support the level of impairment including detailed documentation to support judgments. The department shall rely on the independent management reviews and assessments made by it on the basis of review of financial and non-financial parameters. The department shall arrive at conclusions in consultation with the Credit and Finance & Accounts departments.

This ECL policy should be subjected to review and revision not later than on an annual basis.