FINQUEST FINANCIAL SOLUTIONS PRIVATE LIMITED
EXPECTED CREDIT LOSS ESTIMATION POLICY

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Version Control:

Particulars	Date	Version No.
Adopted in the Board Meeting held on	21.01.2021	V. 1
Revision in the Board Meeting held on	02.03.2023	V. 2
Revision in the Board Meeting held on	26.06.2025	V. 3

Contents

1. Purpose

1.1 The Company follows Indian Accounting Standards for preparing its books of accounts. As per Ind AS 109, the Company has to provide for Expected Credit Losses on its financial assets. Further, the RBI Circular (defined below) has directed to have a board approved policy for computation of Expected Credit Loss (ECL) that addresses policies, procedures and controls for assessing and measuring credit risk on all lending exposures, commensurate with the size, complexity and risk profile specific to the NBFC.

1.2 In view of the above, Policy on Expected Credit Loss ("the Policy") has been prepared by the Company for prescribing the guiding principles for assessing and measuring credit risk on all lending exposures, commensurate with the size, complexity and risk profile specific to the Company.

2. Definitions

Unless otherwise defined or apparent from context, the following terms shall have the meaning as assigned herein below, and cognate expressions shall be construed accordingly:

Board/ BoD	shall mean Board of Directors of the Company
Company	shall mean Finquest Financial Solutions Private Limited
RBI Circular	shall mean the Reserve Bank of India (RBI) circular on Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023 dated October 19, 2023.
Policy	shall mean this ECL Policy formulated by the Company
Standard	shall mean Indian Accounting Standard 109

3. Scope of Policy

3.1. The Policy covers the following:
   a. Approach of the Company for computation of ECL
   b. Segmentation of loan portfolio
   c. Mechanics of the computation of ECL – including the assumptions for deriving various factors for computing ECL
   d. Changes in the assumptions by the management
   e. Prudential floor for provisioning against assets as per the applicable regulatory framework

4. Approval Authority

4.1 The Policy is guided by the RBI Circular and Ind AS 109 Financial Instrument. The Policy shall be approved by the Board of Directors of the company and shall be effective and applicable from the date of such approval.

5. Approach

5.1 The Company shall measure the amount of ECL on financial instruments to reflect an unbiased and probability-weighted amount. The ECL will be computed on assets as mentioned in para 5.5.1 of the Standard.

5.2 In this regard, the historical loss experience of the Company and management expertise on similar assets will be considered, and which shall also be further adjusted based on the current observable data. The key inputs into the measurement of ECL are the Probability of Default (PD), Loss Given Default (LGD) and Exposure at Default (EAD).

5.3 These parameters shall be derived from the Company's internally developed statistical models and historical data.

5.4 For new product segments where sufficient historical data is not available, the Company will use external data, which may be procured from credit bureaus and third-party providers for estimating ECL parameters or performance of an existing product which closely resembles the new product.

5.5 In addition, reasonable and supportable information on future economic conditions including macroeconomic factors will be considered. Company shall ensure that the parameters and basis on which ECL is computed are adequately reviewed from time to time in order to ensure that the dynamic nature of such parameters is kept up with.

5.6 In its ECL models, the Company shall rely on a broad range of forward-looking information including macro-economic inputs. As required by the Standard, Macro Economic (ME) overlays will be factored in ECL Models and accordingly, the Company shall use relevant ME variables e. Over time, new ME variable may emerge to have a better correlation and may replace the previous ME being used.

6. Segmentation

6.1 The impairment approach under Ind AS 109 requires financial entities to segmentize their portfolio based on their risk profiles. Accordingly, the entire loan portfolio would be segregated on the basis of homogeneity of borrowers under different risk segments.

6.2 Above segmentation may change from time-to-time based on the changes in business model and associated risks, portfolio performance, change in risk profile etc.

7. Exposure at Default and its Staging

7.1 **Staging of assets**

The Standard requires financial instruments to be categorized into 3 different stages on the basis of the degree of risk. In accordance with the Standard, Company shall undertake staging of assets as follows:

> ➢ Stage 1 – Advances are > 0 days ≤30 days past due (DPD)
> ➢ Stage 2 – Advances are > 30 DPD < 90 DPD and
> ➢ Stage 3 - Advances are 90 DPD and above.

- **Stage 1 – 12- months ECL:** For exposures where there is no significant increase in credit risk since initial recognition and that are not credit-impaired upon origination, that is to say assets with no past overdues shall be under Stage 1. All financial instruments are to be allocated to stage 1 on initial recognition. The portion of the lifetime ECL associated with the probability of default events occurring within the next 12 months will be recognized for Stage 1 assets.

- **Stage 2 – Lifetime ECL, not credit-impaired:** If a significant increase in credit risk (SICR) is identified at the reporting date compared to initial recognition, then instrument is transferred to stage 2. For credit exposures where there has been a significant increase in credit risk since initial recognition but are not credit-impaired, a lifetime ECL is recognized.

- **Stage 3 – Lifetime ECL, credit-impaired:** Financial assets are assessed as credit impaired upon occurrence of one or more events that have a detrimental impact on the estimated future cash flows of that asset. For financial assets that have become credit-impaired, a lifetime ECL is recognized by way of impairment of value of asset.

7.2 **SICR Criteria**

The Company shall continuously monitor all assets subject to ECL Provisioning. In order to determine whether there has been a significant increase in credit risk (SICR) since initial recognition.

Considering the retail nature of lending, DPD movement plays an important role in the risk categorization of the loan portfolio. The Company shall apply a secondary qualitative method for triggering a significant increase in credit risk for an asset, from time to time as may be applicable, such as:

- if contractual payments are more than 30 DPD
- moving of a customer/facility to the negative profile or
- restructuring of the loan account as per Company's policy
- moratorium cases, other than those under special regulatory dispensation, such as a general dispensation during COVID 19

7.3 There is a rebuttable presumption under RBI Circular that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days. However, in limited circumstances, if Company decides to rebut the presumption, for a single

account or a cluster of accounts, it shall be done only with clear documentation of the justification for doing so. All such cases shall be placed before the Audit Committee. Company shall not defer the recognition of significant increase in credit risk (SICR) for any exposure that is overdue beyond 60 DPD.

7.4 The Company shall consider a financial instrument defaulted, and therefore Stage 3 (credit-impaired), for ECL calculations in all cases when the borrower becomes overdue for a period of more than 90 days on its contractual payments. Any exception with respect to classification of accounts that are past due beyond 90 DPD but not treated as impaired, shall be approved by Audit Committee, with the rationale for the same clearly documented. Further, the number of such accounts and the total amount outstanding and the overdue amounts should be disclosed in the notes to the financial statements.

7.5 The categorization of loan portfolio into various stages may be done based on other parameters such credit score etc. EAD, PD, and ECL provision shall be estimated for every stage based on exposure, historical performances, and macro-economic overlay.

8. Exposure at Default

The exposure at default (EAD) is an estimate of the exposure at a reporting date. It shall include outstanding loan amount accrued interest and expected drawdowns on non-discretionary loan commitments.

9. Probability of Default

9.1 The Probability of Default (PD) is the likelihood that the borrower will default in future.

9.2 Analysis of historical data regarding days past due (DPD) or delinquency of loans is the primary input into the determination of the term structure of PD for exposures.

9.3 The Company collects performance and default information about its credit risk exposures analyzed by type of product or borrower as well as by DPD. The Company shall employ Statistical models to analyze the data collected and generate estimates of the PD of exposures.

9.4 In case of newly launched products, where the Company does not have sufficient historical data to estimate PD, it also uses industry level aggregate data obtained from credit bureaus, peer lending institutions, or third-party data providers or performance of an existing product which closely resembles the new product.

Particulars	Stage 1	Stage 2	Stage 3
Classification	Accounts From 0 day and less than or equal to 30 DPD default.	Accounts more than 30 DPD and less than 90 DPD default.	Accounts with more than 90 DPD default.
Period of expected losses	12 months	Lifetime	Lifetime
PD	3.01% * (1-year average Cumulative Default Rate for BB rated debt – Source: Default and rating transition study by CRISIL Ratings up to fiscal 2024)	10.13% (3 years average Cumulative Default Rate for BB rated debt – Source: Default and rating transition study by CRISIL Ratings up to fiscal 2024)	Stage 3 – Provision = Higher of A or B below A. Provision = Difference between the outstanding loan amount and the present value of Realisable value B. Provision = As per RBI's prudential norms
LGD	100%	100%	Stage 3 – Provision = Higher of A or B below: A. Difference between the outstanding loan amount and the present value of Realisable value B. As per RBI's prudential norms.

- For Probability of Default of Group Companies - A provision at the rate of 1% shall be applied to all loan exposures extended to subsidiary and group companies, in recognition of the inherent credit risk and associated probability of default in related party transactions.

10. Loss Given Default

10.1 Loss given default (LGD) is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD.

10.2 The Company uses collection details on previously default cases for calculating the estimated recoveries and consequently the LGD, and further deducts estimated direct cost of collection from default cases.

10.3 Appropriate discounting rates are applied to calculate present value of future estimated collection net of direct collection cost. LGD thus

calculated is used for all stages, i.e. Stage 1, Stage 2 and Stage 3.

10.4 For newly launched products, where historical collection data is not available or insufficient, the Company may use the collection performance of an existing product which closely resembles the new product or industry level aggregate data obtained from credit bureaus/third-party data providers, peer lending institutions or regulatory guidance available if any.

11. ECL computation

ECL shall be computed at each reporting period under different scenarios with weightages decided by management from time-to-time.
Expected Credit Loss = Exposure at default x Probability of default x Loss given default x Discounting Factor
Discounting Factor (Df) will be EIR of the respective portfolio.

The parameters such as PD and LGD shall be refreshed periodically.

12. Management Overlay

12.1 Any overrides to components like PD, LGD, and EAD shall be documented with rationale and such overrides are subject to approval of Audit Committee. Also, the criteria for reversal of the overrides shall be aligned at the time of application of the overrides.

Further, the Management, if it so desires, may provide for higher losses than that arrived at based on the manner discussed above.

Changes in the ECL model, parameters and key assumptions

The parameters and assumptions considered as well as their sensitivity to the ECL output shall be documented. No change in the parameters, assumptions and other aspects of ECL model shall be made merely for the purposes of profit smoothening. The rationale and justification for any change in the estimation methodology of ECL shall be documented and approved by the Board. Similarly, any adjustments to the estimated ECL (i.e. a management overlay) resulting in lower provisioning should be approved by the Audit Committee of the Board (ACB) and its rationale and basis should be clearly documented.
The followings are parameters and assumptions:

i. probability of default (PD), loss given default (LGD), exposure at default (EAD), and discount rate, alongside assumptions about macroeconomic conditions and forward-looking information
ii. Company must conduct sensitivity analysis to understand the impact of changes in these parameters on the ECL as follows:
Stress Testing - Simulating adverse economic conditions to assess the resilience of the ECL estimate.

ECL estimation - Regularly validating the ECL calculation to ensure its accuracy and reliability.

13. Prudential Floor

13.1 Company shall hold impairment allowances as required by Ind AS.

13.2 In parallel, Company 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 which are different compared to principles followed under Ind AS for ECL estimation and accordingly reported where required.

13.3 If the impairment allowance under Ind AS 109 is lower than the provisioning required under IRACP (including standard asset provisioning), Company shall appropriate the difference from its net profit or loss after tax. Endeavor shall be made to make adequate provision through impairment allowance itself.

The difference appropriated against net profit or loss after tax shall be transferred to "Impairment Reserve", the withdrawal from which shall be possible only with the permission of the RBI, or in such manner as may be prescribed by the RBI from time to time.

14. Publishing on website/ Disclosures

Appropriate disclosures as required in regulatory guidelines, from time to time, shall be made by the Company on its website or by way of notes to financial statement.

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