

## Annex 1

### Indicative Illustration on Valuation of Securitised Notes

	End of year-1					End of year-2					End of year-3				
Tranche	Gross outstanding Exposure	RW	RWA	Proportionate weight	Incremental Provision	Gross outstanding Exposure	RW	RWA	Proportionate weight	Incremental Provision	Gross outstanding Exposure	RW	RWA	Proportionate weight	Incremental Provision
Senior	50	100%	50	1.77%	1.77	30	100%	30	1.07%	0.98	10	100%	10	0.36%	0.30
Mezzanine	300	300%	900	31.86%	31.86	300	300%	900	32.09%	29.52	300	300%	900	32.32%	27.15
Equity	150	1250%	1875	66.37%	66.37	150	1250%	1875	66.84%	61.50	150	1250%	1875	67.32%	56.55
<b>Total</b>	<b>500</b>		<b>2825</b>		<b>100</b>	<b>480</b>		<b>2805</b>		<b>92</b>	<b>460</b>		<b>2785</b>		<b>84</b>
Cumulative Provision = 500 * 20% = 100						Cumulative Provision = 480 * 40% = 192					Cumulative Provision = 460 * 60% = 276				

	End of year-4					End of year-5				
Tranche	Gross outstanding Exposure	RW	RWA	Proportionate weight	Incremental Provision	Gross outstanding Exposure	RW	RWA	Proportionate weight	Incremental Provision
Senior	0	100%	0	0.00%	0.00	0	100%	0%	0.00%	0.00
Mezzanine	290	300%	870	31.69%	24.09	270	300%	81000%	30.17%	20.51
Equity	150	1250%	1875	68.31%	51.91	150	1250%	187500%	69.83%	47.49
<b>Total</b>	<b>440</b>		<b>2745</b>		<b>76</b>	<b>420</b>		<b>2685</b>		<b>68</b>
Cumulative Provision = 440 * 80% = 352						Cumulative Provision = 420 * 100% = 420				

**Year-1:** Total tranche-wise exposure (senior, mezzanine, and equity in descending order), as given in the table, for end of year-1 is ₹500 Cr. As prescribed in the Directions, 20% provision (=20% \* ₹500 Cr = ₹100 Cr) is divided among the three tranches in proportion to the products of two factors- exposure amount and risk weights. For illustration, the end of year-1 calculations are explained below:

Tranche	Risk weight <sup>\$</sup>	Exposure (in ₹Cr)	RWA (Risk weight X Exposure)	Weight	Provision (in ₹Cr)
Senior	100%	50	= 50 * 100% = 50	= 50/2825 = 1.77%	= 1.77%*100 Cr = 1.77
Mezzanine	300%	300	900	31.86%	31.86
Equity	1250%	150	1875	66.37%	66.37
<b>Total</b>		<b>500</b>	<b>2825</b>	<b>100%</b>	<b>100</b>

<sup>\$</sup> Actual risk weights shall be derived on the basis of table given under Paragraph 25 of these Directions. Indicative RWs used for simplicity of calculation only.

**Year-2:** Now, we assume that there is recovery of ₹20 Cr which is used to pay off part of senior tranche. Total exposure at the end of year 2 is reduced to ₹480 Cr while net exposure = Rs380 Cr (₹480 Cr – provision of ₹100 year made in year 1). As we have stipulated, total provisioning at the end of year 2 should be 40% of gross outstanding exposure =  $40\% \times 480 \text{ Cr.} = ₹192 \text{ Cr.}$  Out of this total provisioning requirement, ₹100 Cr provisioning has already been made in year-1, so incremental provisioning is only ₹92 Cr as given in the table.

**Note:** *The incremental provisioning estimated in this table does not account for write-back of excess provisioning on account of recovery in any given tranche. The actual requirement for any additional/incremental provisioning shall account for such written back provisions.*

**Year-3:** Similarly, at the end of year-3, total exposure has now been reduced to ₹460 Cr which require total provisioning of  $60\% \times ₹460 \text{ Cr} = ₹276 \text{ Cr}$  out of which cumulative provisioning of ₹192 Cr has already been made in first two years. This implies that incremental provisioning of ₹84 Cr is required in year 3 which will again be redistributed among three tranches in proportion of their risk weighted exposure value. However, if the cumulative provisioning amount required for any tranche works out to more than the outstanding amount for that tranche, then the excess provisioning shall get allotted to the tranche just above it, following the principle of risk-sensitivity. In scenario where even that tranche doesn't have sufficient capacity, the provisioning amount get allotted upwards till it is allotted completely.

For example, in the above example, the cumulative provisions required for the equity tranche at the end of third year would work out to be about ₹184 Cr ( $66.37+61.50+56.55 = 184.42$ ), which is more than the total exposure of ₹150 Cr. Thus, the excess of ₹34 Cr shall be allocated to the tranche just above it, i.e. the mezzanine tranche.

**Year-4:** Similar mechanism as above

**Year-5:** In the last year, as we observe, the gross exposure remains ₹420 Cr (₹80 Cr recovery only) which requires total provisioning of  $100\% = ₹420 \text{ Cr.}$  Out of this, ₹352 Cr has already been provided for, implying the need of incremental provision of ₹68 Cr only. This makes net exposure equals to zero, as desired in the Directions. However, if lender decides to carry this asset beyond the fifth year, then, it should be valued at ₹1.