INDEL MONEY LIMITED

RISK MANAGEMENT POLICY

Introduction

Non-Banking Financial Companies ("**NBFCs**") form an integral part of the Indian financial system. NBFCs are required to ensure that a proper policy framework on risk management systems with the approval of the Board is formulated and put in place. This Policy document has been prepared in line with Reserve Bank of India ("**RBI**") guidelines.

Objective and purpose

The main objective of this Policy is to ensure sustainable business growth with stability and to promote a pro-active approach in reporting, evaluating and resolving risks associated with the business. In order to achieve the key objective, the Policy establishes a structured and disciplined approach to risk management, in order to guide decisions on risk related issues.

General provisions

This Policy represents the basic standards of risk assessment to be followed by the Company. Changes in the Policy will become effective upon approval by Board of Directors of the Company. All relevant employees must be thoroughly familiar or made familiar with it and make use of the material contained in this Policy.

Risk management

Risk management is a business facilitator by making more informed decision with balanced risk-reward paradigm. The Company shall follow a disciplined risk management process and shall take business decisions, ensuring growth and balancing approach on risk reward matrix. The various types of risk associated with our business which are detailed as under:

➢ **Credit risk**

- A risk of loss due to failure of a borrower to meet the contractual obligation of repaying debt as per the agreed terms, is commonly known as risk of default.

- Credit risk encompasses both the loss of income resulting from inability to collect anticipated interest earnings as well as the loss of principal resulting from loan defaults.

- Risk mitigation –

  (a) Location selection

  Before establishing any branch, a detailed survey is conducted which takes into account the following factors:

  (i) Credit culture: To see if there is a history of a good credit culture and some level of financial literacy.
  (ii) Economic activity: To see if it is in an economically active area not overly dependent on seasonal demands or on monsoons, etc.
  (iii) Political stability: To see if there is any history of local political influence on micro finance activities.

  (b) Credit bureau check

A credit check is done for every customer through an automated system-to-system integration with the credit bureau. As part of this check, the various parameters as specified in the loan policy are looked at to verify a customer's credit worthiness and also ensure that they are not overburdened.

These will be dynamic and reviewed periodically based on RBI Regulations, directives and internal norms.

(c) Customer verification

(i) The loan application is processed only after verification of customer's address and documents provided. Every Customer is met by the company official at his/ her residence before loan is approved to confirm the correctness of details furnished.

- **Operational risk**

- Operational risk is the risk of possible losses, resulting from inadequate or failed internal processes, people and systems or from external events.

- The risk can emanate from procedural lapses arising due to higher volumes of transactions; lapses in compliance with established norms; regulatory as well as internal guidelines; misplaced/ lost documents, collusion and fraud; breakdown or non-availability of core business applications.

- Skill gap and sudden attrition of key personnel in the Company, is also an operational risk, which needs to be countered and addressed by the application of appropriate HR strategies.

- Risk mitigation –

(a) Process compliance

(i) Surprise checks on field branches and rate them on pre-defined compliance parameters, identify gaps in process compliance and roll out initiatives to correct loopholes.
(ii) Ensure that the designed processes are being followed on the field – including interaction with the customers during various stages of the relationship lifecycle.
(iii) Ensure all branch activities are carried out as per norms/ procedures as mentioned in the operational manual.
(iv) Identify any process lapses/ deviations and provide guidance to branches/ employees to ensure compliance.
(v) The branches are rated on various pre-defined criteria for its adherence to the processes. Based on the score obtained by the branch, the next visit date shall be determined.
(vi) Training of employees is conducted so as to avoid process violations and ensure strict compliance.

(b) Document storage and retrieval

(i) The Company recognizes the need for proper storage of documents as also their retrieval for audit and statutory requirements.
(ii) Physical storage: The Company shall maintain an established record of all the physical loan documents and shall store them in a specialized secure facility.

(iii) Scanned copies: The Company shall store scanned copies of the loan documents for easy retrieval especially for audit purposes where physical documents are not required.

(iv) The Company maintains software facility to process with system generated records, documents etc.

(c) Non-compliance reporting

(i) The Company encourages all its employees to report any non-compliance of stated processes or policies without fear.

(ii) All issues reported shall be categorized for nature and severity as financial or non-financial; major or minor; procedural lapse or gross violation; and breach in process or disciplinary issue.

(d) Internal audits

(i) The key objective of internal audit department is to cross check the functions and various internal controls existing in the Company, the standards viz. RBI directions, credit policies, KYC aspects etc.

(ii) Deviations will be reported for correction in a timely manner. All significant audit observations of internal audits and follow-up actions are presented to the management.

(e) Reporting structure

(i) It shall be ensured that not more than 500 borrowers are handled by one staff.

(ii) Branches shall have branch head, accounts assistant and assistant branch manager to monitor financial and non-financial parameters of the Company

➢ **Liquidity risk**

- Liquidity risk is the possibility of negative effects on the interests of stakeholders resulting from the inability to meet current cash obligations in a timely and cost-efficient manner.

- Liquidity risk arises largely due to maturity mismatch associated with assets and liabilities of the company. Liquidity risk stems from the inability of the company to fund increase in assets, manage unplanned changes in funding sources and meet financial commitments when required.

- Due to the high reliance on external sources of funds, the Company is exposed to various funding and liquidity risks.

- Concentration of a single source of funds exposes the Company to an inability to raise funds in a planned and timely manner and resort to high cost emergency sources of funds. Further, concentration of funding sources can also result in a skewed maturity profile of liabilities and resultant asset-liability mismatch.

- A high degree of leverage can severely impact the liquidity profile of the Company and lead to default in meeting its liabilities.

- Risk mitigation –

(a) Short term liquidity forecasts to identify gaps and thereby take immediate corrective actions to bridge the same.

(b) The exposure profile to the lenders is regularly updated to ensure that skewness does not creep in in respect of the sources of external funds.

(c) With the major borrowings of the Company in the form of long tenor NCDs, the Company adequately plans its business to meet its repayment obligations in the event of adverse impact on business.

(d) The Company is exposed to perception risk because of inherent industry characteristics. At the risk of negative carry on its funds, it is prudent to maintain some amount of excess liquidity. This enables Company to meet its repayment obligations as well give time to take necessary corrective actions to ensure an adequate funding pipeline.

(e) The Company targets adequate leverage and healthy levels of capital adequacy to safeguard itself against the impact of adverse market conditions. It also affords reasonable time to tie-up timely equity infusion.

(f) Daily cash collection and centralized (Head Office) fund management and loan disbursement through bank channels are implemented by the Company. The Company also maintains daily minimum reserve.

➢ **Portfolio concentration risk**

- This is the risk to Company due to a very high credit exposure to a particular business segment, industry, geography, location, etc. though in the context of micro finance, it pertains predominantly to geographical concentration.

- Risk mitigation –

(a) The Company intends to maintain a diversified exposure in lending to customers across various states to mitigate the risks that could arise due to political or other factors within a particular state.

(b) With this in mind, the Company has steadily diversified its presence to 02 (two) States and is planning to extend its business portfolio to other States as well.

(c) The Company follows district wise allocation of loan portfolio without any religious or community barriers.

➢ **Compliance risk**

- The Company is present in an industry where the Company has to ensure compliance with regulatory and statutory requirements. Non-compliance can result in stringent actions and penalties from the regulator and/ or statutory authorities and which also poses a risk to the Company reputation.

- These risks can take the form of non-compliance with RBI regulations, non-compliance with statutory regulations, Income Tax Act, Companies Act, non-compliance with covenants laid down by lenders etc.

- Risk mitigation – The Company regularly monitors and reviews shortfalls in compliance system and implements measures to rectify variations, if any.

➢ **Reputation risk**

- It is the risk to earnings and capital arising from adverse perception of the image of the Company, on the part of customers, counterparties, shareholders, investors and regulators.

- It refers to the potential adverse effects, which can arise from the Company's reputation getting tarnished due to factors such as unethical practices, political activism, regulatory actions, customer dissatisfaction and complaints leading to negative publicity.

- Presence in a regulated and socially sensitive industry can result in significant impact on Company's reputation and brand equity as perceived by multiple entities like the RBI, Central/ State/ Local authorities, banking industry and customers.

- Risk mitigation –

  (a) Strict adherence to Fair Practices Code: All employees are trained and instructed to follow fair practices in all their dealings.

  (b) Grievance redressal mechanism: The Company has a defined grievance redressal mechanism in place and the same is communicated to all customers.

  (c) Customers connect: The Company has established a tele-calling facility to pro-actively reach out to customers to ensure service quality and adherence to Company policies/ processes by the field employees.

  (d) Delinquency management: The Company does not resort to any coercive recovery practices and ensures delinquency management including restructuring of loans where necessary.

➢ **Interest rate risk**

- Interest rate risk is the risk of financial loss from changes in regulatory changes and market interest rates.

- The greatest interest rate risk occurs when the cost of funds goes up faster than the Company can or is willing to adjust its lending rates.

- Risk mitigation –

  (a) Maintain a financial model that reflects the investment and loan portfolio so as to test the Company's sensitivity to an increase or decrease in interest rates. Company's sensitivity to changes in interest rates affects short and long term profitability.

  (b) Asset and liability management functions to cost-effectively manage borrowed funds and the investment portfolio.

➢ **Governance risk**

- This risk is associated with inadequate governance or a poor governance structure with an organisation.

- As the Company face the challenges of management succession and the need to recruit managers that can balance social and commercial objectives, the role of Directors becomes more important to ensure the Company's continuity and focus.

- Risk mitigation –

    (a) The Board of Directors shall clearly communicate performance expectations and lines of accountability.

    (b) Proper direction and accountability from Board of directors, to oversee effective governance mechanisms, strategic decision making, clearly communicate performance expectations and lines of accountability.

➢ **External business environment risk**

- External business environment risk refers to the inherent risks of the Company's business activity and the external business environment. The Company's business is directly affected by external business environment such as competition, disasters, customer satisfaction etc. The Company needs to check the validity of their assumptions against reality on a periodic basis, so as to respond accordingly.

- While external business risks are out of Company's direct control, Company can still anticipate them and prepare for their impact. As MFIs become formal financial institutions and more linked to the financial and political economy, they become more vulnerable to external risk exposures

- Risk mitigation –

    (a) Integrate an effective system of risk management into the Company's business culture and operations. An effective risk management system to encourage Directors and senior managers to ask whether they are prepared for certain possible internal and external situations and whether they have built in sufficient cushion for unexpected events.

    (b) Reduce vulnerability to external risks by systematically analyzing preparedness for potential events.

➢ **Transaction risk**

- It arises on a daily basis in the Company as transactions are processed and is particularly high as the Company handle high volume of small transactions daily. As the Company make many small, short-term loans, the degree of cross-checking is not cost-effective, so there are more opportunities for error and fraud.

- Inconsistencies between the loan management system data and accounting system data, inadequate loan tracking information, disbursement and payment received information.

- Risk mitigation –

    (a) The Company has implemented simple, standardized and consistent procedures for transactions throughout the branches. Effective internal controls are incorporated into daily procedures to reduce the chance of human error and fraud at the branch level.

(b) Regular MIS reporting, monitoring, rectification and minimizing the number of times data has to be manually entered reduces the chance and frequency of human error. MIS does reflects loan tracking, e.g. disbursements, payments received, current status of outstanding balances etc.

(c) MIS collects data and transforms it into the information which can ensure decision making. MIS generates overdue information almost on a daily basis, which helps in analysing delinquency.

(d) Branches maintain daily zero cash keeping and separate individuals (accounts assistants) monitor transactions in the branches.

➢ **Human Resource risk**

- Human resource risk in the Company arises due employee turnover, replacements, training, skill, etc. Shortage of critical skills within the Company's workforce, compliance/ regulatory issues, succession planning/ leadership, gap between current talent capabilities and business goals also accounts for human resource risk in the Company.

- Risk mitigation –

(a) Ensuring that the right person is assigned to the right job and that they grow and contribute towards Company's excellence.

(b) Company properly analyses and implements methods for recruitment of personnel at various levels in the branches and head office.

(c) Company has proper appraisal systems with the participation of the employee, consistent with job content, peer comparison and individual performance for revision of compensation on a periodical basis which is followed regularly.

(d) A sense of belonging and commitment is inculcated in the employees and also effectively train them in spheres other than their own specialization. Activities relating to the welfare of employees are undertaken.

(e) Employees are encouraged to give suggestions and discuss any problems with superiors. Efforts are made to keep cordial relations with employees at all level.

(f) Job profiles are specified, police verification and house verification of employees are conducted, and recruitment of employees is done from various communities.

(g) Employee training, staff welfare, 360 degree appraisal and yearly increments are followed by the Company.

Risk assessment of borrowers

It is generally recognized that certain borrowers may be of a higher or lower risk category depending on the customer's background, our references, borrowers net worth and the ability to refund and pay interest etc. As such, the Principal Officer shall apply to each of the customers due diligence measures on a risk sensitive basis which shall be reviewed every year. The basic principal enshrined in this approach is that the concerned persons should adopt an enhanced customer due diligence process for higher risk customers. Conversely, a simplified customer due diligence process may be adopted for lower risk of categories of

customers. In line with risk based approach, the type and amount of information and documents shall vary depending on the risk category of a particular borrower and should be collected from the client.

Obligations of the Principal Officer

The Principal Officer is required to carry out risk assessment to identify, assess and take effective measures to mitigate its money laundering and financing risk with respect to such borrower or geographical areas, nature and volume of transaction, repayments by borrowers etc. The risk assessment shall also take into account any specific information provided or circulated by Government of India and RBI from time to time. The risk assessment carried out shall consider all the relevant risk factors before determining the level of overall risk and the appropriate risk level and type of mitigation to be applied. This assessment shall be documented, updated regularly and made available to competent authorities and self-regulating bodies as and when required. In case of change in perception, the risk assessment should be again done to ascertain whether it is prudent to continue with the exposure with such borrower or not. In case it is felt that the funds are not safe, the funds should be recalled immediately without delay.

Audit review and policy renewal

The risk management system and its efficiency is analysed through audit reviews and effective methods and measures are adopted to ensure modifications in the policy on the basis of audit findings. Shortfalls in the policy are identified and are rectified by way of renewal of policy with approval of Board of Directors.

Board of Directors meetings and review

The Board of Directors, in their meetings, shall oversee the implementation of the system and review its functioning periodically.

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