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VEDIKA CREDIT CAPITAL LTD

PARTNER IN THE GROWTH OF MICRO ENTREPRENEURS

# RISK MANAGEMENT POLICY

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## INTRODUCTION

The Board of Directors ("Board") of Vedika Credit Capital Limited ("Company" or "Vedika" or "VCCL"), has adopted the following policy which encompasses practices relating to identification, assessment, monitoring and mitigation of various risks to the core business of the company.

## PURPOSE

The purpose of this policy is to effectively mitigate risk which is unanticipated and unintended losses to VCCL that may occur while accomplishing company's goals and objectives. The possibility of loss to the company could be either financial or brand image or reputation of the company.

## PRINCIPLES

For risk management to be effective, all operations/departments of the Company must apply the following principles to the context of the business and its objectives:

- Risk management must create and protect value required for sustained growth
- Risk management must be closely integrated into the processes of every functional department.
- Risk management must be tailored to the context and fit for purpose
- Risk management is dynamic, iterative and responsive to change.

## DEFINITIONS

- "Board" means Board of Directors of the Company.
- "Company/Vedika" means Vedika Credit Capital Limited
- "Directors" mean Directors on the Board of the Company.
- "Policy" means Risk Management Policy
- "RBI" means Reserve Bank of India

## RISK CATEGORIZATION AND MITIGATION FRAMEWORK

Broad Risk Categories & Sub-Categories in Financial Industry: -

**Credit Risk**

- Default Risk
- Concentration Risk

**Market Risk**

- Interest Rate Risk
- Liquidity Risk

**Operational Risk**

- Fraud
- Data & Information Security
- Documentation
- Regulatory & Compliance
- Transaction
- Human Resource/ Competence
- Legal

**Other Risks**

- Reputation
- Strategic

**Following are the key risk categories applicable to VCCL along with their possible mitigation factors that are either being implemented or in planning stage.**

**Credit/ Default Risk:**

This risk arises when a borrower or counter party fails to meet its repayment obligations as per agreed terms and conditions. Also, failure to recover the expected value of collateral security taken in lieu of a loan can further expose a lender to credit risk.

**Mitigation:**

- A minimum two identity proof policy for every borrower and uses credit bureau and UIDAI databases to authenticate identity proofs.

  Ans - MEL & JLG - UID is mandatory and voter card / pan card any one

  ER - UID is mandatory buy 2nd KYC (Voter/Pan Card is optional)

- A structured and standardized credit approval process supported by an effective customer training programme, tele-verification, risk assessment along with legal and technical due diligence as and when required

- Using credit bureau data scrub and internal customer profiling to select customers for loan renewals and cross-sell new products

- Credit & Risk vertical is being set up at every level of operation to filter out potential defaulters at the sourcing stage by assessing factors like branch to pin-code mapping, intra-group pin-code uniformity, etc.

- Strict adherence to SRO-recommended responsive guidelines

- The internal audit system periodically verifies the customer sourcing and verification processes to identify malpractices and non-adherence to defined procedures

- A robust collection method ensures to keep delinquency rate below the industry standard. Also, a separate recovery team has been set up to dedicatedly focus on all 90 plus DPD cases.

- A monthly provisioning earmarked to mitigate NPA losses (1% + 3 month moving average of NPA flow)

Note: - In case of any conflict between Credit/Operational Policy and content of credit risk as mentioned in this policy. Credit Policy will prevail

**Concentration Risk:**

This risk to the company arises due to a very high credit exposure to either a borrower, community, industry, or geographical location/ area.

**Mitigation:**

- To mitigate this, below are various portfolio thresholds should be maintained:
    - No state should have more than 35% of total AUM
    - No district should have more than 1% of total AUM. For Metro cities/ districts this threshold is set at 3%
    - Minorities should not be more than 30% of the total active borrowers

- In order to mitigate credit concentration in specific profession, VCCL adopts a diversification approach whereby
    - Every location/branch should have a minimum of three professions to lend.
    - Branches having five or less professions, no single profession should have more than 40% of portfolio. Branches having 6 to 10 professions, the portfolio threshold for a profession is 30%. Branches having more than 10 professions, the threshold limit stands at 20%.

  - The above thresholds should be evaluated and reset periodically. An alert-based system should be in place in Loan Management Software to forewarn when the assigned thresholds are about to cross.

- In order to diversify its product portfolio, the Company has also started lending for consumer durables, business loans, two-wheeler loans, and e-rickshaw loans.

**Interest Rate Risk:**

Interest rate risk arises due to fluctuations in interest rates in the market. The immediate impact of changes in interest rates is on company's earnings (i.e., reported profits) by changing its Net Interest Income (NII).

**Mitigation:**

- VCCL is into funding of loans which are always fixed rate loans. The company manages this risk on NII by pricing its loan products to customers at a rate which covers interest rate risk. The lending IR is always kept at a safe margin from borrowing IR to ensure a better NII.

- VCCL also prudently uses its loan tenure keeping in mind the tenure of its borrowings from external sources.

- The risk from the earnings perspective can be measured as changes in the Net Interest Income (NII) or Net Interest Margin (NIM). Measurement of such risk is done at the time of deciding rates to be offered to customers. Once interest rate risk is measured, lending rates are finalized.

- Income gap analysis needs to be carried out regularly through comparing company's rate sensitive assets and rate sensitive liabilities.

**Liquidity Risk:**

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. Failure to timely recovery of debts and huge NPAs also impacts the liquidity profile of the company. Due to reliance on external sources for funds, VCCL is also exposed to funding and liquidity risks:

**Mitigation:**

The key liquidity management policies being followed at VCCL finance management team include:

- Multiple Funding Sources: VCCL does not rely on a single source for funding and always maintains a healthy list of funders to meet its funding needs. Also, VCCL negotiates favorable borrowing terms and conditions that allows the company to maintain a healthy cash flow

- Co-lending Agreements with big nationalized banks and divert bulk of new portfolio to co-lending model

- Exploring alternative funding sources: In order to diversify its funding sources, VCCL needs to venture out alternative sources like Non-Convertible Debentures. The company should aim to raise 25% of its funding needs from such alternative sources

- Regular ALM Meetings: This is done to identify any short-term liquidity gaps and thereby take immediate corrective actions to bridge the same

- Lender Exposure Updates: The exposure profile is regularly updated and reviewed to ensure that skewness does not creep in with regards to the sources of external funds.

- Capital Adequacy: VCCL should target to maintain healthy levels of capital adequacy in excess of 50%. The Company maintains a strong capital position with the capital ratios well above the thresholds defined by the regulatory authorities through continuous and timely capital infusion.

The company also commits to adhere to the set of liquidity risk management guidelines as per RBI circular (dated 4th November 2019) on Liquidity Risk Management Framework for Non-Banking Financial Companies. The key initiatives as part of this framework includes:

- Formation of Asset-Liability Management Committee (ALCO) to manage and oversee overall liquidity risk under Chief Executive Officer with CFO and CRO being members of the committee.

- Granular Maturity Buckets and Tolerance Limits

- Setting up of various liquidity risk monitoring tools including tracking of key liquidity ratios like short-term liability to total assets; short-term liability to long-term assets; commercial papers to total assets; non-convertible debentures (NCDs) to total assets; short-term liabilities to total liabilities; long-term assets to total assets;

- Setting up a Contingency Funding Plan

**Operational Risk**

It is defined as the risk of loss resulting from inadequate or failed internal processes, people, system and external events. These risks are inherent to business operations including those relating to client acquisition, service delivery to clients, business support activities, information security, physical security, human resource and business activity disruptions.

**Mitigation:**

- Document Storage and Retrieval: VCCL recognizes the need for proper storage of documents as also their retrieval for audit and statutory requirements. The Company is maintaining all the original documents in a fireproof vault at a dedicated space allocated for specific purpose. There is a further need to assign barcode to all physical loan documents for better record management.

- Digitization of Documents: The company should also start storing scanned copies of the loan documents for easy retrieval especially for audit purposes where physical documents are not required.

- Fraud Prevention Policy: VCCL encourages all its employees to report any non-compliance of stated company processes or policies without any fear or bias. All such issues are handled through a well-established process – background investigation, holding a hearing by a committee, and ensuring actions as per the committee's recommendations is carried out. All issues reported are categorized for nature and severity:
    - Financial or Non-Financial
    - Major or Minor
    - Procedural Lapse or Gross Violation
    - Breach in Process or Disciplinary Issue

The Audit department must maintain a record of the entire case history which is signed off by senior management on closure.

- Internal Audits: Internal Audit at Branch and Corporate/Regional Offices is carried out on a quarterly basis by an independent vertical team which is directly responsible to the Board Audit Committee. The scope of this Internal Audit covers all key functions including HR, Operations, Credit, Administration, Finance and Accounts. The team audits the company's adherence to all Statutory and Regulatory Guidelines that have been prescribed for NBFC-MFIs. The scope of these audits is reviewed periodically and modified to keep pace with a dynamic business environment. All significant audit observations of Internal Audits and follow-up actions are presented to the Board Audit Committee.

- Internal Financial Control: In compliance with requirement of the new Companies Act 2013, taxation policies and other financial regulations, the company has appointed an external advisory firm with key focus on accounting standards, financial reporting, bookkeeping, balance sheet generation, banking norms and corporate taxation.

- Data & Information Security: The company has leveraged of modern cloud-based technologies and all its business applications and data are hosted in secured data centers with mirrored redundancies such that in the event of any system going down, an alternate system is made operational within hours. The key data and information security initiatives include:
    - A robust data backup and recovery mechanism for all databases
    - Secured Email Policy to protect data exchange outside the company
    - Stringent Data sharing policy with access control and monitoring
    - Mobile Device Management Policy
    - Virtual Private Network to restrict access to key company resources, software and systems
    - Engaged professional experts to manage IT infrastructure

- Company has also hired professional external firm to conduct yearly IS Audit to identify security gaps in IT infrastructure and software system and recommend suitable measures to bridge the gap

- Outsourcing Policy: The Company has established an Outsourcing policy in accordance with RBI guidelines wherein a detailed check is done for all the outside vendors before any work is outsourced. It is mandatory to sign Non-disclosure Agreement with each external vendor where data sharing is being done.

**Regulatory and Compliance Risk**

This risk primarily arises due to non-compliance with RBI regulations and guidelines, non-compliance of regulations of other statutory bodies, and non- compliance with covenants laid down by lenders and SROs.

**Mitigation:**

- The company is in practice of mitigating the risk through regular review of legal compliances carried out through internal as well as external compliance audit.
- The company may consider implementing a Compliance Management System with inbuilt workflows to track, update and monitor compliances.
- Internal Audit also conducts audit of compliance function on a quarterly basis wherein all regulatory compliances are reviewed in detail.
- Quarterly Compliance Certificate certified by the CEO/CFO needs to be submitted to the Board on quarterly basis.

**Human Resource Risk**

HR Risks emanates from company's inability to acquire/ retain required talent pool to carry out company's long-term objectives. Along with talent management other key HR risk areas are professional ethics, leadership quality, compensation policy, employee training and development, and local labor related regulations.

**Mitigation:**

- VCCL's HR policy is oriented towards providing equal opportunity to every employee, inculcate in them a sense of belonging and commitment and effectively train them in spheres other than their own specialization.
- A talent identification, nurture and retention program has been initiated to retain talent and motivate them on a regular basis.
- Employee training has been given highest priority and various employee training program has been initiated.

- At VCCL, employee compensation is determined by a fair appraisal system with the participation of the employee and is consistent with job content, peer comparison and individual performance.

**Reputation Risk**

This is related to adverse perception about 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, regulatory actions, customer dissatisfaction and complaints leading to negative publicity.

The risk can emanate from non-compliance with regulations, customer dissatisfaction and misrepresentation of facts and figures in public

**Mitigation:**

Considering the business model, the following aspects have been put in place to reduce vulnerability related to reputational risk:

- Compliance with Fair Practices Code: All customer-facing employees need to be trained and instructed to follow fair practices as per RBI prescribed guidelines in all their dealings with the customers. DRA training for collectors is a step towards this.

- Grievance Redressal Mechanism (GRM): The Company has a defined GRM in place and the same is communicated to all customers at the time of sanction of loan. This is also available on the website of the Company. A dedicated customer-care team is looking after day-to-day customer grievances which is being monitored by the Senior Management.

- Delinquency Management: The Company does not resort to any coercive recovery practices and all recoveries are made in accordance with the Recovery policy and Fair Practice Code of the Company.

- Stringent Selection Criteria: Vendors, employees and other associates of the VCCL are selected after confirming to the stringent criteria prescribed by the management.

- Reference Check: The management carries out a reference check for all the vendors from the market before having them on board to ensure utmost integrity while carrying out their duties.

- Legal Obligations: All employees, vendors and associates are required to sign legal contracts wherein specific clauses related to non-disclosure of mutual data are ensured to protect the Company from any reputational risks.

- A No-Gift Policy has been implemented throughout the organization to discourage gift/bribe culture

**Strategic Risk**

It is the risk to earnings and capital arising from lack of responsiveness to changes in the business environment and/or adverse business decisions, besides adoption of wrong strategies and choices. Strategic risks emanate out of the choices made on markets, resources, technology and delivery model that can potentially impact long-term competitive advantage and business sustainability of the company.

**Mitigation:**

- The senior management and strategy team should be proactive in its approach towards changes in economic/business environment as the business strategies are regularly discussed with the senior officials of the organization so that adequate and timely steps can be taken. Regular meeting of all HoDs and Senior Management is being conducted and all strategic issues are intensely discussed with action taken report.

- All important strategic matters are referred to the Board, consisting of members with diversified experience in the respective fields, for intense deliberations, to derive the benefit of collective wisdom.

- The management may consider in future to obtain Directors and Officers liability insurance in order to protect the Board and Senior Management from taking decisions during their duties which might adversely affect the business.

- Regular review of business model including the operation areas, product & business segment, targeted customers and other stakeholders

- Periodic competitive analysis of our peer companies and new entrants in the industry to remain in competition and change our market strategy if required.

- Keeping a tab on emerging technologies that may disrupt the existing market and customer base of the company.

**RESPONSIBILITIES**

**General**

- All staffs and departments are responsible for Company Risk Management and will comply with the Risk Management Framework, including this, Policy. This includes:

    - Understanding the Company's objectives and the role that their work unit (or controlled entity) plays in achieving those objectives;

    - Understanding their role in the Company and the Risk context relevant to that role;

    - Conducting proportionate Risk Management appropriate to one's role; and

    - Escalating and reporting significant Risks, or significant changes to the Risk context, to their line manager or, if there is a specific area of the Company responsible for oversight of the risk, to that area.

  - If a Risk or Risk Management matter is escalated to a staff member in accordance with this Policy, that staff member must provide timely feedback to the reporter about any action intended or taken on that matter.

- **Board of Company**
  - Board is responsible for Overviewing Company's Risk Management. This includes:
    - Developing and endorsing the Company's Risk Management Framework;
    - Approving major decisions that may affect the Company's risk profile or exposure; and
    - Annually endorsing the Strategic Risk Register.

- **Risk Management Committee**
  - The Risk Management Committee's role and obligations are outlined in its Terms of Reference. Among other things, this involves:
  - Satisfying itself that the Company and any controlled units have appropriate strategies in place to manage their Risks, and reporting its findings back to the Board;
  - Considering reports and information from various sources about Risk and Risk Management at the Company and reporting on those to the Board;
  - Overviewing planning of internal audit activity, including approving the internal audit schedule; and
  - Providing strategic advice to the Board Members about the Company's Risk Management.

- **Members of the Committee are responsible for:**
  - Managing, and reporting to the Board on, any strategic risks that they own;
  - Responding to, and actioning (if appropriate), internal (and external) audit recommendations and items recorded in the Risk Management Action Plan; and
  - Ensuring that key strategic, operational and Major Project Risks within their areas of responsibility are identified, documented and communicated internally.

- **Heads of Work Units (Departments)**
  - Functional heads of the VCCL controlled entities are responsible for Risk Management by their work unit or controlled entity including:
    - Implementing, and ensuring compliance with, this Policy within the work unit or controlled entity; and

- Maintaining an Operational Risk Register for their work unit or controlled entity, that is reviewed at least annually and sent to the Risk Manager annually for collation.

**PERIODICAL REVIEW OF THE POLICY**

The Policy is flexible and easy to understand and comply with by all levels of employees. The Board should review this Policy periodically but at least once in a year, so that it remains appropriate in the light of material changes in regulatory requirement with respect to the Company's size, complexity, geographic reach, business strategy, market and best governance practices.

The policy can also be reviewed as and when deemed necessary by the Top Management and amendments effected to the same, subject to approval of the Board if any, and when practical difficulties are encountered. The Top management may also review the policy on document retention to comply with any local, state, central legislation that may be broadcast from time to time

**AMENDEMENT OF THE POLICY**

The Board of Directors on its own and/or on the recommendation of the top management can amend this policy as and when required deemed fit. Any or all provisions of this Policy would be subjected to revision/amendment in accordance with the regulations on the subject as may be issued from relevant statutory authorities, from time to time.