LAKME INVESTMENT AND FINANCE LIMITED

RISK MANAGEMENT POLICIES

Version Control

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1. **Objective:**

This Policy has been framed to comply with Master Direction – Reserve Bank of India (Non-Banking Financial Company –Scale Based Regulation) Directions, 2023 and amendments thereon. NBFCs are required to put up a proper Board approved policy framework on risk management systems. The main objective of the policy is to keep the Board of Directors and Top Management to take risk informed decisions. It aims to protect the reputation of the organization, enable the Company to make consistently profitable and prudent business decisions across all its offices and ensure an acceptable risk-adjusted return on capital or any other equivalent measure.

"Risk" can be defined as the effect of uncertainty on the objectives of the Company. Risk is measured in terms of consequences and likelihood. Risks can be internal and external and are inherent in all administrative and business activities. Every organization continuously manages various types of risks. Formal and systematic approaches to managing risks have evolved and are now regarded as good management practices and are also called risk management.

The specific objective of this policy is:

- To ensure that all current and future material risk exposures of the Company are identified, assessed, quantified, appropriately mitigated, minimized and managed i.e. to ensure adequate systems for risk management are available
- To enable compliance with appropriate regulations, wherever applicable, through adoption of best practices
- To assure business growth with financial stability

2. **Types of Risks:**

The management has identified inherent and residual risks, categorized by their likelihood and impact on the business. Following risks have been identified by the Company

a. **Business and Strategic Risk**
b. **Credit Risk**
c. **Liquidity Risk**
d. **Market Risk – Price and Interest rate**
e. **Operation Risk Policy**
f. **Information Technology Risk**

g. **Regulatory Risk**

a. Business and 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 which impacts Company's growth and shareholder's value.

Factors affecting Business and Strategic Risk:

- Government policy and decisions of Courts
- Comprehensive range of Products emerged in the market
- Sustainable and strong relationships with dealers and customers
- Continuity to enhance our capabilities and industrial expertise
- Competition risk
- Technical and Product Obsolescence
- Inflation risk

Mitigation:

- The management is proactive in its approach towards changes in the economic/business environment as the business strategies are regularly discussed with the senior officials of the organization so that adequate steps can be taken.
- Also,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.

b. Credit Risk

The key risk for NBFC or other institutions involved in the lending business is Credit risk.

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

Possibility of losses associated with decline in the credit quality of borrowers or counterparties

Factors affecting Credit Risk:

- Allocation of Portfolio value
- Credit strength and credit rating of customers
- Default of customer
- Interest rate
- Underlying assets quality
- Customer trend changes and diversification

Risk Mitigation:

- **Target segments:** The Company shall target retail segments and provide credit facilities "Direct to Retailers" not exceeding the pre-approved credit period or the credit limit. The Company also intends to expand its horizon in the subsequent year by providing other lending facilities / credit products to its target customers.
- **Debt Burden ratio:** DBR largely displays the ability of a customer to repay the loan. While some customers might not have documentary proof of income (considering the customer profile of the company); the credit team will rely on physical visits, etc. which justifies the income, business enquiry and other information from organized sector to arrive at an estimated income for a customer. Since most of the income is estimated, it has fixed a conservative DBR threshold of 20% at the portfolio level.
- **Asset Quality and value check:** The Company where applicable will involve independent experts from the respective fields to check the quality of the assets and the valuation of assets to ensure that the underlying assets are immediately marketable and in good condition.
- **Sourcing of funds:** To have better spread over cost of funding and cost of investments, the sourcing of funds will be planned competently.
- **Credit committee check:** A credit check is done for every customer by the credit committee. As part of this check, the various parameters specified in the loan policy are looked at to verify a customer's credit worthiness and ensure that they are not

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

- **Customer verification:** The loan application is processed only after verification of the customer's address and documents provided. Every Customer is met by the company official before the loan is approved to confirm the correctness of details furnished.
- **Credit Underwriting Process:** There shall be a structured and standardized credit underwriting / approval process to ascertain the credit worthiness of the borrower. The physical verification aspect would be covered by Field Credit and the final sanction of the file, after taking a comprehensive view of various inputs.

c. Liquidity risk:

Liquidity risk may be defined as the inability of a business concern to promptly discharge its payment obligations. Liquidity implies that the Company can meet its present and future cash flows satisfactorily without any adverse impact on business operations or the overall financial position. Like all financial institutions, liquidity risk assumes critical importance for the Company especially because inability to meet repayment obligations promptly could also signify a serious threat to its market reputation giving rise to a chain reaction which can cascade into further liquidity constraints.

Factors affecting Liquidity Risk:

- Collection failure within the age buckets
- Inefficient Fund Planning
- Unplanned payments

Risk Mitigation:

The broad strategies adopted by the Company to address the risk are as under

i) The majority of schemes are of short-term nature with a tenure up to 1 year.

ii) Daily monitoring and validation of treasury dashboards for better fund planning

iii) Maintaining adequate level of undrawn bank balance to meet contingencies.

iv) Implementing a robust collection and recovery mechanism.

v) Efficient cash management system to ensure optimum cash holding and reduce idle cash

vi) Deploying short term surplus, if any, in the form of liquid investments made in approved schemes

d. Market Risk – Price and Interest rate:

Market risk is defined as the risk to the earnings from investments due to adverse movements in the price and / or interest rates.

Factors affecting Market Risk:

- **Interest rate risk**
- **Equity Price risk**
- **Market share**
- **Market share fluctuations**
- **Recession or depression which affects the customer's buying capacity**
- **Emergence of new product and competition.**

Risk Mitigation

Market risk is addressed through:

i) An appropriate Loan to Value which provides adequate cushion to withstand fall in market price

ii) Inculcating a culture of recovery & collection amongst employees and borrowers through a system of incentives for employees and rebate for borrowers

iii) Marking-to-market the collateral and regular monitoring of risk accounts / branches

iv) Constant follow up in case of defaulted EMI Loans Market risk (interest) is addressed through:

a. Fixing / reviewing interest rates on loans based on time to time

b. Extending short term loans largely matched with short term borrowings

c. Charging higher rates on loans of extended and defaulting period.

v) Periodical market study and customer evaluation will be done and reviewed by the Board and the management for corrective and improved actions.

vi) Periodical validation of market share and the existence of continuity of the customer will be done.

e. Operational Risk:

Risks inherent to business operations include those relating to client acquisition, service delivery to clients, business support activities, information security, physical security, human resource and business activity disruptions.

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Thus, operational risk arises from 4 broad causes: people, processes, systems and external factors.

Examples of 'Operational Risk' are frauds committed by employees, physical damage to assets, failure of IT hardware / software, incorrect data, manipulation of data, misuse of customer information, improper maintenance of records, lack of or breakdown in internal controls, changes in laws / regulations etc.

Factors affecting Operational Risk:

- **Quality and ethics of people**
- **Consistent revenue growth**
- **Consistent profitability**
- **High quality investments/portfolio**
- **Failure of internal controls**
- **Non-compliance with regulatory requirements**
- **Inaccurate Data management and reporting**

Risk Mitigation:

i. **Effective Human resource system:**

- The Company shall properly analyze and implement methods for recruitment of personnel at various levels.

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- Ensuring that the right person is assigned to the right job and that they grow and contribute towards the Company's excellence.
- The 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.
- Skillsets and ethical behaviors will be monitored.

ii. **Risk based Internal Audit:**

The An effective Risk-Based Internal Audit (RBIA) is an audit methodology that links an organization's overall risk management framework and provides an assurance to the Board of Directors and the Senior Management on the quality and effectiveness of the organization's internal controls, risk management and governance related systems and processes.

iii. **Internal Financial Control:**

- Internal financial control will be put in place in the form of SOP and Policies
- Effective training and Compliance checklists will be implemented and monitored.

f. Information Technology Risk

The principal goal of an organization is to establish uninterrupted business operations. The Company uses automated information technology (IT) systems to process their information, risk management plays a critical role in protecting an organization's information assets from IT-related risks. An effective risk management process is an important component of a successful IT security program.

Factors affecting IT Risk

- **Quality of Infrastructure assets and management**
- **Cyber Security threat and Vulnerabilities.**
- **Data management and protection risk**
- **Technology vendor and third-party risk**
- **Ability to upskill or reskill manpower**

- **Role based access controls**

Risk Mitigation:

The Company has framed comprehensive IT Policies and Procedures:

- The IT Steering Committee will be responsible for framing comprehensive IT policies and its effective implementation.
- Periodical IT control and vulnerability test will be done and reviewed.
- Periodical IT audit will be in place.
- IT Infrastructure, assets and their effective usage and functionalities will be periodically assessed.
- Effective Document, Storage and Retrieval process will be put up in place
- Business continuity and Disaster Recovery Plan

g. Regulatory Risk:

All NBFCs are under the regulatory purview of the Reserve Bank of India, SEBI and Ministry of Corporate Affairs. In addition, it is also required to comply with various central, state and commercial laws applicable in the conduct of the various activities of the business. The Company also must comply with the RBI circulars, regulations and master guidelines issued by RBI from time to time.

The Company shall respond effectively and competitively to regulatory changes, maintain an appropriate relationship with the regulators / authorities, strengthen the reliance on capital and improve the quality of in-house compliance.

Major list of acts to be complied with

- **Companies Act 2013**
- **Reserve Bank of India Banking Regulations Act 1949**
- **RBI master circulars and directions**
- **Goods and Service Tax Act (GST) 2017**
- **Income tax Act 1961**

- **Micro, Small and Medium Enterprises Development Act, 2006**
- **The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI Act) of 2002**
- **Insolvency and Bankruptcy Code 2006**
- **Contracts Act**
- **Shops and Establishments Act**
- **Prevention of Money Laundering Act 2002**

Factors affecting Regulatory Risk

- **Non- compliance of Prudential Norms**
- **Change in Trade Policy and Government Regulations**
- **Change in Tax Policies**
- **Fraudulent activities (Internal and external)**
- **Non-Compliance by delayed filing and unintentional defaults.**
- **Failure to follow Fair Practice Code**
- **Violating Policies and Corporate Governance**

Risk Mitigation:

- Effective MIS reviewing mechanisms will be put in place.
- The Credit Committee shall ensure that the Company adheres to credit concentration guidelines and will also review if there is appropriate diversification in the lending portfolio.
- The Company has established a Grievance Redressal mechanism and Fair Practices code which shall ensure that the customer satisfaction-related issues and fair practices are being adhered to.
- Compliance checklists dashboards will be validated, reviewed and monitored by top management and the Board periodically.
- The responsibility for ensuring compliance with regulatory requirements and directives on a day-to-day basis rest with the MD/CEO.

- The Internal Audit function and statutory audit function provides assurance through audit of the compliance.
- Non- Compliance can result in stringent actions and penalties from the Regulator and/or Statutory Authorities, which also poses a risk to Company's reputation.

h. Reputational Risk:

Reputation risk occurs by the acts of people and regulatory authorities.

Reputation risk could result in loss of revenues, diminished shareholder value and could even result in fines being levied by the relevant regulators. The Company realizes that its goodwill depends on its reputation, which has been built over the years, and hence, protecting its reputation assumes paramount importance.

Factors affecting reputation risk:

- **Timely and quality of service**
- **Degree of Compliance mechanisms**
- **Perception of Customers**
- **Regulatory actions**
- **Fines and Penalties.**

Risk Mitigation:

- Effective Whistleblower Policy
- Effective Customer relationship management and grievance redressal mechanisms
- Timely compliance to regulatory requirements
- Effective change management.