

RISK MANAGEMENT FRAMEWORK & POLICY

Approved by the Board of Directors at its meeting held on April 30, 2024

Five-Star Business Finance Limited is a Systemically Important Non-Deposit taking Non-Banking Financial Company (“NBFC-ND-SI”) registered with the Reserve Bank of India. The company was established in 1984 and has been operating in the financial services space for about 40 years. The company is currently engaged mainly in providing Collateralized Small Business Loans to its customers in urban, semi-urban and fast- growing rural geographies.

NBFCs are subject to a plethora of risks. Efficient and timely management of such risks is essential to the survival and success of an NBFC.

Risk Management Framework:

The Risk Management Framework or the Risk Appetite Framework is the overall approach, including policies, processes, controls and systems, through which risk appetite is established, communicated as well as monitored. The chief components of a Risk Management Framework are:

- A. Mission, Strategy and Operating Model
- B. Risk Appetite Statement
- C. Risk Governance Model
- D. Risk Identification, Classification and Policies managing these Risks
- E. Key Risk Appetite Indicators / Thresholds
- F. Monitoring of the Risk Management Framework.

A. Mission, Strategy and Operating Model

Vision Statement of FSBL:

Reaching the unreached through suitable credit solutions

Mission Statement of FSBL:

Provide appropriate credit solutions to the hitherto unreached segment of the market by developing a niche underwriting model, built towards evaluating the twin strengths of the borrowers’ intention to repay and ability to repay, with the ultimate objectives of increasing customer satisfaction and maximising stakeholder returns.

FSBL provides funds predominantly to the unreached section of the business population of India. FSBL adds value by providing medium to long term loans and supports its clients as a formal complementary source of financing. It endeavours to take care of the interests of all its stakeholders and at the same time ensuring that it respects the law of the land and remain compliant to its rules and regulations.

FSBL’s strategy and operating model is to:

- Identify and do a preliminary evaluation of its potential customers through its own branch network and then underwrite those proposals by their inhouse credit team, using their underwriting methodology of “non-templatised” approach, for credit decision making.
- The focus is to reach out to those customers who are predominantly in non-metro areas and are willing to enter into formal organised lending channel to fund their business/personal requirements.
- Secure the loan exposure by taking a collateral from its customers
- Ensure adequate risk diversification by ensuring that the average ticket size is largely maintained around the level of 3-5 lakhs.

In order to support its lending operations, the Company finances its activities through equity, borrowing from Financial Institutions and by issuing bonds/NCDs/CPs/Securitized paper in the capital markets. The main objective is to ensure that FSBL is able to operate and continue its core activities even during stressed market conditions. The composition and the maturity profile of the liquidity portfolio are aligned with this objective.

B. Risk Appetite Statement

FSBL, being a NBFC, is governed by the regulations laid down by the Reserve Bank of India (RBI). FSBL’s risk management systems and procedures are reviewed and refined on an ongoing basis in order to comply, in substance, with what the company identifies as the relevant market standards, recommendations and practices. The key elements of the Risk Appetite Statement are as follows:

1. Risk Culture

Risk culture consists of norms, attitudes and behaviour related to risk awareness, risk management and the controls that affect decisions on risk. The Board of Directors, Senior Management and all employees of the company should contribute towards maintaining a sound risk culture in the company. A sound risk culture enables the company to do the right thing, even in trying circumstances. The guiding principle is that those responsible for risk-taking are also accountable for managing the associated risks.

FSBL follows sound corporate governance and business practices. We abide by the various policies and regulations issued by the regulators and the various governing agencies of our country and follow them in letter and spirit. All individuals in our company are expected to contribute and promote a sound risk culture.

2. Capital

Capital is required to absorb losses from unexpected risk events, and to ensure smooth operations even in adverse economic conditions. Having a strong capital position helps the company to avail debt and also helps in bringing down the cost of funds. Since capital has such an important role in the company's operations, an adequate capital management framework is an essential part of FSBL's operations. FSBL is committed to maintaining a strong risk-based capital position.

FSBL will strive to maintain a strong capital position with respect to the total risk exposure. We would use risk-based approach to assess our capital needs and would hold capital buffers on top of the regulatory stipulated minimum capital requirement.

3. Lending

FSBL's main business of lending is predominantly to individuals involved in businesses and to support their growth in their area of business. Loans are also given for asset creation / personal / consumption purposes after due underwriting. FSBL recognises the risk arising from lending to this stratum of society and hence will follow a non-templatised model of underwriting, whereby the company would conduct detailed customer diligence, analyse the loan proposal from various perspectives and also secure the exposure by taking a property collateral from its customers. The aim of credit risk management is to maintain high portfolio quality with appropriate risk diversification.

FSBL provides medium to long term financing to our customers predominantly to support them in their business development activities. We strive to maintain a high quality of the loan portfolio by following our unique underwriting practices and at the same time securing our loan exposure by availing a collateral from our customer. We would diversify risk by ensuring that we focus on small ticket sized loans and ensure geographical spread of our customers.

4. Treasury

Treasury enables and supports FSBL's lending operations and is thus an integral part of the company's business operations. Funding, Asset – Liability Management, and Investment Management are the primary operations of the Treasury function. Treasury acquires funds through borrowings from banks and issuing bonds/NCDs/CPs/Securitized paper in the capital markets. The Company effectively manages the risk exposures arising on account of the maturity mismatches between assets (loans) and liabilities (borrowing and equity).

Since the exposure in the assets and liabilities are in the same currency, there is no currency risk. FSBL aims to mitigate operational risks in its treasury operations but is conscious of the prevailing market and credit risks to manage its capital effectively.

FSBL, through its treasury activities, will enable and support the company's lending operations by acquiring optimal cost funding from diversified sources and by maintaining a strong liquidity position. We are cognizant of liquidity risk arising out of maturity mismatches between borrowing and lending tenures and would aim to keep it within the defined threshold levels.

C. Risk Governance Structure:

In order to manage the risks in FSBL effectively and efficiently, the risk governance structure will be both at Board Level and Management Level.

1. Key Principles of Risk Governance Structure:

The Board of Directors will be responsible for overall governance and oversight of the core risk management activities.

The active monitoring and execution of the risk management strategies will be delegated to the Risk Management Committee and further sub-delegated to the following Management Risk Committee viz. the Asset Liability Management Committee (ALCO) and Credit Committee (CC). The charter of these Management Risk Committees is spelled out in the note on “Corporate Governance Guidelines”.

Further the segregation of responsibilities and duties would be across the ‘three lines of defence’ model, whereby front-office functions, risk management department and Internal audit roles are played by functions independent of one another. The same would be discussed in detail in the subsequent sections of this policy.

Risk Framework & Policy is approved by the Board on an annual basis and is defined based on FSBL’s risk appetite which helps to align risk, capital and performance targets. All major risk classes, viz. Credit risk, Liquidity Risk and Other Risks, are managed through focused and specific risk management processes.

The Risk department/ function shall have appropriate representation on management committees of FSBL and its respective businesses to ensure risk view is taken into consideration in business decisions, monitoring, stress testing tools and escalation processes shall be established to monitor the performance against approved risk appetite.

2. Risk Management Committee:

2.1 Composition of RMC:

The Reserve Bank of India, vide circular DNBS (PD) CC NO. 288/03.10.001/2012-13 dated July 2, 2012, has envisaged the creation of a Risk Management Committee by all NBFCs. This Committee will be responsible for the identification and measurement of risks and also taking suitable measures to prevent the occurrence of such risks.

RMC is empowered by the Board of Directors to manage the risks in FSBL and it manages the same through oversight of the risk management function and laying down risk measurements and mitigants.

- i) RMC shall comprise of at least two directors of the board (of which at least one is an independent director) and MD
- ii) In case of exigencies, presence of any one independent director and MD is sufficient quorum for RMC meetings
- iii) CEO, CFO and CRO would be permanent invitees to RMC meetings
- iv) Company Secretary shall be secretary of RMCB
- v) The Chairman and members of RMCB will be approved by the Board of Directors

2.2 Frequency of Meeting:

RMC shall meet at such intervals as may be required, provided however gap between any two meeting shall not exceed one hundred and eighty days and its findings shall be presented to the Board in the subsequent Board meeting.

2.3 Roles and Responsibilities of RMC:

- a) The key roles and responsibilities of RMC includes: Approve / recommend to the Board for its approval / review of the policies, strategies, and associated frameworks for the management of risk
- b) To identify areas of risks as also various types of risks involved in the business.
- c) To suggest methodologies to measure / quantify the risks.
- d) To control and mitigate various types of risks involved.
- e) To specify the risk bearing capacity/risk appetite of the NBFC.
- f) Sub-delegate its powers and discretions to executives of FSBL or management committee of FSBL, with or without power to delegate further
- g) To ensure appropriate Risk Organization structure is set up and maintain independence of Risk Management Department
- h) To set objectives and review performance of CRO
- i) To monitor and review non-compliance, limit breaches, audit/regulatory findings and policy exceptions with respect to Risk Management

- j) To ensure regulatory compliance on risk management and prudential norms set by RBI/ Govt. / Other regulatory agencies
- k) To maximize the returns to all the stakeholders, with an acceptable level of risk, for the purpose of protecting, preserving and increasing the worth of the Company.

3. Risk Management Structure:

FSBL has adopted the “3 LINES OF DEFENCE MODEL” for management of its risks.

- The 1st Line of Defence will be the Business and Support Units that will own the risks and manage the same, as per laid down risk management guidelines. The primary responsibility for managing risks on a day to day basis will continue to lie with the respective business units of the Company.
- The 2nd Line of Defence will be the Risk Management Department that would support the 1st Line of Defence by drawing up suitable risk management guidelines from time to time to be able to manage and mitigate the risks of the Company.
- The 3rd Line of Defence will be the Audit Functions – primarily the Internal Audit functions that are supported by External Audits. The 3rd Line of Defence focuses on providing the assurance that the risk management principles/policies and processes well entrenched in the organisation and are achieving the objective of managing the risks of the organization.

Accordingly, the Company has set up a Risk Management Department (RMD) headed by the CRO for the purpose of managing risk related issues across the organization.

4. Risk Management Department:

The Risk Management Department will be an advisory guide to all business units of FSBL. The RMD will help in translating the Risk Framework and Policy of FSBL into the respective business process and to ensure that it is adopted and embedded in the daily workings of the organisation. It will continue to monitor the same from a central perspective and consolidate the findings and present it to RMC through the CRO.

5. Chief Risk Officer:

Based on the circular DNBR (PD) CC. No.099/03.10.001/2018-19 dated 16 May 2019, FSBL has appointed a Chief Risk Officer and following points have been adhered to in this regard:

- 5.1 The CRO is a senior official in the hierarchy of an NBFC and possesses adequate professional qualification/ experience in the area of risk management.
- 5.2 The appointment of CRO shall be for a fixed tenure (extendable post the expiry of the fixed tenure) and would be subject to the approval of the Board.
- 5.3 The CRO would report to RMC and does not have any reporting relationship with the business verticals of the NBFC. Further, neither would he have any business nor would there be any ‘dual hatting’ i.e. the CRO has not been given any other responsibility
- 5.4 The CRO shall be involved in the process of identification, measurement and mitigation of risks. All credit products shall be vetted by the CRO from the angle of inherent and control risks. The CRO’s role in deciding credit proposals, if any, shall be limited to being an advisor.

D. Risk Identification, Classification and Policies managing these Risks:

FSBL has identified and classified the primary risks that it faces under the following:

1. Credit Risk

The key risk for NBFC or any other institutions involved in lending business is Credit risk. According to RBI, credit risk is defined as

- Possibility of losses associated with decline in the credit quality of borrowers or counterparties
- Default due to inability or unwillingness of a customer or counterparty to meet commitments in relation to lending,

- trading, settlement and other financial transactions
- Loss from reduction in portfolio value (actual or perceived)

Hence it is imperative that the company should have a robust credit risk management system to address the above risk. The effective management of credit risk is a critical component of comprehensive risk management and is essential for the long-term success of any lending organisation.

Credit risk management should encompass identification, measurement, monitoring and control of credit risk exposures. The objective of the same should be to minimize the risk and maximize company's risk adjusted rate of return by assuming and maintaining credit exposure within the acceptable parameters. The credit risk management shall include credit norms and policies approved by Board. The credit policy shall include:

- Target segments

The segments targeted by the company will largely comprise of Services segment. This is based on the company's past experience over 25 years that this segment is least impacted by cyclical issues. The company would also largely not focus on seasonal and speculative sectors/activities.

- Debt Burden ratio

DBR largely displays the ability of a customer to repay the loan. While most of the customers might not have documentary proof of income (considering the customer profile of the company), the credit team will rely on physical visits, look for lifestyle related expenditure or assets created by the customers, which justifies the income, business enquiry and other information from organised sector to arrive at an estimated income for a customer. The company is aware of the fact that since most of the income is estimated, it has fixed a conservative DBR threshold of 50-60% at the portfolio level.

- Collateral Based Loans

In order to secure the intention to repay aspect of the customer, the company ensures that its loan exposure is backed by collateral in all cases. Hence, for all the loans sanctioned by the company, property is compulsorily asked as collateral.

- Loan to Value Ratio

The company has fixed a LTV threshold of 40-50% at the portfolio level; thereby ensuring that its loan lent to the customer remains at the top of the mind for repayment obligations of the customer.

- Credit Underwriting Process

There shall be a structured and standardized credit underwriting / approval process to ascertain the credit worthiness of the borrower. The Credit Department will have a four-eye process for scrutinising a file (over and above the scrutiny done by the Business Department). The physical verification aspect would be covered by Field Credit and the final sanction of a file, after taking a comprehensive view of various inputs, would be done by an Approval Credit Officer.

Further it is also to be noted that approval limits have been fixed for various parameters in order to bring such cases to the notice of the higher authorities viz. Head – Credit / CCO / CEO / MD. Notwithstanding the above, the cases where there are approval limit triggers in loan amount, LTV, and DBR are considered significant by the company since these have a larger impact than the other parameters and hence are tracked much more closely by the company.

The Company shall follow a process of revisiting the credit policy and processes from time to time, based on experience and feedback. The latest Credit Policy of FSBL covers in detail as to the various policies and procedures to address this risk.

FSBL's primary business model is delivered through its own employees vide its extensive branch network. This helps in having better control on the customer experience and uniformity of sourcing culture in the company. FSBL ensures that sufficient training is given to its employees on the credit and KYC procedures for onboarding and evaluation of its customers. FSBL has constituted a KYC policy in line with the RBI requirements.

2. Liquidity Risk

The next risk that is very specific to NBFCs or other institutions involved in the activity of lending is liquidity risk or the risk of inadequate liquidity to further the business. NBFCs depend on banks, other NBFCs and other financial institutions for their funding needs. In addition, NBFCs also resort to issue of Non-Convertible debentures, Commercial papers, Securitization and Direct Assignment transactions for meeting their funding requirements. Lack of adequate liquidity or non-availability of liquidity on time would seriously hamper the business prospects of NBFCs.

FSBL is also dependent on banks and financial institutions and other funding structures for its funding and hence the liquidity risk needs to be managed efficiently in order to ensure smooth functioning. Availability of liquidity alone is not sufficient but managing the cost of funds at an optimal level is a very important indicator to ensure company profitability. The cost of funds charged by the banks and financial institutions to a NBFC depends on a multitude of factors (listed below) and the ALCO is tasked to keep track of these factors and ensure that they stay in favor of the Company at all times.

- ✓ Company size – the larger the company size, the lower the cost of funds;
- ✓ Portfolio quality – Demonstration of a strong portfolio quality over long periods of time would help the company get cheaper funds;
- ✓ Capital adequacy and Leverage – the higher the capital adequacy and lower the leverage, the company will be able to attract lower cost funds for its operations;
- ✓ Credit rating – the better the credit rating of the company, the lower would be its cost of funds;
- ✓ Multiple sources of funds – A company which has access to multiple sources of funds will be able to rationalize its costs better than a company which is dependent predominantly on a single source of funds.

One of the primary activities for a NBFC is to raise financial resources to fund the operations of the company. These resources can be raised through a multitude of channels and through various financial instruments. FSBL shall have a Resource Planning Policy, which captures the guidelines and procedures to be followed while raising funds for the company. The company can raise resources vide Bank/FI Borrowings, CP, NCD, Securitisation, Direct Assignment, ECBs etc. The Resource Planning policy also ensures a well-diversified borrowing profile with limits fixed for different kinds of lenders and different kinds of structures.

Another aspect to the liquidity risk is matching the asset-liability profile such that there is no negative asset-liability mismatch, at least in the short to medium term. In the event of the assets having a longer tenor as compared to the liabilities, the Company would have a negative ALM resulting in cash flow issues. While this risk needs to be monitored and managed by the Risk Management Committee, given the sophisticated nature of the risk, this is typically managed by the ALCO (Asset-liability Committee). While the door to door tenure of loans is up to 7 years, the behavioural tenure of the loans happens to be around 4-5 years after adjusting for prepayments. The Company has a Liquidity Risk Management and ALM policy which stipulates permissible limits for mismatches across various time buckets.

In addition to raise of funds, another important aspect of liquidity is also how these funds are safely held till they are disbursed to potential customers of the company. This is addressed in the Investment policy, which clearly lays down the permissible forms of investments, thresholds for different forms of investments, and so on.

The Resource Planning Policy, Liquidity Risk Management & ALM Policy, Securitisation Policy and Investment Policy cover in detail the aspects mentioned above.

3. Other Risks

3.1 Collateral Risk:

FSBL'S business model is based on providing loans backed by property as collateral. Since the lending of the company is entirely secured by collateral, FSBL primarily deals with Collateral risk stemming from Title risk, Valuation Risk and Enforceability Risk.

- Title Risk: FSBL has a Board approved policy that clearly enumerates the kinds of properties and associated documents evidencing the title of such properties, that can be taken as collateral for the loan. Moreover, the legal scrutiny of such documents would be done by two lawyers, external as well as internal lawyer. Over and above, wherever it is feasible, an online EC check also would be done vide the external lawyer or by a company representative to ensure that the customer holds a clear title. The Collateral Management policy also lays down the methods by which the mortgage on the property shall be registered in favour of the Company. This ensures that the company is the sole beneficiary of the property should there be some issue in servicing of the loan by the borrowers.
- Valuation Risk: The valuation of these collaterals would be done inhouse through the company's own representative. These representatives would go by the market value of these properties, which can be found out by local enquiry (Guideline values would be compared with , wherever applicable) and would take the Forced Sale Value of such property as the final value in order to arrive at the LTV ratio. The Collateral Management Policy clearly lays down the methodologies for valuation of collateral, and that policy also addresses all the points related to collateral, in depth.

3.2 Financial Risk

Every Company, especially financial institutions, which is in the process of lending and collecting moneys, needs to manage its financial risk in a prudent fashion.

Financial risk could take the following forms:

- ✓ Compliance with Accounting Standards – this is essential to ensure that the company’s financials including the balance sheet and profit & loss account reflect the true and correct picture of the company’s position and all the errors of Omission and Commission are avoided
- ✓ Adequacy of Internal Financial Controls – every company needs to develop its own set of Internal Financial Controls, which will serve as the check and balance to ensure the orderly and efficient conduct of its business
- ✓ Clearly documented and consistent accounting policies – it is essential for every company to develop its set of accounting policies in line with applicable Accounting Standards and also maintain consistency in the adoption of such accounting policies over the course of financial years.

The Accounting Policy of FSBL has been framed to ensure that the relevant accounting principles are adhered to.

3.3 Operational Risk

Another risk that is prevalent to many institutions is the inadequacy of processes to maintain checks and balances in the conduct of its operations. Necessary controls are essential to ensure that there are no intentional or unintentional errors that creep into the process.

In this regard, the company has set up a dedicated operations department, who are responsible for maintaining the necessary controls over the various processes. The operations staff shall independently carry out or check the various processes like data entry, preparation and verification of MODs, necessary checks before disbursements, scrutiny of documents at each stage as required, ensure safe custody of the property documents and the like. With such independent checks, it is envisaged that the errors would decrease significantly.

Moreover, detailed SOPs for all business units have been created and documented to ensure that risks emanating from these operations are managed. These SOPs are owned by the respective business units and are placed at least annually once to the RMCB/Board.

3.4 Technology Risk

In this digital era, as organizations use information technology (IT) systems to process their information, risk management plays a critical role in protecting an organization’s information assets from IT and cybersecurity-related risks. IT risks refer to any type of risks to information technology that can negatively impact the organization's business operations and objectives, whereas cybersecurity risk is the probability of exposure or loss resulting from a cyber-attack or data breach.

Information technology risks encompass a wide range of potential scenarios such as:

- Hardware and software defects, bugs, and system malfunctions, Outages
- Regulatory risks
- Cyber threats, such as viruses, ransomware, and other types of malwares
- Data breaches, data loss, and data theft
- Human error

Common cyber risks in IT systems include but are not limited to:

- Ransomware
- Data leaks
- Phishing
- Malware
- Insider threats
- Phishing attacks
- Social engineering attacks
- Denial-of-Service attacks.

To address these key risk areas, Five Star Business Finance has implemented necessary security controls based on comprehensive IT policies and procedures. Vulnerability Assessment and Penetration Testing and Information Security audit are undertaken periodically to ensure that the company remains protected from any threats that may have arisen during the course of the year and also to ensure that all the policies and procedures, as laid out, are followed properly.

An effective risk management process is an important component of a successful IT security program. The principal goal of an organization's risk management process should be to protect the organization in its entirety and its ability to carry out its operations, not restricted to its IT assets. Five Star Business has established processes on information security risk management that take into account vulnerabilities, threat sources, and security controls that are planned or in place. These inputs are used to determine the resulting level of risk posed to information, systems, processes, and individuals that support business functions. It aims at identifying and acting on risk to improve the overall security posture. All these points are also deliberated in detail by the IT Strategy Committee, which is a Board level Committee and comprises of directors with relevant expertise.

Information Technology Risk Management Framework

The practice of risk management within the organization shall be based on impact analysis and risk assessment. The organization shall determine what types of safeguards are appropriate to address their defined risks. The organization cannot, and is not expected to, mitigate every risk, but must prioritize based on the threat to the organization's mission and available resources. The risk management practices implemented by the organization will vary depending upon the nature of the organization's information assets.

Practices that must be included in the organization's risk management program are:

- Discover endpoints and data (desktops, notebooks, servers, mobile devices, and other computer assets).
- Inventory endpoints and data (desktops, notebooks, servers, mobile devices, and other computer assets).
- Categorize the information system (impact/criticality/sensitivity).
- Select and tailor baseline (minimum) security controls.
- Supplement the security controls based on risk assessment.
- Document security controls in the system security plan.
- Implement the security controls in the information system.
- Assess the security controls for effectiveness.
- Authorize information system operation based on mission risk; and,
- Monitor security controls on a continuous basis.

The risk management process is iterative and should be followed throughout a system or process's life cycle.

A. Risk Identification and Assessment

- Identifying and classifying assets within scope.
- Determine the threats and vulnerabilities to the assets, identifying the potential impact of each vulnerability being exploited, and determining the likelihood of occurrence.
- The consolidated information about risk should be maintained in a risk register.
- The risk register shall comprise the following minimum components:
 - Category
 - Risk
 - Risk Description
 - Impact Description
 - Probability Score
 - Impact Score
 - Inherent Score
 - Mitigating Action/Comment
 - Compensatory Control

B. Risk Response

Once risk has been assessed, the proper course of action must be determined and implemented. Options include:

- Risk Acceptance – This is a documented decision not to act on a given risk at a given time and place. It is not negligence or “inaction” and can be appropriate if the risk falls within the risk tolerance level.

- Risk Avoidance – These are specific actions taken to eliminate the activities or technologies that are the basis for the risk. This is appropriate when the identified risk exceeds the risk tolerance, even after controls have been applied (i.e., residual risk).
- Risk Mitigation – These are specific actions taken to eliminate or reduce risk to an acceptable level. This is the most common approach and is appropriate where controls can reduce the identified risk.
- Risk Transfer – These are specific actions taken to shift responsibility for the risk, in whole or in part, to a third party. This may be appropriate when it is more cost-effective to transfer the risk, or when a third party is better suited to manage the risk.

C. Risk Monitoring

Five Star Business Finance must monitor the effectiveness of its risk response measures by verifying that the controls put in place are implemented correctly and operating as intended. This must occur annually, at a minimum. In addition, a process should be defined to monitor significant changes in the factors used to assess the risk (e.g., assets, threats, controls, regulations, policies, risk tolerance). These changes may indicate a new assessment if needed.

Point 4.1.1 & 4.1.2 under Master Direction – Reserve Bank of India (Filing of Supervisory Returns) Directions – 2024 requires the Board and Senior Management shall include the identification assessment and management of data quality as a part of overall risk management framework. All these are sufficiently covered under Cyber security policy of the company.

3.5 Compliance Risk

- FSBL is an NBFC coming 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.
- FSBL recognizes that the regulatory landscape is under periodical review and this requires the company to be proactively prepared, as best as possible, to meet with the challenges posed by the changes. The company shall respond effectively and competitively to regulatory changes, maintain appropriate relationship with the regulators / authorities strengthen the reliance on capital and improve the quality of in-house compliance. All reports, returns and disclosures stemming from regulations are submitted promptly and accurately to reflect the correct position.
- Business processes shall be defined in a manner to ensure comprehensive regulatory compliance considering the multitude of regulatory agencies the company has to deal with. Competent and knowledgeable specialist officers shall be recruited to ensure compliance.
- The responsibility for ensuring compliance with regulatory requirements and directives on a day to day basis rests with the Business Heads, who will comply with the Compliance requirement of the Company. The Internal Audit function provides the assurance through audit of the compliance levels. Relevant Committees of the board provide oversight for management of these compliances.

3.6 Human Resources Risk

The success of any institution lies in the strength of its people. It is essential for a company to attract and recruit the right set of people, manage their monetary and non-monetary expectations so that they are able to contribute towards the growth of the Company. Some of the tenets of the risk management framework to manage the HR risk are given below:

- Ensure availability of a dedicated workforce of good vintage
- Ensure a pool of resources which can be tapped into should there be a need for additional resources
- Benchmarking salaries and incentives with industry standards so that the attrition levels are managed
- Ensure minimal attrition
- Have a well-defined HR Policy, which addresses all HR related aspects like recruitment, performance management, career progression, smooth separation and exits, employee grievance redressal, etc.

The latest HR Policy of the company has been compiled to address all the facets of HR requirements of the company

3.7 Vendor Management Risk

Non-core functions may be outsourced to reputed and approved agencies which specialize in the concerned activity on the premise that these agencies have the capability to perform the tasks more efficiently with or without cost reduction. Some common activities which can be outsourced are security of offices, premises cleaning, document storage etc. Due diligence on these agencies and materiality of outsourcing contracts will be assessed as per RBI Guidelines and the management of the same will be as prescribed by RBI at all times. Third Party Risks are key risks as the FSBL engages with many different external parties for carrying out its activities either on a continuous basis (Outsourcing) or on a contractual basis (consulting assignments, etc). These third-party risks have to be managed appropriately at all times to ensure that company not only realizes the value and objectives of the engagement itself but is protected at all times from any extant regulatory and legislative guidelines.

FSBL predominantly avails the services of external vendors only for Office Management Services. Core activities of the company like sourcing, KYC exercise, underwriting and collection will not be outsourced to any third party. In other non core, but critical areas ; if outsourcing is being done - either their activities would be verified by an internal team of the company or a rigorous auditing exercise would be conducted, in order to ensure that the relevant risks are managed effectively.

A detailed Outsourcing Policy has been framed and the guidelines prescribed therein shall be adhered.

3.8 Reputational Risk

Reputation risk is the loss caused to the Company due to its image or standing being tarnished by certain incidents or actions arising from its business operations. Such incidents or actions may be attributable to the Company or any employee(s) or executive(s) committed either consciously or otherwise. 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 years, and hence, protecting its reputation assumes paramount importance. The company has framed required policies, which shall ensure that its customers and its employees are treated fairly and in a transparent manner, while achieving its business objectives thereby not giving any scope for the reputation to get tarnished in any manner.

The latest FPC Policy, Grievance Redressal Policy and Sexual Harassment Policy has been documented keeping in mind the requirement to protect the reputation of the company.

3.9 Fraud Risk

This would encompass the following wrong actions carried out either by the employees or by the customers of the Company:

- a. Wrong underwriting of files i.e. not adhering to the underwriting norms of the company or indulging in collusion to approve the wrong files, etc.
- b. Misuse or non-accounting of collections received from customers, either through cash or other digital means.
- c. Availing of loans by customers through fraudulent means i.e. forging of documents including property papers, etc.
- d. Other forms of wrong/non-accounting, manipulation of set process and procedures.

This can result in loss of revenue and would also be detrimental to the reputation of the company. The company has put in place adequate internal controls including checks and balances in all the processes, automation and digitisation of processes, etc to ensure that the incidents of fraud don't take place.

E. Key Risk Indicators (Kri) for FSBFL:

In order to measure and monitor in a quantitative manner, the establishment of KRAI is imperative. KRAI is derived by studying the various policies approved by the board and identifying the key parameters, which is critical in meeting the risk policies and objectives of the company. The adherence to these KRAs would be monitored on a quarterly basis in the RMC. Any breaches would be escalated to the Board and appropriate measures would be taken to address the same. As a good practise, an Early Warning Signal (EWS), would be given to the Board if the actual measured KRAI parameter is more than 90% of the threshold range provided herewith.

These are the KRI for FSBL for the FY 2023-24:

S No	Risk	Parameters	Threshold Range	EWS to Board
1.	Compliance Risk	Exposure Norms	Single Borrower Exposure – 2 % of owned funds	1 %
2.	Compliance Risk		Single Group of Borrower's Exposure – 4 % of owned funds	2 %
3.	Compliance Risk	Leverage Ratio	4x	3.6x
4.	Compliance Risk	Capital Adequacy Ratio	20%	22%
5.	Credit Risk	Exposure to Top 50 Borrowers	Less than 5 % of owned funds	4 %
6	Credit Risk	NPA	Not more than 3.5% of AUM	3.2%
7.	Credit Risk	State wise Concentration of Portfolio	A single state should not constitute more than 50 % of the AUM	45%
8.	Credit Risk	State wise Concentration of Disbursals	Less than 50% disbursal from single state	45%
9.	Credit Risk	DBR	Not to exceed 60 % at the portfolio level	54%
10.	Credit Risk	LTV	Not to exceed 50 % at the portfolio level	45 %
11.	Credit Risk	Average Ticket Size	Not more than 5 Lacs for disbursements done in a quarter/year	4.5 Lacs
12.	Credit Risk	Balance Transfer/Takeover	Not more than 10 % of portfolio	8 %
13.	Liquidity Risk	Cap on Borrowing Structure based on Product	Not more than 50% in any single borrowal product (other than TL)	45%
14.	Liquidity Risk	Ratio of ST borrowings to Total borrowings	Short-term borrowings (CC/WCDL/CP etc., all put together) should not exceed 10% of total borrowings.	9%
15.	Liquidity Risk	ALM Cumulative negative Mismatch	Upto One Year Bucket - Not more than 10 % of the cumulative cash outflows of the respective time-buckets	9%
16.	Liquidity Risk		Above One Year upto Five years Buckets - Not more than 15 % of the cumulative cash outflows of the respective time-buckets. A	13.5 %

F. Monitoring of the Risk Management Framework:

Having established a framework to manage risk, it is imperative that it be monitored religiously. FSBL would monitor the same by conducting adequate risk reporting to its various committees and the Board. The reporting would be done by MD/CEO/CFO/CRO to these committees in the relevant forums in the form of relevant dashboards/reports.