

Risk Management Policy



**Servitium Micro Finance
Private Limited**

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INTRODUCTION AND OBJECTIVES OF RISK MANAGEMENT POLICY

1. Introduction

Servitium Micro Finance Private Limited (SMPL) is registered as a Non-Banking Financial Institution under section 45 I A of the Reserve Bank of India (RBI) Act, 1934. As per the registration granted to SMPL it is currently classified as a Non-Banking Finance Company-Micro Finance Institution under Base Layer.

SMPL has adopted the Self-Help Group (SHG) Model for its Micro Finance Business and is also providing Individual Micro Loans (IML). The company is presently running its operations in two states of the country, and its operations are being undertaken with a mix of manual as well as technology-based efforts.

Financial services business esp. Micro finance Business involves various types of risks like (included but not limited to): -

- Credit Risk
 - Liquidity Risk
 - Operational Risk (Including technology risk)
 - Market Risk
 - Compliance & Regulatory Risk
 - Reputation Risk
 - Capital Risk (Efficient use of capital)
 - Human Resource Risk
 - Strategic Risk & Other Risk that may be identified time to time
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If the above risks are not managed and mitigated properly, this may lead to disruption in business and impact on the attainment of main objectives of the organization. Risk management works towards identifying and managing threats that could adversely impact the organization. This involves reviewing operations, processes & procedures of the organization, identifying potential threats and likelihood of their occurrence, and taking appropriate actions to address the most likely threats.

Primary objective of risk management is to ensure that the company's asset and liability profile, its exposures and its operational & business activities do not expose it to losses that threaten the viability of the organization. In all circumstances, all activities giving rise to risk must be identified, measured, managed, mitigated and monitored.

Risk Management is a process, affected by an entity's Board of Directors, management and other personnel, applied in strategy-setting and across the company, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.

Hence this policy covers risk management which includes risk assessment, mitigation and continuous review of the same.

2. Objectives of policy

The main objective of the policy is to keep the Board of Directors, Risk Management Committee and Top Management apprised of the applicable risks promptly and regularly.

This risk management policy aims, among other things, 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, Risk-Appetite based Risk-Tolerances (including defined Risk Limits as applicable) and to be within its overall risk capacity or any other equivalent measure.

In a nutshell it seeks to ensure growth with profitability within the limits of risk absorption capacity. The objectives can be shortlisted as under: -

1. Establish methodologies for identification, measurement and management of risk.
2. To build profitable and sustainable business with conservative risk management approach.
3. To have risk management as an integral part of the organization's business strategy.
4. To manage the risks proactively across the organization.
5. To develop a strong risk culture across the organization.

RISK GOVERNANCE FRAMEWORK & REPORTING

Effective implementation of risk management would require active participation from all the stakeholders. The role and responsibility of various stakeholders is listed below:

(i) Role of the Board of Directors

The primary role of the Board will be to risk oversight of management and corporate issues that affect Risk. The Board can fulfil the role of Risk Oversight by:

- Developing Policy and Procedures around risk that are consistent with the organization's strategy and risk appetite.
- Developing and implementing controls against Fraud Risk.

Risk Appetite: Risk appetite is the Company's capacity to bear risk and its attitude towards risk. While setting up the risk appetite, the following needs to be considered:-

- Financial strength of the company
- Regulatory requirement
- Risk Taking Capacity of the senior management
- Proposed business plans

Some components of the risk appetite can be quantified while others are more subjective and qualitative e.g. reputational risk.

(ii) Roles of Risk Management Committee

The purpose of the committee is to assist the board in its oversight of various risks. The committee:

- Approves and reviews compliance with risk policies, monitors breaches / triggers of risk tolerance limits and directs action.
- Reviews and analyses risk exposure related to specific issues and provides oversight of risk across organization.
- Reviews reports of significant issues prepared by internal risk oversight functional groups, including risk exposure related to specific issues, concentrations and limits excesses.
- Nurtures a healthy and independent risk management function in the company Inculcates risk culture within the organization.
- Approves the Enterprise-wide Risk Management (ERM) framework.

Composition and Term of Reference of the Risk Management Committee (RMC)

The RMC is the body responsible for the management of Risks in the Organization, and it manages the same through oversight of the risk management function of the Company, and through approval of the various policies and processes of the Company.

The Committee reports to Board of Directors. SMPL has constituted the executive level Risk Management Committee having executives representing various departments of the company. The TOR including constitution of RMC, Term of Reference, reporting with frequency is attached with the policy.

(iii) Role of Audit Committee

As per RBI guidelines and as per the provisions of Companies Act, 2013, SMPL has constitute an audit committee.

Audit committee shall evaluate the internal financial controls and risk management systems on quarterly basis. The risk management responsibility for the Audit committee will mainly be towards operational risk, as follows:

- Identifying and presenting operational risks in the course of regular internal audits with recommendations for corrective actions.
- Focusing on the internal audit work for significant risks and auditing the risk management processes across the organization.

(iv) Senior Management

Senior Management will be responsible for the following: -

- Identifying and prioritizing the risks
- Prepare policies, systems, processes & guidelines to reduce risks.

(v) Middle Management

Middle Management will monitor the risks and adherence to them by branches

(vi) Branch Management

Branch management will do following things: -

- Implementation of risk management process through field staff
- Monitoring of adherence to the procedures

(vii) Field Staff

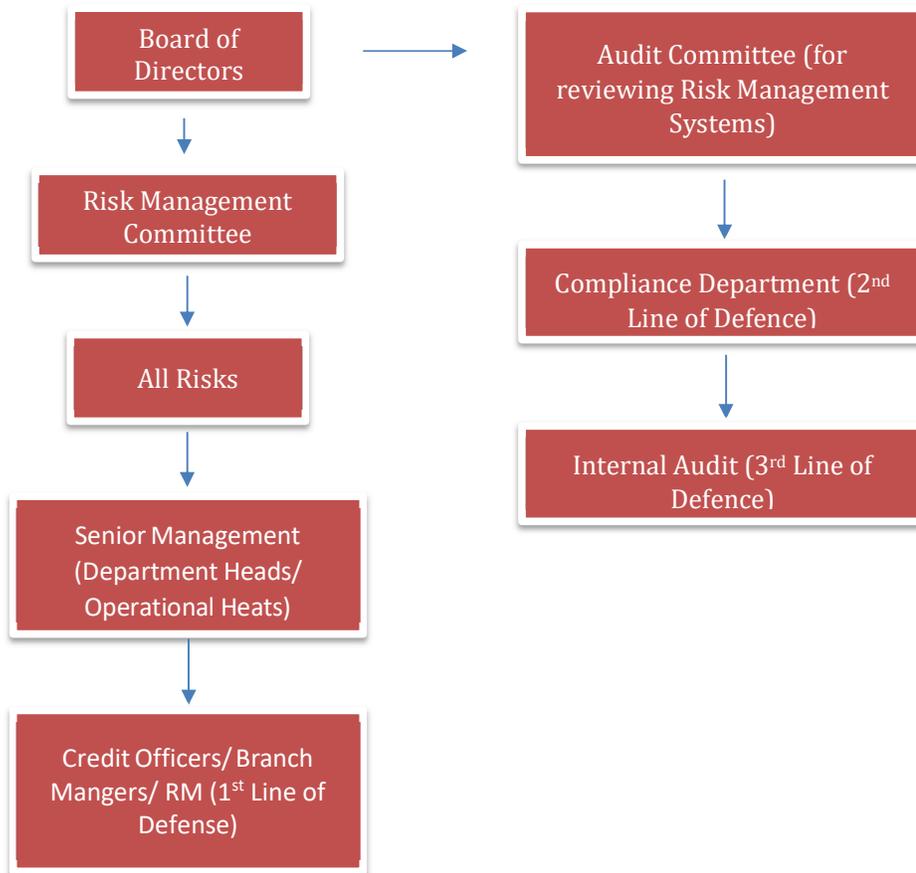
The field staff implements the procedures and offers feedback on the required changes

(viii) Internal Audit Department

Internal Audit Department: -

- Verifies that policies and procedures related to risk management are implemented properly
- Identifies deviations and detects early warnings and frauds

Management Structure of Risk Management in SMPL



- SMPL adopts the 3 LINES OF DEFENSE MODEL” for the Management of its Risks.
- The 1st Line of Defense will always be the Business and Support Units that will own the risks and manage the same, as per laid down risk management guidelines.
- The 2nd Line of Defense will always be the Compliance Department that would support the 1st Line of Defense by the drawing up of suitable risk management guidelines from time to time to be able to manage the risks of the Company.
- The 3rd Line of Defense will always be the Audit Functions – primarily the Internal Audit functions that are supported by the External Audits, and other audits like Regulatory Audits, etc. The 3rd Line of Defense focuses on providing the assurance that risk management principles/policies and processes are achieving the objective of managing the risks of the organization at all times.

As of now SMPL does not require appointing a full-time Risk Head and the Risk Management team is divided among the department heads for their respective fields and work. The second line of defiance as of now will be with Compliance Department which will undertake the functions of Risk Manager.

The Compliance Department will undertake following functions/work: -

- Identification of risk points in the organization and assessing or measuring their impact on the business.
- Formulation of Risk Management Policies.
- Devising strategies for controls and mitigation of risks.
- Reports to Top Management, Risk Management Committee and Board of Directors on risk matters.
- Vetting of product policies on a risk angle.
- Vetting credit proposals in risk angle.
- Assisting Credit units to develop Credit Assessment Models.
- Conduct portfolio analysis to measure migration in risk.
- Risk vetting of operational guidelines.
- Part of credit approval process.

The person nominated from compliance department will be invited in the meetings of the different committees including ALCO.

Roles of various departments in risk management

1. Compliance Department (Headed by Risk Head)

1. Know Your Customer
2. Combating the Financing of Terrorism
3. Process and Product (from compliance point of view)
4. Compliance of all applicable norms

2. Credit Department (Head-Credit)

1. Portfolio Risk Management
2. Credit process and underwriting

3. Finance Department (Headed by Finance Manager)

1. Liquidity Risk
2. Reputational Risk
3. Asset and Liability Management

4. MIS Department (Headed by MIS Head)

1. Forecasting
2. Statistical Analysis

5. Business Strategy (Headed by OM & ZM)

1. Economic Research
2. Strategic Analysis
3. Delinquency Management
4. Business and Product related Risk

6. Human Resource Department (Headed by Head-Human Resource Management)

1. Conduct Risk
2. Manpower Related Risk

Risk Reporting

Risk Management will not be completed without a structured process for reporting risk-related information to all its stakeholders.

Risk Reporting therefore has two significant categories – Reporting to External Stakeholders and Reporting to Internal Stakeholders.

1. Risk Reporting to External Stakeholders:

External Stakeholders are always regulatory and legislative bodies. As a Financial Institution, we have many a report to submit on risk related information – mainly from the Credit Risk side, but on the whole, these reporting cover an all-round perspective of risks of the Company.

The Compliance Department will not only interact with the Regulators, it will advise all internal stakeholders on the relevant and extant reporting to be followed, from time to time.

2. Risk Reporting to Internal Stakeholders

Internal stakeholders are primarily

1. Board of Directors
2. Committees of the Board
3. Top Management Team
4. Functional Management Teams
5. Operational Stakeholders in all locations and departments

3. Frequency of reporting

The reporting related to Risk Management will be done as per following frequency: -

S. No.	Person	Frequency
1	Board of Directors	Quarterly
2	Senior Management	Monthly
3	Operational Teams	Monthly
4	Others	As and when required

RISK MANAGEMENT PROCESS

What is Risk?

Risk is an 'uncertainty of outcome that affects the objectives' that is a two-sided coin, on one side it has threat, and on the other it has opportunity.

Risk is inherent to any business and NBFC-microfinance institutions (NBFC-MFI) are no exception. What makes NBFC-MFI special is absence or near absence of traditional risk mitigation mechanisms like collaterals and guarantees. Management of **Credit Risk**, therefore, becomes extremely important for NBFC-MFI. The monitoring, analysis and management of credit risk under group or individual lending models is core to the effective functioning of an NBFC-MFI.

All NBFC-MFIs face **Operational Risks**. Failure of a particular process, staff and client frauds, MIS failure are some of the risks that are common and have a direct bearing on the day to day functioning of the NBFC-MFIs.

The NBFC-MFIs are relying on commercial bank funding. Increasing integration of the microfinance sector with the mainstream financial sector, together with diversification into new geographies not only adds complexity to the credit and operational risks but also create additional risks in the microfinance risk landscape. These additional risks that need proactive management are interest rate fluctuation and liquidity, which can be collectively categorized as **Financial Risks**.

In addition, there is always a risk of failure of the strategic choices made by the NBFC-MFIs. Mission drift, competition, product development and governance are the issues that have come to the fore in the NBFC-MFIs. Therefore, there is a need for additional emphasis on **Strategic Risks** within NBFC-MFIs. A proactive and systematic management of all these strategic risks are important for the growth and sustainability of an NBFC-MFI.

Risks interact with each other



- **Early warning system for potential problems:** Less time fixing problems means more time for commercial business and growth.
- **Efficient use of capital:** Risk management allows management to qualitatively measure risk, fine-tune the capital adequacy ratio, and evaluate the impact of potential shocks to the financial system or institution.

Risk Management Process

Risk Management Process can be understood with following diagram



Hence, the Risk Management Process involves following steps: -

Steps	Details
Step 1: Identify, assess and prioritize risk	Under this step the identification, assessment and prioritization of risk is being done by the Risk Management committee.
Step 2: Develop strategies and policies to measure risk	<p>Under this step the Risk Management Committee develops strategies and policies to measure the risk so that any of the following decision can be taken:-</p> <p>Risk Avoidance: SMPL may choose to avoid risks which have high probability, are beyond its control and can have devastating effect on its functioning</p> <p>Risk Acceptance: If the probability of occurrence and the impact of a particular risk are minor and manageable relative to the cost of controlling it, SMPL may choose to accept such a risk</p> <p>Risk Mitigation: If the likelihood of a risk is high and the impact of the risk is low to medium and the costs to manage it in house is also cost effective, SMPL may try to mitigate such risks</p>
Step 3: Design policies and procedures to mitigate risks	Designing of the policies and procedures regarding the risk mitigation.
Step 4: Implement and assign responsibility	During this step the mitigation plan is implemented and accordingly responsibilities are assigned
Step 5: Test effectiveness	Internal Audit or other responsibility centers test the effectiveness of the risk management process adopted by the

	company
Step 6: Revise Policy and Procedure	The policy and process related to Risk Management is reviewed and necessary actions for the improvement are taken

KEY RISKS

Risks and uncertainties form an integral part of SMPL's business which by nature entails taking risks. Each transaction that SMPL undertakes changes its risk profile. Following are the key risks identified by SMPL: -

Credit Risk	Risk of default by Borrower
Operational Risk	Risks related to Process, People and Systems
Market Risk	Liquidity Risk and Risk related to Interest Rate
Strategic Risk	Emerging Risk and External Risk
Other Risks	Reputational Risk, Compliance Risk, conduct Risk, Human Capital Risk, outsourcing Risk, model Risk, IT Risk and Fraud Risk

- **Credit Risk:** Default risk from borrowers (loan repayment capacity, group dynamics)
- **Liquidity Risk:** Mismatch between inflows (repayments/ loans Raised) and outflows (Disbursements/Debt Servicing)
- **Operational Risk:** Internal processes, fraud, tech failures, manpower issues.

Market Risk: Interest rate fluctuations. Market risk is the risk to SMPL earnings and capital due to changes in the market level of interest rates or prices of securities, foreign exchange and equities, as well as the volatilities, of those prices. Market Risk consists of:

- a) Liquidity Risk
- b) Interest Rate Risk

Maintaining an optimal balance sheet structure and cash flow patterns shall be the keystone of the market risk management strategy.

- **Competition Risk:** Competition Risk is the chance that competitive forces will prevent you from achieving a goal. It is often associated with the risk of declining business revenue or margins due to the actions of a competitor.

Liquidity risk: Liquidity risk arises where the Company is unable to meet its obligations as and when they arise. Liquidity risk will be measured at a structural level and a dynamic short term level. SMPL may need to address liquidity risk and report to RBI on a periodic basis.

Interest rate risk: Interest rate risk management and reporting helps identify potential risks to earnings and capital resulting from adverse fluctuations in market interest rates.

Strategic Risk: Risks that derive from the decisions that the Management takes about the products or services that the organization provides. It include risks associated with developing and marketing those products or services, economic risks affecting service sales and costs, and risks arising from changes in the technological environment which impact on revenue.

It's a possible source of loss that might arise from the pursuit of an unsuccessful business plan. For example, strategic risk might arise from making poor business decisions, from the substandard execution of decisions, from inadequate resource allocation, or from a failure to respond well to changes in the business environment.

Strategic Risk needs to be assessed both in qualitative & quantitative terms. Assessment of an incident or a potential risk aims at quantifying the risk in financial terms to the extent possible. Risk control shall be laid down by capturing various strategic risk assessment processes of success to help assessment it effective implementation and maintenance.

Reputational Risk: SMPL is also exposed to reputation risk arising from failures in governance, business strategy and process, regulatory-compliance. These risks are generally covered under Operational risks. Reputational risk is the risk of potential damage to the Company due to deterioration of its reputation. The reputation of the Company may suffer as a result of its failure to comply with laws, regulations, rules, reporting requirements, standards and codes of conduct applicable to its activities, rather than compliance with the internal limits or procedures. Proactive measures to minimize the risk of losing reputation could be a sound risk management framework, good corporate governance, high level ethics and integrity, good business practices and reporting of all breaches which lead to reputational risk to the attention of senior management and the board.

Compliance Risk: Compliance risk is the risk arising from non-adherence to prescribed law in force, regulations, policies, procedures and guidelines which may give rise to regulatory actions, litigations, deficiency in product or services depending on the level of non- adherence. The corporate governance function is primarily designed to avoid incurrence of compliance regulatory-legal risk.

Conduct Risk

Conduct risk refers to the potential for a company's actions or behaviors to cause harm to its customers, stakeholders, or the broader market. It encompasses ethical, moral, and legal standards, and is particularly relevant for NBFC-MFIs. Effective conduct risk management is crucial for mitigating the risk of regulatory actions and reputational damage.

Human Capital Risk

Human capital risk refers to the potential for loss or failure associated with an organization's human resources, impacting its ability to achieve operational, business resiliency, and continuity goals. It encompasses a range of issues stemming from employee behaviours, events, and the overall management of the workforce. These risks can lead to financial losses, reputational damage, and hinder strategic objectives.

Being an NBFC-MFI the Human Capital of SMPL is very important to provide its services hence risk associated with Human Capital is identified and mitigation plans are made.

Outsourcing Risk

The company has outsourced its main technology, i.e. LOS and LMS. The outsourcing risk is associated with material outsourcing. The Risk also associated with other material outsourcing which may be done by the company from time to time.

These risks include loss of control, communication barriers, security and potential quality issues.

Model Risk:

Model Risk refers to the potential for adverse consequences arising from decisions based on incorrect or misused models. This includes errors in model design, data inputs, assumptions, implementation, or the use of the model beyond its intended scope. For an NBFC-MFI, model risk can significantly affect credit decisions, risk assessment, provisioning, and financial forecasting.

Information Technology Risk (IT Risk)

IT Risk, or Information Technology Risk, refers to the potential for loss or disruption resulting from inadequate, failed, or compromised IT systems, infrastructure, processes, or services. For an NBFC-MFI, IT Risk can significantly affect service delivery, data integrity, customer trust, regulatory compliance, and business continuity.

Fraud Risk

Fraud Risk refers to the possibility of financial or reputational loss resulting from intentional acts of deception, misrepresentation, or concealment by internal or external parties. For an NBFC-MFI, fraud may occur at any stage of the credit or operational cycle and can involve employees, customers, intermediaries, agents, or third-party service providers.

Physical Risk

Physical Risk refers to the potential for financial loss, operational disruption, or reputational damage due to the direct impact of environmental, climate-related, or external physical events. These risks arise from Robbery, natural disasters, extreme weather, infrastructure failures that can affect the physical assets, staff, branches, and customer operations of an NBFC-MFI.

Socio Political Risk

Socio-Political Risk refers to the potential for financial, operational, or reputational losses resulting from changes in the socio-political environment, including government policies, political instability, civil unrest, regulatory shifts, or public sentiment. For NBFC-MFIs, such risks are particularly relevant given their grassroots presence, reliance on community engagement, and sensitivity to local and regional political dynamics.

RISK MANAGEMENT STRATEGY AND KEY RISK MANAGEMENT

Risk Management Strategy will be adopted based on the basis of likelihood and impact of the risk event.

Likelihood means what is the possibility of happening (frequency) of risk event and impact means what will be effect on the company if any risk event happens.

The Risk Management Strategy has following 4 options:

Possible Strategy	When to be opted with example
Avoid	When likelihood and impact is very high e.g. Avoiding large ticket size loans, avoiding the problematic area, i.e. default areas or chronic disaster risk area
Accept	When likelihood and impact is low, Accept. e.g. Loan losses in case, where all recovery measures are exhausted
Control/Mitigate	When likelihood is high and impact is low, Control. e.g. Most of the operational risks. Mitigation through Product design, Operational Processes, HR policy & Performance measures (PAR and ratio analysis)

Key Risk Management

1. Credit Risk Management:

Credit risk is the risk of failure of borrower to repay. This default by the borrower either be willful default or due to the reasons beyond the control of the borrower. To effectively manage the credit risk, which is a major risk in the microfinance, SMPL continue to evolve the credit delivery procedures as the business grows. The following are some of the practices (only suggestive list) which may be adopted to mitigate this risk:-

(i) New Area selection:

- Before entering a new area for expanding the business, SMPL shall do a due diligence using the pin code and check the credit bureau report to know the existing performance of other MFIs portfolio in that area. This will help SMPL to avoid the known problem areas with a poor repayment track record.
- Apart from the secondary data research, SMPL shall do primary research to know more about the area proposed for expansion as the quantitative data alone will not reveal the full picture, e.g. in many areas of a State, data may show that microfinance penetration is less, but the area may be having other problems like political influence.
- SMPL shall make use of the Pin code level/district level reports shared by SRO or otherwise available to understand the trends in different operational areas.

(ii) Targeting of clients:

- Targeting women in rural areas.
- Preferring clients with their own houses.
- Avoiding clients who migrate during off seasons.
- Focusing on clients who are involved in some income generation activities or intend to start the economic activity with the loan.
- Selecting clients with two livelihood income streams e.g. Agriculture + allied activities like dairy or poultry & small business (MSME).

- Clients with proper KYC (Know Your Customer) documents viz Aadhaar card and Voter ID, duly verified with UIDAI through OTP. SMPL may explore a systems which is QR code enabled, so that the Aadhaar card information can be auto-filled in the document without any error during the onboarding process.

(iii) Focus on Basics of Group dynamics:

- After COVID-19 pandemic, many areas have still not reverted back to the center meetings, collections and field staff are making collections at the individual houses, which increases their time commitment in the field. Hence, SMPL will focus on Basics of Group dynamics and will do its best efforts to re-start the center meetings.
- Conduct regular group meetings on specific dates and collections at the group meeting.
- Ensuring participation of all members in the group meetings.
- Proper updating of group records on a real-time basis during the meeting and recording the repayment collections in the group records from the members.
- Ensuring the peer pressure at the group level so that the social collateral i.e. joint and several liabilities can be enforced in case of defaults.
- Adequate Training (CGT-Continuous Group Training) of clients on group dynamics and loan products and processes, especially on pricing of loans and grievance redressal.

(iv) Sourcing of clients:

- Sourcing of clients within a radius of 15 to 20 kms from the servicing branch (to be extent possible).
- Clients should be selected only after the credit bureau check with any of the credit information companies.
- SMPL may use Mobile apps through which the loan officers do the on-boarding process quickly and check the credit history with the credit bureau on a real time basis and this reduces the turnaround time and reduces the credit risk.

- SMPL may use the Geo-tagging facility to tag their field staff to ensure that they enter the on-boarding data only from the field and the clients house coordinates are also mapped.
- SMPL may develop a Scorecard for clients in association with Credit Bureaus with an objective of enabling the good customer selection and effective sourcing of clients for lending. The data are sourced from two sources viz. Data in application received from the client and the data from the credit bureaus. Customers are segmented into three categories viz. Existing customers with credit track record with SMPL, New Customers with credit track record with other MFIs and New customers without credit track record. In variables (such as Age, Education, Occupation, Location (Rural or Urban), State, House (Own or Lease), Dependents in the family, Income, Expenses, FOIR ID cards (Aadhaar and Voter ID), How long as a customer?, Delinquency for various time periods (Last 30, 60, 90 days, 18 months & 24 months) in the past, Performance of Income generation loan Vs total loan outstanding of the borrower, Tenure, and term (Short term or Long term) of loans availed may be considered for arriving at the scores for clients and the variables combination varies for each of the 3 segments. This will help SMPL to source the good clients more effectively.

(v) Product design:

Products shall be designed in such a way so that the first loan borrower starts with a small size loan and the loan size will increase with every loan cycle.

(vi) Lending Process:

- SMPL is having a written Credit operation manual (Loan Policy Guidelines) explaining the step-by-step lending process and the same will be modified from time to time as and when required.
- SMPL gives training to the field staff on credit operational processes so that the staff will do the due diligence properly and select the right borrowers.

(vii) Loan appraisal:

- SMPL will ensure that the total monthly repayment obligations should not exceed 50% of the monthly household income. SMPL shall capture the household income through the proxy indicators and estimate the FOIR (Fixed Obligations to Income Ratio) and ensure that it is not more than 50%.

- After doing detailed working and study SMPL may prescribe a range of FOIR to clients from different areas depending upon the risk expected. For example, clients from normal areas – Up to – 50% FOIR.

(viii) Loan approval:

- SMPL has centralized the loan approval process (at HO level only).
- SMPL will explore to put filters to keep the portfolio growth within limits in various parameters and decisions on the clients already having loans with other financial institutions will be assessed accordingly.

(ix) Portfolio Diversification:

To avoid concentration of portfolio in certain geographies, SMPL may set the ceiling for the geographical exposures at the state, District and branch level.

(x) Loan documentation:

- During the loan documentation process, borrowers will be briefed about the loan sanction terms and conditions, especially loan amount, interest rate, processing fees, insurance amount and repayment term & EMI.
- Borrowers' along with co-borrowers' signature will be obtained in the loan sanction letter for having accepted and understood the terms of the sanction.

(xi) Loan disbursement:

Loan disbursement will only be done after completion of the process and after doing the penny drop transaction in the bank account of the borrower to ensure the correctness of the bank account of the borrower through penny drop process.

SMPL will explore the possibility of doing tele-call check before the disbursement to ensure that the right borrower gets the loan.

(xii) Portfolio analysis:

SMPL shall analyze the performance of the portfolio according to ticket size, tenure, purpose, branch, sector, scheme-wise, state and so on and if any outlier in the trend is noticed, the case may be analyzed further, and necessary actions are taken.

(xiii) Insurance:

- SMPL takes the credit life cover for the borrower & co-borrowers loan amount & for the loan term covering both the borrower and spouse.

(xiv) Loan repayment:

- Close monitoring of loan accounts by the branch team and the immediate supervisors of the branch at frequent intervals must be done.
- Follow up on stressed assets (e.g. For SMA -1 accounts i.e. Overdue more than 15 days) and NPA & written-off a/cs by a Head Office team.

(xv) Natural Disasters:

The occurrence of natural disasters will also induce credit default risk by the borrowers e.g. Loss of livelihoods due to the cyclone or floods. Loss of crops due to the drought. Loss of properties due to the earthquake, hence while deciding the areas the natural calamity must be kept in mind.

(xvi) Client Protection principles & Code of Conduct:

- SMPL shall follow the client protection principles and code of conduct to promote responsible lending so that the borrowers are not overindebted.
- SMPL has put in place a proper grievance redressal mechanism and the contact details of the Grievance Redressal officers (at HO Level) is being made available to the clients and as well as have been displayed in the branches.
- SMPL is already offering Toll-free numbers facility to the clients so that they can know their loan details (Loan amount, EMI paid, loan outstanding) in vernacular language and as well as voice their complaints to the Company.

(xvii) Internal Audit:

- SMPL has ensured the Internal audit team's independence by making the Head- Internal Audit not to report to Sales, but to the Audit Committee directly.

- Internal audit teams will take up periodical visits to the branch based on risks (Branches are rated using a Risk rating framework periodically i.e. Low risks branch visited once in a quarter and Moderate risk branches visited bi-monthly and High risk branches visited monthly) and they verify whether all the lending process steps have been followed by the branch or any deviations have been made.
- Apart from regular audits, Surprise snap audits shall be conducted by the Internal Audit team to keep a close vigil.

2. Operational Risk Management:

Operational risk is the risk of losses associated with the failure of the internal processes & systems or external events, or human failure or IT failure or frauds. The following are some of the practices (only suggestive list) which may be adopted to mitigate this risk:-

(i) Sourcing of clients:

- Clients with proper KYC documents (Aadhaar card and Voter ID card) are selected and verified with UIDAI through OTP.
- Digital verification of KYC documents eliminates the scope for frauds.
- Client's mobile number verification through OTP.

(ii) Product Design:

SMPL shall focus on the product design to prevent the borrowers using the loan for some other purpose or borrowers seeking the additional loan from other sources as the loan product they availed has not served their specific needs. The situation will lead to delinquencies.

(iii) Loan Appraisal:

- SMPL has a separate team, i.e. Credit team at HO level to do the appraisal. Segregation of duties of sourcing and appraisal by different teams has been followed. Sourcing -Business team & Appraisal by Credit team ensures the objective appraisal and prevention of selecting the ghost borrowers.
- House verification is done by the field team and verified by credit team through geo tagging. Head office team may check the house site verification digitally through a video call but also engages with a Personal Discussion with the prospective borrower during the video call). This will also prevent ghost loans.

Loan appraisal is being done strictly as per the prescribed internal process.

(iv) Loan documentation:

- During the loan documentation process, borrowers will be briefed about the loan sanction terms and conditions, especially loan amount, interest rate, processing fees, insurance amount and repayment term & EMI.
- Borrowers' along with co-borrowers' signature will be obtained in the loan sanction letter for having accepted and understood the terms of the sanction.

(v) Loan disbursement:

- Loan disbursements must be paid directly to the bank account of the borrower after doing penny drop.
- Verification of borrowers through tele-call before disbursement.
- Sending the SMS to the mobile of the borrowers immediately after the disbursement.
- Post disbursement, tele-call team may make calls to the borrowers and check the receipt of the loan amount by the borrower.

(vi) Loan repayment:

- Loan repayment collections preferred to be done in the group meeting and not in individual borrower's houses.
- SMPL has entered into tie up with collection points of Banks and Payment bank's customer service points to deposit the cash collected by the loan officers at the nearest point instead of bringing it to the branch located in a far-off place to reduce the cash transit risk.
- Customers are encouraged to receive loans through digital mode.
- Partial payment of the EMIs by borrowers must be checked carefully/stopped to avoid fraud by field staff.
- Cashless repayment collections reduce the stress levels of staff drastically as they need not carry the cash from the centers to their branches and the time saved by the credit/field officers can be optimally used by them for other tasks, resulting in increase of productivity.

- SMPL may start sending SMS to the borrowers once they receive the repayment collections from the borrowers.

(vii) Monitoring:

- Regular monitoring by operational teams at various level i.e. Branch level, regional level and ADM/ZM/HO level through weekly / monthly reviews must be done.
- Analysis of dashboard reports (Indicators like Portfolio at Risk, SMA (Special Mention Accounts) and NPA movements, write offs) closely and taking immediate action by Head office.
- SMPL reconciles the Demand, Collection, Overdue and the amount collected Vs amount deposited in the bank on a daily basis and the dashboard reports on unreconciled items is being shared with the field team immediately for their close follow up on the very next day.
- Comparing the Performance of portfolio of the region with the industry portfolio and with the data of the last year same period to identify any patterns that requires proactive actions by the management.
- When supervisors go to field visits, they must go at random and without being accompanied by the credit/field officers passbook checking with the system to be mandatorily done by the supervisor/auditors.
- While monitoring the progress or reviewing the performance targets achievement, the supervisors shall not force the field staff to achieve the business targets violating the processes or deviating from the ethics.

(viii) Post disbursement follow-up:

- SMPL may conduct the loan utilization check by visiting the borrower's place.
- Even for regularly repaid loan accounts, random checks have to be done to check the hidden delinquency i.e. groups paying the EMIs instead of the borrower, as this may lead to a potential default in the near future.

(ix) Internal Audit:

- Internal audit team enters the branch at the opening time of the branch first and checks the cash at the branch and tallies with the cash book.

- Internal audit team verifies whether all the process steps include the maker/checker concepts followed by the branch.
- Internal audit team also verifies the borrowers in the field.

(x) Internal Control:

Prudent internal control measures have been put in place by SMPL viz.

- Maker – Checker model for approvals at every level.
- Joint signatures for operating bank accounts
- Data access on a need-to-know basis with proper log-in and passwords.
- Taking periodic trial balances and reconciliations.

(xi) Insurance:

SMPL has taken the adequate insurance cover for covering cash-in-transit risk covering the cash-in-transit risks.

(xii) New Product/Process approval:

- All the new product and related processes will be approved as per the policy for new product/process approval.
- SMPL shall ensure that the Product/Process Approval Committee, while checking the other aspects of the products before launch, shall have a thorough check of all possibilities for any risk from the new product/process.
- New Product/Process approval shall take care of the availability of IT controls and controls for ensuring compliances to the statutory and regulatory requirements.

(xiii) Clients Satisfaction Survey:

SMPL may conduct the Clients Satisfaction survey to find out how far clients are satisfied with its products and services and accordingly should take further action in the matter.

(xiv) Credit/field officer rotation:

As the microfinance business involves close interactions with the clients, when a credit/field officer leaves the company, that credit/field officer also takes away

the micro-level knowledge about the clients and it takes at least 3 to 6 months for new staff coming to this position to close this knowledge gap. This transition period of 3 to 6 months is highly risky for the company, and it opens up opportunities for operational risk. Hence, SMPL may focus on retaining the field staff and as well as practicing the staff rotation at the credit/field officer level.

(xv) Strong second level:

In Microfinance operations, people in all functional roles accumulate lot of specific experience related to their context and once they leave the company, that wisdom goes with them and creates problems in the transition period as the new person coming in that place takes a reasonable time to rebuild the lost connection between the company and the people. So, company can place the second level persons at every management level – Assistant Branch manager at the Branch, Regional Manager at area/regional level, assistant divisional manager and zonal manager so that the transition periods can be effectively handled by the company without any risk to the underlying portfolios.

(xvi) Training to Clients:

- SMPL gives training to clients on various products and especially on the interest rates and other fees that they have to pay. As per the RBI guidelines, the factsheet containing all details regarding the loan should be given to clients to make them understand that they have taken an informed decision.
- SMPL also give training on financial literacy for enhancing the financial literacy among borrowers.

(xvii) Group Level Records:

- Credit/field officer shall insist that the group leaders record the loan repayment collections made in the group meeting in the group records during the meeting itself.
- Loan cards/ Passbook issued to the borrowers shall be properly filled in as and when the borrower repays the monthly instalments. This will be checked by the Internal Auditors also.

3. Liquidity Risk Management:

Liquidity risk is the risk of a situation wherein NBFC (company) is not having sufficient cash and liquid funds to pay for the loan repayment obligations and its operational

expenses. If Bankers perceive that any company is not liquid or if the bankers see a large scale defaults in an area, they stop further funding to that company, which results in immediate downgrade of the rating of that company, which aggravates the situation and other risks also emerges (due to the shortage of funding, when disbursal is stopped by the company, the clients stop the regular repayment forcing the credit risk default).

As per the requirement prescribed by RBI the company has formed the ALCO (Asset-Liabilities Management Committee), which is responsible for ensuring adherence to the risk tolerance/limits set by the Board and as well as implementing the liquidity risk management strategy. ALCO decides on the desired maturity profile and mix of incremental assets and liabilities, sale of assets as a source of funding, the structure, responsibilities, and controls for managing liquidity risk, and overseeing the liquidity positions of entire company.

The best practices for managing the liquidity risks are as follows:

(i) Diversification:

The Company will plan and manage its fund requirements in a manner that it does not depend on a single lender and accordingly shall diversify the borrowing sources – Public sector banks, Private sector banks, NBFCs and other lenders.

(ii) Minimum Liquidity:

- The company shall have cash and liquid funds equal to at least 2 months of loan repayment obligations and operational expenses. Of course, it will have a negative carry cost which should also be managed accordingly.

(iii) Asset-Liability Matching:

- The Company shall borrow for long term and lend for short term so that company will not face the asset-liabilities mismatch.
- Statement of Structural Liquidity will be prepared by the company by placing all cash inflows and outflows in the maturity ladder according to the expected timeline of cash flows so as to find out the liquidity gaps in different time buckets. The company shall ensure that there are no short term (30 days) negative mismatches above the prescribed limits.

(iv) Raising fresh Equity Capital:

- Even though banks are comfortable with giving loans up to 5 to 6 times of the Net own funds, the company shall start planning the equity raise once it reaches the borrowing equal to 4 or 4.5 times of their own funds.
- During the liquidity crisis, when promoters bring in their own funds, it gives the confidence to the lenders and investors, and they will also reciprocate by extending their funding to the company and this will enable the company to navigate the liquidity crisis (if any) soon.

(v) Covenants of Financing Institutions:

- The company shall closely monitor the funding covenants (Common funding covenants include Portfolio at Risk, Write-off, Capital Adequacy Ratio (CAR), Profitability changes in senior management, change of business) of financing institutions carefully, as the breach of funding covenants will be treated as “Event of Default” and necessary actions will be triggered by the lenders, including stoppage of lending.
- To avoid the breach of covenants, the company may plan to have more provisions as a buffer during the good years, which will help it to absorb the unexpected shocks during the bad year.

(vi) Liquidity Contingency Plan (LCP):

- Liquidity Contingency Plan shall identify the early warning signals to the liquidity risk, fix roles & responsibility to a specific person, keep open the channels of communication with the lenders and investors.
- LCP will also identify the potential contingency funding sources and the amount/estimated amount which can be availed from these sources, well-structured escalation/ prioritization procedures detailing when and how each of the actions shall be activated, and the lead time needed to avail the additional funds from each of the contingency sources.

The ALCO shall be discussing liquidity coverage ratio (LCR) and various other ratios related to liquidity risk including stock ratios and the same shall also be placed before Risk Management Committee to analyze the same from risk management point of view.

(vii) Postponing the Capital expenses:

To manage the liquidity problems, the company may postpone the expansion plans thereby reducing the capital expenses and conserve the cash.

(viii) Stress testing:

- The company shall conduct stress tests on a regular basis for different short-term and protracted NBFC-specific and market-based stress scenarios (individually and in combination) and for survival horizons.
- While designing liquidity stress scenarios, the nature of the Company's business, activities and vulnerabilities shall be taken into consideration so that the scenarios incorporate the major funding and market liquidity risks to which the company is exposed.

4. Governance Risk Management:

Corporate governance of the company provides the structures and processes by which company is directed and controlled. Good corporate governance helps the company operate more efficiently, improve access to capital, mitigate risk, and safeguard against mismanagement. It makes company more accountable and transparent to investors and other stakeholders and offers them the tools to respond to emerging concerns.

The best suggestive practices for mitigating the governance risks are as given below:

- The company will keep its Board professional by having more number of Independent Directors.
- Board shall ensure the independence of the audit process and put in place a clearly defined risk management system and monitor the risks closely & mitigate the risks.
- Independent Directors shall keep asking the right questions to the promoters and key managerial persons to avoid the transactions involving conflict of interest.
- Board shall promote the organizational culture by nurturing the values like integrity, transparency, honesty from the top to down the line.
- Board shall evolve a transparent process for decision making and fix accountability to specific roles in the management.
- Board members may take up field visits and keep open the feedback loops, especially the negative feedback loops so that they can detect the early warning signals and take corrective actions at the budding stage of the problems.

- Board shall keep sufficient internal checks and balances over the executive's decisions

on related party transactions and generous compensation practices for senior management.

- Board shall ensure the balancing of financial and social objectives of company and staff is focused both on “Profit and Purpose-making a difference in the lives of clients and staff and serving all the stakeholders
- Board shall make proper disclosures and observe that the statutory and regulatory compliances are complied with by the company on time.

The Finance Department shall jointly define and periodically review the methodology used for calculating liquidity costs, with oversight from ALCO (Asset-Liability Committee).

Internal Rate of Return (IRR) and Net Interest Margin (NIM) Strategy

To ensure sustainable profitability and risk-adjusted returns, the Company shall develop and adopt a formal strategy for the management of IRR and NIM, which shall include:

- Periodic assessment and monitoring of IRR for all products, with clear benchmarks and thresholds.
- Identification of key risks to IRR and NIM, including interest rate volatility, funding mix changes, prepayment risks, and competitive pricing pressures.
- Use of scenario analysis and stress testing to evaluate the impact of adverse movements in interest rates and liquidity conditions on IRR and NIM.
- Establishing early warning indicators and limits to detect and respond to erosion in IRR and NIM targets.
- Incorporating IRR/NIM risk assessments into the product development, pricing and portfolio review processes.

ALCO shall be responsible for oversight of IRR and NIM strategies and shall report key deviations and risks to the Risk Management Committee on a quarterly basis.

5. Reputation Risk Management:

Reputation risk is the risk of loss due to negative perception of the public, authorities on account of unethical practices and lack of transparency in pricing by Company. The suggestive best practices to mitigate the reputation risks are as follows.

(i) Communication:

All terms and conditions of the loan shall be clearly communicated to the borrowers in vernacular language.

(ii) Transparency:

- As transparency in operations of company will build trust among the stakeholders, Company shall be transparent in loan delivery process and especially pricing of loans.
- Loan cards/Passbook shall be issued which show the loan amount, repayment term, interest rate, processing fees and insurance details.
- Pricing information shall be provided to the borrowers through a standardized fact sheet.
- Company shall prominently display the minimum, average and maximum interest charged by them on the microfinance loans at all its offices and on the website.

(iii) Fair Practice Code:

- The company shall display the Fair Practice Code at all its offices and also on the website.
- The company shall follow the client protection principles and shall ensure responsible lending.

(iv) Recovery of loans:

The company shall ensure that its staff or agents (if appointed) are not engaged in harsh recovery methods.

6. Cyber Security Risk Management:

Cyber security risk is the risk of a possible threat of potential disruption to the business or to a business reputation by a cyber-attack. Cybercrime attackers steal confidential data from the system and disrupt the business operations of the companies. The best practices in Cyber security risk mitigation are as given below.

- Board and committees shall invest quality time to discuss the emerging cyber

security risks and may bring in good quality talents for tackling cyber security risks.

- The company should educate its staff not to click the links sent by the third parties through email or SMS.
- The company shall ensure that the systems are secured by anti-virus.
- For approving financial transactions, the company shall have 2 step authentications.
- Provision of middle ware so that the members cannot reach the backend and front end directly.
- Emails from unknown sources shall not be opened.
- Creation of strong passwords, keeping the passwords confidential and changing the passwords often.

Other than above there shall be a detailed cyber security program which will be reviewed and updated from time to time.

Risk Mitigation Strategies:

1. Code of Conduct and Ethical Standards

- Implementing of **Code of Conduct**, applicable to all employees, field staff, and agents.
- Clearly define acceptable behaviors, red lines, and disciplinary consequences.
- Include guidelines on customer communication, field behavior, group meeting protocols, and complaint handling.

2. Field Staff Training

- Mandatory **induction and periodic refresher training** on:
 - Customer rights and protection
 - RBI Fair Practices Code
 - Grievance redressal procedures
 - Gender sensitivity and inclusion
- Use real-life case studies and role-play exercises to reinforce ethical behavior.

3. Customer Education & Transparency

- Provide customers with:
 - Loan cards with interest, charges, and repayment schedule
 - Pre-disbursement counseling sessions (CGT and GRT)
 - Loan agreement in local language
- Obtain signed customer declarations post-counseling.

4. Grievance Redressal Mechanism

- Multi-tiered grievance resolution system:
 - Field-level resolution
 - Branch/area escalation
 - Centralized Grievance Officer
- Display helpline numbers and escalation matrix in branches and group meetings.
- Maintain grievance MIS and analyze trends for systemic improvements.

A. Human Capital Risk

Human capital risk refers to the potential for loss or failure associated with an organization's human resources, impacting its ability to achieve operational, business resiliency, and continuity goals. It encompasses a range of issues stemming from employee behaviors, events, and the overall management of the workforce. These risks can lead to financial losses, reputational damage, and hinder strategic objectives.

Being an NBFC-MFI the Human Capital of SMPL is very important to provide its services hence risk associated with Human Capital is identified and mitigation plans are made.

Key aspects of human capital risk:

Operational Risks:

These include risks related to fraud, theft, workplace safety incidents, and non-compliance with procedures.

Business Resiliency and Continuity:

Human capital risks can impact an organization's ability to maintain operations during disruptions, such as pandemics or other crises.

Talent Management:

Risks related to talent acquisition, development, and retention are crucial, including talent scarcity, high employee turnover, and leadership gaps.

Employee Engagement and Performance:

Dissatisfaction, reduced productivity, and misconduct can all pose risks.

Compliance and Regulatory:

Organizations must also manage risks associated with compliance with labor laws and regulations.

Examples of human capital risks:

Employee Turnover:

High turnover can lead to loss of knowledge, skills, and productivity, as well as increased recruitment and training costs.

Leadership Gaps:

Lack of effective leadership can hinder decision-making, employee motivation, and overall performance.

Negligent Hiring:

Poor hiring practices can lead to unqualified or unethical employees, increasing the risk of misconduct and operational failures.

Workplace Safety Incidents:

Accidents and injuries in the workplace can result in significant costs, including medical expenses, lost productivity, and potential legal liabilities.

Compliance Violations:

Failure to comply with labor laws and regulations can result in fines, penalties, and reputational damage.

Data Breaches:

Employees can be a source of data breaches, either intentionally or unintentionally, leading to significant financial and reputational losses.

The company shall review the above risk and shall design and monitor the mitigation plans.

Risk Mitigation Strategies

1. Robust Talent Acquisition Strategy

- Streamline recruitment with clear role definitions and selection criteria.
- Build a recruitment pipeline in advance for field operations.
- Use background verification and behavioral assessments, especially for customer-facing roles.

2. Structured Onboarding and Induction Programs

- Develop standardized induction modules focusing on:
 - Organizational values and mission
 - Regulatory compliance and RBI fair practices
 - Customer service and conduct expectations

3. Training and Capacity Building

- Implement periodic training calendars for all levels of staff.
- Include topics such as:
 - Credit underwriting and collection ethics
 - Technology usage (LMS/MIS apps)
 - Financial literacy and gender sensitivity
- Track training effectiveness through assessments and field observations.

4. Retention and Incentive Mechanisms

- Design performance-linked incentive (PLI) schemes aligned with responsible practices.
- Offer non-monetary benefits such as recognition programs, learning opportunities, and career progression tracks.
- Periodically review compensation to remain competitive.

5. Succession Planning & Talent Mapping

- Identify key roles and build succession pipelines.
- Develop internal leadership through Management Trainee Programs and Fast Track Growth Paths.

6. Employee Engagement and Well-being

- Conduct employee satisfaction surveys, grievance redressal forums, and field feedback sessions.
- Promote work-life balance, field safety SOPs, and mental health awareness campaigns.
- Offer insurance and health benefits to mitigate personal risk.

7. Compliance & Ethics Monitoring

- Deploy a Code of Conduct and HR Manual covering ethics, disciplinary process, and conflict of interest.
- Implement whistleblower channels and periodic staff audits.

8. Digitization and Automation of HR Processes

- Using of HRMS platforms for:
 - Attendance and leave management
 - Goal setting and performance appraisal
 - Training tracking and compliance alerts

B. Information Technology Risk (IT Risk)

IT Risk, or Information Technology Risk, refers to the potential for loss or disruption resulting from inadequate, failed, or compromised IT systems, infrastructure, processes, or services. For an NBFC-MFI, IT Risk can significantly affect service delivery, data integrity, customer trust, regulatory compliance, and business continuity. RMC shall take regular input from the ITSC related to the IT Risk.

1. IT Infrastructure Risk Management

- **Hardware Redundancy:** Use failover servers, backup power supplies, and redundant network connectivity.
- **Software Controls:** Deploy licensed, patched, and updated software applications.
- **System Hardening:** Secure servers and endpoints with antivirus.

2. Cybersecurity Risk Controls

- **User Access Management:**
 - Role-based access controls (RBAC)
 - Multi-factor authentication (MFA)
 - Timely deactivation of ex-employee access
 - Regular Penetration Testing & Vulnerability Assessment
- **Security Information and Event Management (SIEM):** Real-time monitoring and alerting for abnormal activity.

3. Data Management and Privacy Controls

- **Data Encryption:** Encrypt data at rest and in transit using industry standards
- **Data Localization:** Ensure compliance with data localization norms (especially for Aadhaar data under AUA/KUA).
- **Data Loss Prevention (DLP):** Implement tools to monitor, detect, and block data exfiltration.

4. Disaster Recovery

- **Disaster Recovery (DR) Site:** Maintain an off-site or cloud-based DR site with periodic failover testing.

5. Vendor and Outsourcing Risk Management

- **Third-Party Due Diligence:** Assess vendors for cybersecurity practices, compliance, and IT controls before onboarding.
- **Contractual Safeguards:** Include clauses on data protection, breach notification, audit rights, and business continuity in IT vendor contracts.
- **Ongoing Monitoring:** Review vendor performance and security practices periodically.

6. IT Incident Management

- **24/7 Helpdesk:** Establish a helpdesk or support system for quick resolution of IT issues.
- **Root Cause Analysis (RCA):** Conduct RCA of every major IT incident and report it to management.

7. Compliance and Audit Readiness

- **Internal and External IT Audits:** Conduct audits covering system controls, cyber hygiene, and compliance.
- **IT Asset Register:** Maintain an up-to-date inventory of hardware and software assets.

8. Awareness and Capacity Building

- **User Training:** Regular training for employees on cybersecurity hygiene (e.g., phishing, password safety).
- **Simulation Exercises:** Run phishing simulations and cyber-attack mock drills.
- **IT Staff Skill Development:** Encourage them to develop their skills on continuing basis.

I. Fraud Risk

Fraud Risk refers to the possibility of financial or reputational loss resulting from intentional acts of deception, misrepresentation, or concealment by internal or external parties. For an NBFC-MFI, fraud may occur at any stage of the credit or operational cycle and can involve employees, customers, intermediaries, agents, or third-party service providers.

Risk Mitigation Strategy

A. Governance and Oversight

- The Company adopts a **Zero Tolerance** policy towards fraud in any form and at any level.
- A **Fraud Risk Management Policy (FRMP)** has been implemented which was approved by Board of Directors and shall be reviewed annually by the Board.
- A centralized **Fraud Risk Register** shall be maintained, monitored by the Risk Management Committee (RMC), and updated based on emerging risks and incident learnings.

B. Preventive Controls

1. Process-Level Controls:

- Segregation of duties (So D) in all financial and operational processes.
- Maker-checker validations and dual authorizations for critical transactions (e.g., disbursement, write-offs).
- Mandatory system-based workflows to limit manual overrides.

2. Customer Onboarding & KYC:

- Compliance with RBI and UIDAI-prescribed KYC/e-KYC norms.
- Aadhaar-based biometric verification using AUA-KUA authentication.
- Geo-tagging of field verification for borrower due diligence.

3. Technology Safeguards:

- Use of secure and tamper-proof LMS/LOS with built-in audit trails.
- Integration of fraud detection and analytics tools to flag suspicious patterns.
- Automated reconciliation between loan systems and bank accounts.

C. Detection Mechanisms

- Implementation of **Early Warning Systems (EWS)** based on red flag indicators (e.g., abnormal cash collections, duplicate borrower records, backdated entries).
- Surprise audits and periodic branch inspections.
- Establishment of a **Whistleblower Mechanism** to anonymously report unethical or fraudulent activities.
- Advanced **data analytics** to detect anomalies and investigate fraud indicators.

D. Investigation and Response

- All suspected or reported frauds shall be investigated by a designated Team.
- **Root Cause Analysis (RCA)** to be conducted post-investigation with a focus on control lapses and process gaps.
- Disciplinary and legal action to be initiated in accordance with internal HR policies and applicable laws.
- High-value or complex cases may involve forensic audits through empaneled external experts.

E. Reporting and Escalation

- Fraud incidents shall be reported to Senior Management and the Risk Management Committee.
- All frauds above the threshold prescribed by RBI (currently ₹1 lakh) shall be reported as per **RBI's Master Directions on Frauds - Classification and Reporting**.
- Regular MIS to be submitted to the Board and RMC, detailing fraud trends, categories, financial impact, and control effectiveness.

Risk Mitigation Strategy

A. Governance and Risk Assessment

- Physical risk management forms a part of the Company's **Operational Risk Framework** and is monitored by the Risk Management Committee (RMC).
- Periodic **site-level risk assessments** shall be conducted to identify vulnerable branches or field zones, particularly in geographies prone to natural calamities or unrest.

B. Employee and Field Staff Safety

- **Field Visit Protocols:**
 - Geo-tagging of visits and check-in/check-out systems.
 - Mandatory reporting structure and emergency escalation protocol.
 - Avoidance of field visits during local unrest or in unsafe hours.
- **Safety Training:**
 - Awareness sessions on road safety, emergency response, and basic first aid.
 - Dedicated helpline number or local emergency contact for field staff.
- **Insurance Coverage:**
 - Group accident insurance and health cover for employees, including field teams.

C. Physical Record and Asset Protection

- Secure storage for physical loan files, agreements, and statutory records with access control.
- Digitization of key documents and secured upload into centralized systems.
- Regular asset verification and tagging of fixed assets with location and user mapping.

D. Monitoring and Audit

- Inclusion of physical risk parameters in internal audits and operational risk reviews.
- Reporting of all physical incidents (fire, theft, damage) to Risk Cell and RMC with RCA and mitigation steps.
- Key risk indicators (KRIs) to be tracked – such as number of security breaches,

incidents reported, loss events, etc.

K. Socio Political Risk

Socio-Political Risk refers to the potential for financial, operational, or reputational losses resulting from changes in the socio-political environment, including government policies, political instability, civil unrest, regulatory shifts, or public sentiment. For NBFC-MFIs, such risks are particularly relevant given their grassroots presence, reliance on community engagement, and sensitivity to local and regional political dynamics.

Conclusion:

NBFC-MFIs serve low-income clients, so balancing growth with client protection and sustainability is crucial. A robust risk policy keeps defaults low, protects liquidity, and builds trust with investors/regulators.



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