



Arman Financial Services Limited

RISK MANAGEMENT POLICY

1. PREAMBLE

1.1. The Board of Directors ("**Board**") of Arman Financial Services Limited ("**Company**"), has adopted the following policy which encompasses practices relating to identification, assessment, monitoring and mitigation / treatment of various risks to the business. Risk Management Policy ("**Policy**") of the Company seeks to minimize unfavourable impact on the business objectives and develop stakeholder value. Further, the risk management practices seek to sustain and enhance long-term competitive advantage for the Company.

2. PURPOSE

2.1. This Policy has been framed in accordance with the Risk Management framework as issued by Reserve Bank of India ("**RBI**") vide Master Direction DNBR. PD. 008/03.10.119/2016-17 dated September 01, 2016 ("**RBI Circular**") and amendments thereon.

2.2. The purpose of this policy is to address unanticipated and unintended losses to the human resources & financial assets of the Company without unnecessarily limiting the activities that advance its mission and goals. The Company has introduced effective risk management systems that address the issues relating to various risks. The effective management of risk is vital to the continued growth of the Company.

3. PRINCIPLES

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

3.1.1. Risk management must create and protect value;

3.1.2. Risk management is integrated into organizational processes;

3.1.3. Explicit risk management helps decision-makers make informed choices;

3.1.4. Risk management is focused on the sources of uncertainty around the achievement of objectives;

3.1.5. Risk management must be tailored to the context and fit for purpose;

3.1.6. Risk management is dynamic, iterative and responsive to change.

4. DEFINITIONS

4.1. "**Board**" means Board of Directors of the Company.



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- 4.2. “Company” means Arman Financial Services Limited.
- 4.3. “Directors” mean individual Director or Directors on the Board of the Company.
- 4.4. “Policy” means Risk Management Policy.
- 4.5. “RBI” means Reserve Bank of India.

5. POLICY

The Company recognizes that Risk management as one of the key drivers of growth and further to enhance corporate governance. Accordingly, the Board has framed the following Risk Management Policy:

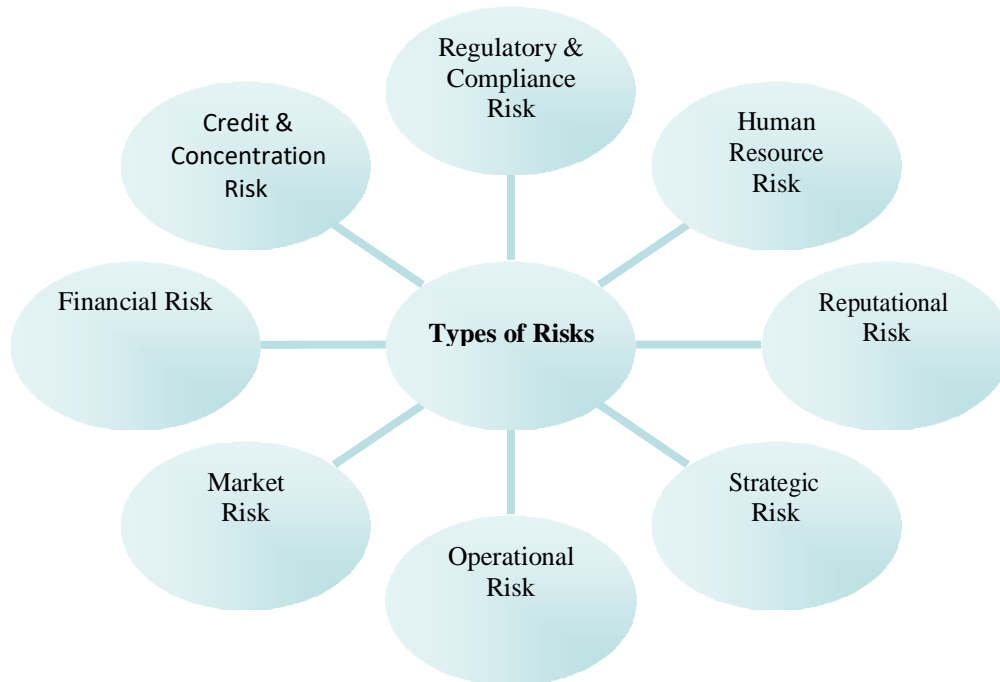
- To continuously thrive for available risks in the organization which directly or indirectly effect the functioning of the organization.
- To ensure the protection of rights & values of Shareholders by establishing a well-organized Risk Management Framework.
- Selecting, maintaining and enhancing the risk management tools used by the program to provide analyses that inform and support the investment actions of the entire organization.

6. IDENTIFICATION, MEASUREMENT AND ASSESSMENT OF RISK

- 6.1. Management’s responsibility, as delegated by the Board, is to operationalize the Risk Management Program and ensure that formal procedures are put in place to identify and define risk with input from representatives across the businesses.
- 6.2. Measurement of risk is completed considering both quantitative and qualitative means using the likelihood and impact criteria as developed by Management and as reviewed by the Board.
- 6.3. The management has identified certain inherent and residual risks which have been divided in accordance with likelihood and its impact on the business.
- 6.4. Following risks have been identified by the organization:



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- 6.4.1. Strategic Risk:** This risk is related to the overall business strategies and the related economic / business environment.
- 6.4.2. Operational Risk:** Arising out of day to day operations- technology failure, fraud, theft, robbery, error, storage and security, human resource, inadequate financial capacity to fulfil obligations and / or to provide remedies.
- 6.4.3. Market Risk:** Risks related to changes in various markets in which the Company operates.
- 6.4.4. Financial Risk:** These risks includes movement in interest rates, liquidity risks, credit risks and political risk.
- 6.4.5. Credit & Concentration Risk:** Credit risks incudes loss due to counterparty default in or failure of timely payment and loss due to a rating-downgrade. Concentration Risk is the risk to the company due to a very high credit exposure to a particular business segment, industry, geography, location, etc.
- 6.4.6. Regulatory & Compliance Risk:** Where privacy, consumer and prudential laws are not adequately complied with by the Company.
- 6.4.7. Human Resource Risk:** Where the employee related factors are not handled cautiously such as safety, security, compensation, etc.



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6.4.8. Reputational Risk: Where the practices followed by the Company are not in consonance with industry as well as internally prescribed standards.

7. RISK CATEGORIZATION AND MITIGATION FACTORS

7.1. The following broad categories of risks have been identified in our risk management framework along with possible mitigation factors:

7.1.1. Strategic Risk:

- **Risk:** It is the risk to earnings and capital arising from lack of responsiveness to changes in the business environment and / or adverse business decisions, besides adoption of wrong strategies and choices.
- **Mitigation:** The management shall be proactive in its approach towards changes in economic / business environment as the business strategies shall be regularly discussed with the senior officials of the organization so that adequate steps can be taken. Also, important strategic matters shall be referred to the Board / Committees of the Board, consisting of members with diversified experience in the respective fields, for intense deliberations, so as to derive the benefit of collective wisdom. The Company shall have the Director's and Officers liability insurance in order to protect the Board and Senior management from taking decisions during the course of their duties which might adversely affect the business.

7.1.2. Operational Risk

- **Risk:** There are inherent risk to business operations including those relating to client acquisition, service delivery to clients, business support activities, information security, physical security, theft, robbery, fraud, human resource and business activity disruptions.
- **Mitigation:**
 - **Document Storage and Retrieval:** The Company recognizes the need for proper storage of documents as also their retrieval for audit and statutory requirements. The Company shall maintain all the original documents in a dedicated space allocated for specific purpose.
 - **Scanned Copies:** The Company shall store the scanned copies of the loan documents, statutory documents / papers / certificates, KYCs of all employees including Directors, KYCs of all customers for easy retrieval especially for audit purposes where physical documents are not required.



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- **Whistle Blower Policy-** The Company shall encourage all its employees to report any instances or suspected instances of violation of the Code, malpractice, corruption, fraud or unethical conduct, leakage or suspected leakage of Unpublished Price Sensitive information of the Company.
- **Internal Audits:** Internal Audit at branch offices shall be carried out periodically by internal audit team of operations. Internal Audit at the Head Offices shall be carried out on a quarterly basis by an independent audit firm appointed by the Board. The scope of this Internal Audit shall cover all key functions including HR, Operations, Credit, Administration, Finance and Accounts. All significant audit observations of Internal Audits and follow-up actions shall be presented to the Audit Committee.
- **Technology Infrastructure:** The Company has been ahead of other similarly placed NBFCs in adoption of a fully computerized environment for conducting its business operations. Redundancy of leased lines / broadbands for data transmission will be provided at each branch office and Head office. The adequacy of the bandwidth of the leased line / broadband will be reviewed periodically and upgraded as per need. Uninterruptible power supply (UPS) will also be given at head office where Company keep it's database server. Database server gets updated online. Only authorized personnel will have access to the data base. Scope to tamper or alter the database will be eliminated through controls. A secured system of access control, both on-site and remote, including password management and secrecy will be in place and reviewed periodically. Suitable anti-virus software will be loaded in the central server and at all user points and updated regularly. A regular 'system audit' will be conducted to cover both hardware and software and the irregularities immediately addressed. An efficient system to report and manage IT incidents and problems will be in place across the network of branch offices.
- **Security:** All the employee shall be given Company's Identity Card which every employee shall wear while he / she is on duty. The Company shall provide to each branch, a good quality safe / lockers for safe keeping of cash / petty cash and other important documents to prevent the theft, fraud and robbery. The Company shall also provide medical and accident insurance coverage to all field level employees. The Company shall provide Closed Circuit Television (CCTV) camera to all the branch which are sensitive in nature.



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7.1.3. Market Risk

- **Risk:** Adverse and unanticipated market and economic developments may significantly change the risk profile and market value of Company's investments. Risks relating to inherent characteristics of our industry including competitive structure, technological landscape, extent of linkage to economic environment and regulatory structure.
- **Mitigation:** Management shall regularly review its business model including the areas it wants to operate. The management shall carry out regular competitive analysis of its peers in the industry so as to remain in competition and change its markets if required. Management shall also track micro / macro economic level data, market trends and forecasts by expert agencies, internal review by team of experts periodically.

7.1.4. Financial Risk

- 7.1.4.1. Interest Rate Risk:** Interest rate risk is the risk where changes in market interest rates might adversely affect an NBFC's financial condition. The changes in interest rates affect company in some way. The immediate impact of changes in interest rates is on company's earnings by changing its Net Interest Income (NII). The Company shall manage this risk on NII by pricing its loan products to customers at a rate which covers interest rate risk. The risk from the earnings perspective can be measured as changes in the Net Interest Income (NII) or Net Interest Margin (NIM). Measurement of such risk shall be done at the time of deciding rates to be offered to customers. Once interest rate risk is measured, lending rates shall be finalized. Given the interest rate fluctuation, the Company shall adopt a prudent & conservative risk mitigation strategy to minimize interest risk.
- 7.1.4.2. Foreign Exchange Risk:** The Company may get exposed to variation in foreign exchange rates on account of its borrowings in foreign currency and change of interest rate on foreign currency borrowings. The change in foreign exchange rates has a direct impact on Company's financials and its competitiveness. The policy lays down the tools that are permitted to be used for hedging of various risks by Company's treasury. The Company shall use only those hedging tools that are permitted by RBI from time to time. In addition to that the said tools must be permitted under the risk management policy.
- 7.1.4.3. Liquidity Risk:** Measuring and managing liquidity needs are vital for effective operations of an NBFC. The importance of liquidity transcends individual institutions, as liquidity shortfall in one institution can have repercussions on the entire system. Board / ALM Committee shall measure not only the liquidity positions of company on an ongoing basis but also



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examine how liquidity requirements are likely to evolve under different assumptions. Experience shows that assets commonly considered as liquid, like government securities and other money market instruments, could also become illiquid when the market and players are unidirectional. Therefore, liquidity has to be tracked through maturity or cash flow mismatches. For measuring and managing net funding requirements, the use of a maturity ladder and calculation of cumulative surplus or deficit of funds at selected maturity dates shall be adopted as a standard tool. Due to the high reliance on external sources of funds, Company may get exposed to various funding and liquidity risks comprising:

- **Funding Concentration Risk:** Concentration of a single source of funds exposes the Company to an inability to raise funds in a planned and timely manner and resort to high cost emergency sources of funds. Further, concentration of funding sources can also result in a skewed maturity profile of liabilities and resultant Asset-Liability mismatch.
- **Asset-Liability Mismatch:** A skewed asset-liability profile can lead to severe liquidity shortfall and result in significantly higher costs of funds; especially so during times of crises.
- **Market Perception Risk:** Due to inherent industry characteristics, the Company may get exposed to perception risks, which can lead to decline in ability of a lender to increase exposure to the Asset Finance -two wheeler and MSME sector and result lack of adequate and timely inflow of funds.
- **Leverage Risk:** A high degree of leverage can severely impact the liquidity profile of the Company and lead to default in meeting its liabilities.
- **Mitigation:** The key liquidity management policies shall be followed at Company include:
 - **ALM Meetings:** This shall be done to identify any short term / long term liquidity gaps and thereby take immediate corrective actions to bridge the same.
 - **Lender Exposure Updates:** The exposure profile to the lenders shall be regularly updated to ensure that skewness does not creep in in respect of the sources of external funds.
 - **Floating Rates:** Company currently borrows all its loans on a floating basis as against the entire lending on a fixed rate basis. This minimizes the impact of any adverse impact in the event of a credit shock in the



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banking system and any continuing effects of the same on overall interest rates in the economy and on Company.

- **Defined Leverage Levels:** Company shall target a leverage of maximum 2x in light of the business model and adequately safeguard itself against the impact of adverse market conditions. It also affords Company reasonable time to tie-up timely equity infusion.
- **Hedging on forex borrowing:** The Company might use following tools for hedging which are currently prevailing in the market:
 - Foreign Currency - INR Options
 - Foreign Currency – to – INR Swaps
 - INR – to – Foreign Currency Swaps
 - Cost Reduction Structures
 - Interest Rate Swap
 - Cross currency swap, and its variations such as Coupon swap, Principal Only Swap
 - Interest rate cap or collar (purchases), Forward rate agreement (FRA)
 - Exchange Traded Hedge Contracts
 - Combination of above permitted instruments which are combination of either cash instrument and one or more generic derivative products; or instruments which are combination of two or more generic derivative products

While applying above tools, the Company shall ensure that:

- The maturity of the hedge shall not exceed the maturity of the underlying transaction.
- The notional of the hedge shall not exceed the notional of the underlying transaction

The execution of hedges shall be done only by designated employees of the Company. The execution of hedges shall only be done with the banks permitted by RBI. The Authorised person executing hedging transactions shall follow the guidelines prescribed by RBI for that purpose and shall report to the management on a monthly basis.

- **Capital Adequacy:** Company shall target to maintain healthy levels of capital adequacy. The Company shall maintain a strong capital position with the capital ratios well above the thresholds defined by the regulatory authorities through continuous and timely capital infusion.



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7.1.5. Credit and Concentration Risk

- **Credit Risk:** Any lending activity by the Company may get exposed to credit risk arising from repayment default by customers. Despite best efforts, there can be no assurance that repayment default will not occur and, in such circumstances, may have an effect on its results of operations. The Company may not be able to realize the full value of its financial assets or there could be delayed in realizing such value. Any such losses could adversely affect the Company's financial condition and results of operations. There can be a significant loss due to a rating-downgrade.
- **Mitigation:** A strong credit risk management process will help in containing the portfolio quality of the Company. Key elements of the credit risk management include a structured and standardized credit approval process supported by a strong system, effective training programs, legal and technical due diligence, monitoring and robust credit risk management strategy at a senior management level.
- **Portfolio Concentration Risk:** Portfolio Concentration Risk is the risk to the Company due to a very high credit exposure to a particular business segment, industry, geography, location, etc.
- **Mitigation:** Company shall maintain a diversified exposure across various sectors and geographies to mitigate the risks that could arise due to political or other factors within a particular state. The Company has steadily diversified into various sectors and geographies and consequently the portfolio has become diversified. Various 3rd party verifications shall also be carried out to secure credit facilities.

7.1.6. Regulatory and Compliance Risk

- **Risk:** The Company may get exposed to risk attached to various statutes and regulations. The company is mitigating the risk through regular review of legal compliances carried out through internal as well as external compliance audit. Company is present in an industry where the Company has to ensure compliance with regulatory and statutory requirements. Non-Compliance can result in stringent actions and penalties from the Regulator and/or Statutory Authorities and which also poses a risk to Company's reputation. These risks can be:
 - Non-Compliance with RBI Regulations
 - Non-Compliance with Statutory Regulations
 - Non-Compliance with SEBI Regulations
 - Non-Compliance with covenants laid down by Lenders



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- **Mitigation:**

- The Company shall implement a Compliance Management System within in the organization to track, update and monitor compliances.
- Internal Audit shall also be conducted on a quarterly basis wherein all regulatory compliances will get reviewed in detail.
- Quarterly compliance certificate certified by the CEO and CS shall be submitted to the Board on quarterly basis.

7.1.7. Human Resource Risk

- **Risk:** Company's Human Resource adds value to the entire Company by ensuring that the right person is assigned to the right job and that they grow and contribute towards organizational excellence. Our growth has been driven by our ability to attract top quality talent and effectively engage them in right jobs. Risk in matters of human resources are sought to be minimized and contained by following a policy of providing equal opportunity to every employee, inculcate in them a sense of belonging and commitment and also effectively train them in spheres other than their own specialization. Employees are encouraged to make suggestions on innovations, cost saving procedures, free exchange of other positive ideas etc. It is believed that a satisfied and committed employee will give of his best and create an atmosphere that cannot be conducive to risk exposure. Employee-compensation is always subjected to fair appraisal systems with the participation of the employee and is consistent with job content, peer comparison and individual performance.

- **Mitigation:**

- **Human Resource Policy and initiatives:** Various programs and initiatives shall be carried out by the HR to retain talent and motivate them on a regular basis.
- **ESOP benefit:** The Benefit of Employee Stock Option Scheme (ESOP) shall be given to motivate talented employees by providing long term performance-based incentive / bonus, apart from their regular Salaries and incentive. This will help the organization to retain the best talent in the organization.

7.1.8. Reputational risk:

- **Risk:** Reputational risk is related to adverse perception of the image or the Company, on the part of customers, counterparties, shareholders, investors



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and regulators. It refers to the potential adverse effects, which can arise from the Company's reputation getting tarnished due to factors such as unethical practices, regulatory actions, customer dissatisfaction and complaints leading to negative publicity. Presence in a regulated and socially sensitive industry can result in significant impact on Company's reputation and brand equity as perceived by multiple entities like the RBI, Central/State/Local authorities, banking industry and the customers. These risks can be:

- Non-Compliance with Regulations
- Customer Dissatisfaction
- Misrepresentation of facts and figures in public
- **Mitigation:** Considering the business model the following aspects shall be put in place to reduce vulnerability related to reputational risk:
 - **Compliance with Fair Practices Code:** All employees shall be trained and instructed to follow fair practices as per RBI prescribed guidelines in all their dealings with the customers.
 - **Grievance Redressal Mechanism (GRM):** The Company shall have the GRM in place and the same shall be communicated to all customers at the time of sanction of loan. This shall also be available on the website of the Company.
 - **Delinquency Management:** The Company shall not adopt any coercive recovery practices and all recoveries shall be made in accordance with the Recovery policy and Fair Practice Code of the Company.
 - **Stringent Selection Criteria:** Vendors, employees and other associates of the Company shall be selected after confirming to the stringent criteria's prescribed by the management.
 - **Legal Obligations:** All employees, vendors and associates shall be required to sign legal contracts wherein specific clauses related to non-disclosure are entered so as to ensure the Company from any reputational risks.

8. RESPONSIBILITY

- 8.1.** Responsibility for risk management shall be shared across the organization. Key responsibilities include:



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- 8.1.1.** Controlling the risks through a formal program is necessary for the well-being of the organization and everyone in it. The jobs and services the organization provides, the safety of the workplace and other benefits all depend to an extent on our ability to control risk.
- 8.1.2.** The Board shall be responsible for satisfying itself annually, or more frequently as required, that management has developed and implemented an effective risk management framework.
- 8.1.3.** The Risk Management Committee shall assist the Board in overseeing the Company's risk profile and shall be responsible for overseeing management's actions in the identification, management and reporting of material business risks.

9. AMENDMENTS:

- 9.1.** This policy may be amended subject to the approval of Board of Directors, from time to time in line with the business requirement of the Company or any statutory enactment or amendment thereto.
