Indian School Finance Company Private Limited

Risk Management Policy **Version 1-06/2024-25**

Dated:15th December 2024

Indian School Finance Company (ISFC) is a Non-Banking Financial Company - Investment and Credit Company (NBFC-ICC) registered with the Reserve Bank of India (RBI), Over past many years under the strategic guidance and support of its principal investor, Gray Matters Capital (GMC) ISFC has built a strong foundation as a key player in the financial services sector, specialising in lending for businesses which creates impact as an additional outcome.

Gray Matters Capital (GMC), a globally recognised impact investment firm based in Atlanta, is committed to creating social change through gender-focused investments. With a mission to positively impact 100 million women by 2036, GMC brings a wealth of experience in sustainable finance and impact-driven investment strategies. This alignment between ISFC and GMC's vision reinforces the company's commitment to responsible lending, financial inclusion, and socially responsible financial practices.

As an NBFC-ICC operating under the RBI's regulatory oversight, ISFC is exposed to a variety of financial risks, including credit risk, operational risk, regulatory compliance risk, and market volatility. Effective risk management is essential for maintaining financial stability, regulatory compliance, and long-term organisational resilience in this dynamic environment. It is critical for ISFC to implement comprehensive risk management strategies that mitigate these risks and ensure the company's continued success in an evolving financial landscape.

This document outlines ISFC's Risk Management Policy, designed to address the key risks inherent in its lending activities and provide a framework for their identification, assessment, and mitigation. By adhering to these principles, ISFC aims to safeguard its operations, uphold its commitment to responsible financial practices, and contribute to the broader goal of sustainable development within the financial sector.

Risk Management Framework:

The Risk Management Framework (RMF) or Risk Appetite Framework (RAF) outlines a comprehensive approach to identifying, assessing, controlling, and monitoring risks associated with its operations. The framework begins with a strong governance structure, including the Board of Directors and the Risk Management Committee, who oversee the implementation of risk management strategies in line with ISFC's business objectives. A clear Risk Appetite Statement is established, defining the types and levels of risk the company is willing to accept in its lending activities, ensuring that risk exposures, such as credit risk, operational risk, market risk, and regulatory compliance risk, are managed within acceptable limits. Identifying and assessing these risks involve structured processes and tools to evaluate their potential impact and likelihood, helping ISFC prioritise appropriate risk mitigation actions. Risk controls, including thorough credit evaluation processes, internal policies, and compliance measures, are put in place to minimise and manage risks, while monitoring and reporting systems track key risk indicators to ensure adherence to the defined risk appetite. The framework is further supported by a strong risk culture, fostering awareness and accountability across the organisation to integrate risk considerations into daily decision-making. Regular reviews of the risk management framework and ongoing alignment with organisational strategy ensure that ISFC remains adaptable to market changes, regulatory shifts, and other external factors, safeguarding its long-term stability and resilience in its lending activities.

Mission, Strategy and Operating Model

ISFC's new vision is to empower women in India by supporting Impact Organizations with debt solutions in Employment, Livelihoods, Skills and Credit access for impact in diversified sectors. Aligning with its mission, ISFC will focus on sector-agnostic debt products for the said business segments whose products and services benefit women and girls. The portfolio aims to achieve social and financial objectives, driving meaningful impact while aligning with Gray Matters Capital's overarching purpose.

ISFC's strategy is to identify and do a preliminary evaluation of its potential customers using GMC existing Investees, Intermediaries, Team Network, Eco System Partners and participating in various investment events network and underwrite these proposals by inhouse underwriting for credit decisioning as per Board approved product policy norms in a non-templatised approach. ISFC initially decided to concentrate on diversified business to ensure diversified portfolios and to avoid product-specific risk. The Loan amount average ticket size is Rs.50L to a maximum of Rs.5Crs overall group exposure.

ISFC has Initial equity to support lending operations, and the company may raise equity using various sources in the future, borrowing from various banks and financial institutions and issuing bonds/NCDs/Securitization.

ISFC's risk management systems and procedures are reviewed and refined continuously to comply, in substance, with what the company identifies as the relevant market standards, recommendations and practices. Through our risk management framework, we aim to manage enterprise-wide risks to maximise risk-adjusted returns while remaining within our risk appetite. As part of this framework, we use principles that describe the risk management culture we wish to sustain. As part of this framework, we use a set of principles that describe the risk management culture we wish to sustain:

Risk-Return Trade-off: Risk is taken in support of the requirements of our stakeholders, in line with our strategy and within our risk appetite.

Responsibility: It is the responsibility of all employees to ensure that risk-taking is disciplined and focused. We consider our social responsibilities and our commitments to customers when taking risks to produce a return.

Risk Identification and Anticipation: Identify and anticipate future risks, ensure awareness of all known risks the company could be prone to, and define the risk universe.

Accountability: Risk is taken only within agreed delegation and where there is appropriate infrastructure and resource. All risk-taking must be transparent, controlled and reported.

Risk Measurement: To ascertain the quantum of either a specific risk exposure or an aggregate risk exposure and the probability of a loss occurring due to those exposures

Risk Reporting and Monitoring: We seek to achieve risk control through efficient and effective risk reporting and monitoring

Risk Appetite Statement

The ISFC Business Loans team will develop a Risk Appetite Statement that reflects the organisation's risk appetite. The Risk Management Committee(RMC) will approve the risk appetite statement.
The risk appetite statement will quantify the risk and decide a threshold for each risk below.

- Reputational Risk
- Financial Risk
- Credit Risk

- Concentration Risk
- Interest Rate Risk on the Book
- Operational Risk
- Compliance Risk

The organisation will monitor the above risk and report to the Risk Management Committee at least quarterly.

The Risk philosophy of the organisation is as below.

Business Lines are Primarily Accountable for Risk: ISFC has established two lines of Défense principle in carrying out effective Risk Management efforts. The first line of defence is the Business Unit, responsible for identifying risks early and conducting mitigation actions on risks. The second line of defence is risk management and compliance units, which are responsible for assessing risks of proposals and formulating and monitoring activities and business processes. The Risk Management Committee of ISFC will have active oversight on the risk management.

Risk Management Culture: The endeavour will be to build a robust and pervasive risk management culture throughout the organisation.

Risk is Understood, Measurable and Manageable: The organisation limits its risk-taking activities to those that are well understood and where there is sufficient expertise, resources, and infrastructure to manage the risks and earn commensurate returns effectively.

Reputational Risk: ISFC thoroughly considers and manages the impact of new initiatives, products, and activities to minimise reputational risk.

Risk-Bearing Capacity: ISFC defines its "risk-bearing capacity" as the ability to bear risk in terms of available capital and the ability to raise additional capital. It also covers the strength of the organisation's operational processes and operating culture. Accordingly, ISFC's capital will reflect its risk-bearing capacity.

Credit Risk Mitigation: Credit risk is the risk of loss resulting from the failure of a borrower or counterparty to honour its financial or contractual obligations to ISFC. Credit risk arises in ISFC's direct lending operations and in its funding and investment activities where counterparties have repayment or other obligations to ISFC.

The organisation measures and manages Credit Risk by adhering to the principles/ guidelines and product policy. A detailed overview of the product & loan policy will be undertaken, and the key components of the product policy are as follows:

- To adhere to the RBI prudential requirements with respect to lending norms and ensure correcting any breaches to such prudential guidelines.
- To maintain a diversified portfolio of assets and avoid undue concentration in exposure to a single segment, product, or industry.
- To design policies that will clearly define its lending limits and other stipulations to financing Business loans, working capital loans, and loans against property and keeping the overall objectives of ISFC and RBI guidelines.
- The policy or Business Plan duly approved by the Board should clearly define the target market and focus customer segment.
- The policy will also define forbidden credit, cautious and restrictive profile.
- The policy also defines the product to be offered and finance eligibility in each of these.
- ISFC ensures to refer to a Credit bureau (CIBIL, CRIF, Equifax, or Experian) before approving any credit.

For the recognition of past-due and impaired loans and advances, the NBFC follows guidelines prescribed by RBI on "Prudential Norms on Income Recognition, Asset Classification and Provisioning Pertaining to Advances" and other circulars/notifications issued by RBI at various times in this regard. The credit policy includes a standard operating process for delivering credit.

Monitoring: ISFC will lay down the various credit evaluation and monitoring processes in the loan proposal, and it will clearly carry out macroeconomic factor analysis, industry analysis, portfolio analysis and account level analysis to control delinquencies. ISFC will implement robust portfolio monitoring systems and tools like Cheque bounce analysis, lagged delinquency, lead delinquency, coincidental analysis, month on month and circulate to board members to closely monitor the portfolio.

Risk Mitigation: External panelled vendors will do ISFC's Fraud check if the RMC deems it necessary. Quarterly, a comprehensive Fraud MIS with action taken and proposed mitigation techniques will be submitted to the RMC.

Operational Risk Mitigation: Operational risk is the risk of loss, whether direct or indirect, to which the organisation is exposed due to external events, human error, or the inadequacy or failure of processes, procedures, systems, or controls. In some form, operational risk exists in the business loan segment and support activities and can result in financial loss, regulatory sanctions and damage to the organisation's reputation. Operational risk encompasses business process and change, technology failure, financial crime, and legal and regulatory risks.
Adopting the lines of defence mechanism stated as below:

- Accountability in the individual business lines for managing and controlling the significant operational risks they are exposed to.
- A well-defined internal control procedure and the operations function to maintain a daily control function checklist to monitor and complete daily critical activities.
- Maker and checker at the critical level of activities. ISFC adopts the Operations Manager as the Maker and outsourced Legal entity to check all critical disbursal documentation.
- Reporting any critical variance to RMC

Market Risk Mitigation: Market risk is the risk of loss from changes in market prices and rates (including interest rates, credit spreads, equity prices, foreign exchange rates, commodity prices and property rate risk), their correlations, and their levels of volatility. ISFC is mainly exposed to only interest rate risk.

Interest Rate Risk Management

- Review the Interest Rates Scenario and decide on the desired composition of various loan portfolios.
- Maximizing of risk-adjusted return; and
- Mitigating interest rate risk to within desired levels.

Risk Management Committee: To enable the organisation to adopt best practices and greater transparency, the company is setting up a Risk Management Committee (RMC) for integrated risk management. The RMC ensures that the risks associated with the functioning of the Company are identified, controlled, and mitigated and lays down procedures, systems and strategies for the same. The RMC shall consist of the following:

1. One Board of Director
2. Executive Director

3. Any other invitee other than Board Member.

With any two members forming the quorum for the meeting. All decisions in the RMC are to be unanimous.

The other optional invitees other than board members to the RMC meeting would be the following:

1. Senior Manager Debt Investment
2. Internal Audit Head
3. Operation Manager

All the minutes of the meeting of RMC will be prepared and circulated to all Board Members.

Purpose of the Committee

1. To identify, monitor and measure the organisation's risk profile.
2. To devise strategy, frameworks, methodologies, systems and tools to contain risks.
3. To ensure implementation of contingency plans for various risks including credit risk, market risk, Interest rate risk, operational risk, liquidity risk, legal risk, reputation risk, strategic risk, compliance risk and any other material risk.
4. To develop policies and procedures and verify models used for pricing products.
5. Conduct periodic studies on the organisation's overall risk, including various exposures, and ensure exposure is well managed.
6. To design stress testing scenarios to measure the impact of unusual market conditions and monitor variance between the actual volatility of portfolio value and that predicted by the risk measures.
7. To monitor compliance of various risk parameters by all the organisation's functions.
8. Building a risk management culture at all levels of the organisation.

Duties and Responsibilities of the Committee

1. Approve strategic action arising from external regulations affecting risk management practices.
2. Approve new credit products and services.
3. Approve various Industry, product, and other quantitative prudential limits related to risk to be implemented in the organisation.

4. Review various macroeconomic risks, Industry risks and other related external risks and take corrective actions, including changes in policy, customer strategy, etc.
5. Review the Portfolio Management and monitoring strategy, including the Early Alert mechanism, loan review mechanism, portfolio analytics, loss forecasting, and portfolio quality report and suggest a corrective action plan.
6. Design and review Stress testing scenarios, examine results to understand the impact of variance, and recommend corrective action.
7. Review stressed and SMA (Special Mentioned Accounts) and decide on account strategy.
8. Review and assess the operational risk management process and mitigation measures.
9. Approve Risk Control Self-Assessment, KRI and Incidence Management reports, which are part of operational risk management.
10. Reviewing and approving various policies
11. Oversee RBI reporting and guidelines related to risk like capital adequacy, etc.
12. Approve risk measurement models like Internal Rating mode, scorecards for retail portfolios, etc.
13. Review the vendor empanelment process and annual renewal of vendors, including outsourcing arrangements (for material vendors as per outsourcing policy).
14. Review significant audit issues and recommend a corrective action plan to tighten control and processes.
15. Approve deviations as per the deviation matrix.
16. Approve and suggest a collection strategy for the portfolio and review the same for tighter control of the portfolio.
17. Setting a correction or rectification of all functions that deviate from standard procedure.

Risk Meetings: - Risk review meetings should be conducted at least once in three months.