VAMA SUNDARI INVESTMENTS (DELHI) PRIVATE LIMITED
(An HCL Group Company)

Corporate Office: A9, Sector 3, Noida - 201301, U.P, India
Registered Office: CP-3, Sector-8, IMT Manesar,
Gurgaon, Haryana-122051
Tel: +91 120 3667180
CIN: U65923HR2008PTC046947

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INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS
(Approved by the Board of Directors on 21st December, 2023)

Reserve bank of India (RBI) vide its circular "RBI/2021-22/112 OR.CRE.REC.No.60/03.10.001/202122 October" has come up with revised regulatory framework for Non-Banking Finance Companies (NBFCs) viz. Scale Based Regulation (SBR) The objective of the SBR frame work is to align risk of the NBFCs with its size and complexity. On the basis of size, activity and the perceived risk, the frame work divides the NBFCs in four broader layers which are as under –

1. Base layer (NBFC – BL)
2. Middle layer (NBFC – ML)
3. Upper layer (NBFC – UL)
4. Top layer (NBFC – TL)

Based on the categorisation descriptions, Vama Sundari Investments(Delhi) Pvt. Ltd. (VSIDFPL) shall fall under middle layer category and it has to follow the frame work guidelines applicable for middle layer category. Among the various facet of SBR, it is required for NBFCs to put in place board approved capital adequacy assessment process to maintain adequate capital to absorb the potential business risk. This documents describes how the capital adequacy is assessed and maintained by the company.

Objective Basic objective of Internal Capital Adequacy Assessment Process (ICAAP) is to align Company's capital with the risk associated with its business model and complexity of the business in various scenarios including unforeseen business scenarios. Assessment of risk will be done from time to time but at least once in a year to ensure Company is maintaining required capital to meet out its planned business growth and to be in compliant with the regulatory requirements set out by the regulators.

Capital adequacy assessment process Company's capital requirement changes with the type of risk the company is exposed with. During Group recognition test as also obtaining group guarantee, such potential defaulters are weeded out at the outset. However, if few such borrowers still get into the system despite all effort, they are persuaded by various means to repay the loan as per schedule.

(a) Over indebtedness of the borrowers At times borrowers get into trap of over indebtedness as they tempt to take loan more than they can manage. With the evolvement of the credit bureau specifically for the microfinance industry and active role of Self-Regulatory Organisations (SROs) this risk has been mitigated to a great extent.

(b) Concentration Risk As a lending company concentration risk is another critical risk which may affect the loan portfolio quality of the company and thereby it may influence capital as well. Company may have following concentration risks

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• Geographical concentration risk
• Product concentration risk

- Geographical concentration risk may arise if the company loan asset is highly skewed in a particular state or district. To mitigate the risk company shall spread out its operations in various locations. However, company keeps close watch on the specific events such as election and any government announcement etc. and assess the impact of it on company's geography's and its loan portfolio.

- Product concentration risk may arise if the company is dependent on single product and product demand may taper down, as it will reduce the profitability and there by the capital. To mitigate this risk company shall diversify its products.

- Other socio, political and economic challenges Socioeconomic, political and other unforeseen events may adversely affect the microfinance business. In the recent past, two major events demonetisation and pandemic have affected the company's business to a large extent. As the company does not have any control on such events, it maintains adequate capital to absorb losses arising because of such risks. Apart from this, the company also tries to contain the losses by being very selective in business expansion in circumstances like demonetisation and pandemic.

2. Market Risk – The Company's capital is mixed of equity and debt and it is skewed towards debts. Company has availed debt through various instrument such as term loan with fixed and variable interest. Debt instruments are exposed to following market risk.

a. Interest Rate Risk The Company if avails the term loan with variable interest it is exposed to interest rate risk. To mitigate the risk, company closely reviews the impact of interest fluctuation on its borrowing cost of overall borrowing exposure. Revised, Reserve Bank of India (RBI) guideline has given a head room to adjust the interest rate of onlending in consonance with fluctuating borrowing cost. This helps the company to mitigate the interest rate risk, however Company is very sensitive and keeps in consideration all important aspects while revising the on-lending interest rate. As the interest rate fluctuation on over all borrowing is not sharp so far, the company has not faced any challenges in managing interest rate risk. Moreover, company has ensured the fluctuation in interest does not adversely impact its capital.

b. Foreign Exchange Risk If the Company avails the ECBs, it is exposed to foreign exchange risk. To mitigate this risk, the Company has policy to do 100% hedging of ECBs received in foreign currency and to be paid in foreign currency.

3. Operational Risk Based on the Company's own experiences, following are the key operational risks that the Company may encounter. These risks are analysed in light of their impact on Company's capital.

a. Internal fraud The Company has digitised its majority of the process, however the collection process is partially digitised. The scope of fraud exists when there are cash transactions. In a few of the Company's processes, cash transaction is involved which exposes it to internal fraud risk. To mitigate this risk, the company has taken due care by setting up various check points such as verification of cash transactions by calling team over a call with customer and internal auditors during their visits and over the call with the customers. Nature of this risk is of low frequency and low impact therefore it does not have any significant impact on company's capital.

b. Employment practices and workplace safety This risk may arise due to breach in some of the statutory payments with respect to employee benefits such as timely payment and remittance of employee provident fund, gratuity, statutory bonus etc. In order to mitigate such risks company keeps track on timely payment and remittance of such dues. As the company has established a fool proof system of cross checking by the accounts team on monthly basis and it also verified by the statutory auditors every quarter, the perceived risk with respect to employee practices is considered insignificant. Risk with regards to workplace safety may arise due to discrimination, sexual harassment or general liability because of damage incurred by the company's staff. The company policies have zero tolerance on such issues and take a strict disciplinary action, including even termination of such errant employee from his/her job. Because of such strict policy being in place perceived risk with respect to workplace safety is quite low. Impact on capital from both of these risks is also low.

c. Clients, products and business practices Misuse of client confidential information, marketing of unauthorised or inappropriate products, omission or incorrect disclosure of effective interest rate may attract risk of legal compensation claim from the clients. To mitigate this risk, the company ensures strict compliance to industry code of conduct established by RBI and Self-Regulatory Organisations (SROs). Historically company has not faced such risk, therefore the risk is perceived low.

d. Business disruption and system failures Business disruption risk due to unforeseen circumstances such as pandemic, political unrest, government policy decision such as demonetisation etc. are the high risk for the company. As the company do not have control over such kind of external risk, the company mitigate this risk by maintaining adequate capital and taking appropriate measures well in time.

Impact of Risk of system failures is low in frequency and medium in impact as the company has adopted adequate measures to mitigate this risk. Moreover, company do not perceive significant impact on capital because of this risk.

To mitigate this risk, company assesses the expected credit loss through a scientifically devised credit loss estimation model and provide for adequately based on the loss estimated by the model. After adjusting such losses on account of loan portfolio provisioning, company ensures that it maintains the capital above the minimum threshold prescribed by the RBI. The Company's Policy on Maintaining Minimum Capital Based on the assessment of the various risks, it is clear that there are two risks which can majorly impact the company's capital - credit risk and operational risk. This is because, it majorly impacts the loan portfolio which is the major assets of the company. Though the market risk is impacting borrowing cost of the company but the risk is limited as the company has headroom to increase the interest rate of the on lending. To mitigate the credit risk and operation risk, company makes the required provision which is estimated through very well defined expected credit loss estimation (ECL) model that is elaborated in the company ECL policy. The company has been comfortably managing the perceived risks by maintaining the capital at RBI prescribed capital limit of Capital to Risk Weighted Assets (CRAR) of 15%, with Tier I capital more than 100% of Tier II capital. Keeping in view the dynamic risk scenario, the company management has decided to keep the CRAR at slightly higher than RBI prescribed CRAR rate. Therefore, the company will maintain minimum CRAR of 16%, post the approval of this policy from the board of Directors of the company.

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