MUTHOOT CAPITAL SERVICES LIMITED

CIN: L67120KL1994PLC007726

POLICY ON CO-LENDING

This Policy was approved by the Board of Directors at the meeting held on 19th June 2021 and reviewed by the Board on 8th August 2023

Version Control:

Sl. No.	Name of Policy	Version	Board approval date	Remarks
1.	Policy on Co-Lending	v1.0	19/06/2021	Policy document approved.
2.	Policy on Co-Lending	v1.1	08/08/2023	Incorporated the exposure limit norms for co lending and customer related issues and other operational aspects as per RBI guidelines

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Policy on Co-Lending

1. Preface

Muthoot Capital Services Limited (MCSL) is looking to diversify its sourcing avenues by addition of Co-Lending.

Co-Lending (CL) partnership will be done with originator partners who have demonstrated track record of quality origination across product(s), customer segment(s), location(s) complying to MCSL's standards. Currently MCSL would restrict its attention to its approved products and in locations where currently its market share is limited.

2. Definitions:

Co-Lending would arise when one larger entity would, to take the benefit of a locally strong entity, jointly plan disbursement of loan to the customers in the geography of that second entity, using a jointly agreed policy using the ground strength of the 2nd entity. The financing could be such that the larger entity takes a larger share of the funding and in some case even 100% of the funding.

i. **Co-Lender:** Muthoot Capital Services Limited (MCSL) an NBFC would be one of the Co-Lenders.
ii. **CL Partner:** CL Partner would be an NBFC which has been onboarded by MCSL as per the Co- Lending (CL) Programme to offer a CL Product. NBFC should not be within the group.
iii. **Servicer:** Servicer is an NBFC, or any other entity contracted by MCSL, to perform list of services agreed upon at the start of CL Program or during or after the end of the program tenure. These are post disbursement services. The Co-Lending Partner could also play the role of the Servicer.

3. The need For Co-Lending

MCSL would work with another NBFC, who would be referred to as the "Partner". The intention is to use the resources that is at the disposal of MCSL and the sourcing and servicing ability that the originator partner has.

MCSL would look for CL Partners with sufficient track record of sourcing, collecting and on their own running successful though smaller businesses. The Co-Lending would be discussed with potential CL Partners who see this as an opportunity to correct their constraints as given below:

Opportunities	Constraints
Expand in existing product / customer	Lack of Capital
Expand in newer product /customer	Technology
Expand in existing geography	Analytics
Expand in newer geography	Balance Sheet / Risk appetite

4. Intended benefits to MCSL from CL Product

1. CL Product provides for frequent and continuous engagement with CL Partner.

2. Adds to its retail finance portfolio.
3. CL Product provides granular revenues in the form of interest income and/or fee income which would bear the same or lower risk than its in-house sourced loans.

4. Sharper market intelligence and understanding of the Partner - Customer - Product - Market / Geography:

While deciding on a Co-Lending Arrangement, MCSL would need to look at the overall risks attached to the arrangement and mitigants associated with those risks.

The following would be considered by MCSL before it starts its Co-Lending activities:

5. Eligibility Criteria for the Partner

- Holds valid NBFC registration certificate.
- Vintage of at-least 3 years.
- Backed by Private Equity (PE) player or should have a minimum AUM of Rs. 50 crores

Portfolio. CL Product would be designed considering the following key tenants:

- **Servicer Risk:** Ability to select right CL Partner.
- **Product Risk:** CL Partner - Product: Co-design the product and process.
- **On tap funding:** Program based approach and ability to let the CL Partner access funds on tap.
- **Review:** Business and risk review at regular intervals.

a) Servicer Risk

- MCSL should ensure that the Partner selected for CL is of reasonable size and already running a profitable lending business, with sound net worth.
- MCSL should ensure that the products offered are products where MCSL has sufficient experience
- MSCL should normally deal with a Partner in geography where MCSL has limited coverage,
- The Origination Process should be clearly defined and steps in relation from sourcing upto collection, recovery and closing of the loan account is clearly defined.
- There should be clear identified terms of engagement, covering:
  - First loss
  - Risk and Revenue sharing
  - Commercials
  - Monthly reporting of disbursements and collections from loans specifically allotted to

MCSL

- Role of Servicer / Partner should be clearly defined. The arrangement should also clearly state that the role of the Servicer / Partner would include, but would not be restricted to:
  - Customer Sourcing
  - Credit Processing
  - Contracting with the Underlying Borrower
  - Disbursement Processing
  - Document Storage
  - Post disbursement Customer Servicing
  - Collections including OD recovery and litigation process where need be
  - Closure

b) Product Risk

CL Partner-Product combination is determined by value which the CL Partner seeks from MCSL's CL Product.

Basis the market intelligence and data analytics, MCSL and CL Partner together would co-design / co- build / Draft the **CL Partner-Product-Process** Note.

The CL Partner-Product-Process Note should cover the following:

1. Executive Summary
2. CL Partner details
3. Intended value sought by CL Partner
4. Product offered to the customer
5. Origination Process at CL Partner**:** End to end customer servicing and solutions
6. CL Product Process including TAT commitments across levels, including in case of deviation
7. CL Product Term sheet**:** Commercials covering business commitment, % of split, fee to the CL Partner, Process for Credit Enhancement, transaction processing and reporting norms.
8. CL Product Review Framework covering business and risk
9. Recommendation based on returns

c) **Underwriting Risk**

Credit policy should be mutually agreed. Credit sanction to be done by both MCSL and the partner. As quick turnaround is the essence of a successful partnership, MCSL will ensure that while giving its final credit approval, there would a quick turnaround in line with the TAT agreed with the Partner.

d) Review

CL Partner and MCSL commit to a periodic review of both business and risk of CL Product. Review framework would provide the agenda of review, frequency and relevant personnel required for review.

6. Commercials: Risk-Return Framework

The arrangement would also cover the commercials where the underlying principle would be MCSL's ability to collect back the last rupee due to it from the underlying customer.

Product structuring and designing is based on the incentive alignment at individual contract and total portfolio level. This is in addition to the qualitative comfort built around reputation risk that CL Partner runs in case of any default.

1. Pari-passu risk sharing: Contract level
   a. Indicative:
      i. MCSL intends to share the risk and funding with the CL Partner in the ratio determined at the start of the relationship.
2. First Loss Credit Enhancement (FLCE) to be provided by the Servicer / CL Partner:
   a. FLCE is to be ensured to be at a pre-determined rate on the Peak Portfolio of the last 12 months, so that MCSL is covered in the scenario of termination of CL Product.
   b. Forms of CE are also evaluated considering the CL Partner - Product. They include:
      i. Cash collateral by way of lien of Bank Deposits
      ii. Corporate Guarantee
      iii. External Support
      iv. Other forms of CE, as may be agreed between the Partners at the start of the relationship.

Return sufficiency for the CL Product risk will be approved by Credit Committee basis the recommendation in the Product note and Term sheet considering the following inputs:

1. Risk taken in CL Product and CE available
2. Split of income
   a. Underlying product yield %, fee income, insurance premium, other income/charges
   b. Interest income to MCSL
   c. Service fee % to CL Partner
   d. Fee income split with MCSL
   e. GST impact
   f. Share of other income / charges to MCSL
3. Pricing of Term loan or On Balance sheet product to the CL Partner

The proposed agreement should cover the following aspects to ensure that there is no ambiguity going forward:

<table>
<tr><th>Sl. No.</th><th>Description</th><th>Particulars</th></tr>
<tr><td>1.</td><td>Transaction Structure</td><td>• The fact that MCSL proposes to tie up with CL Partner in offering loans to borrowers via a CL Program.
• CL Partner offering Services to MCSL via a Servicing Agreement.
• CL Partner proposing to offer CE to MCSL,</td></tr>
<tr><td>2.</td><td>Eligibility Criteria for Loans Comprising the CL Product Agreement</td><td>The document should also specify that the loans shall be identified based on criteria specified below:
• Originated from [Approved Location Schedule]
• [Product name: CL Partner Product]
• Maximum tenor of the loan to be [ ] years
• Minimum tenor of the loan to be [ ] years
• Maximum ticket size of the loan to be INR [ ]
• Minimum ticket size of the loan to be INR [ ]
• Any additional criteria that needs to be stated in the agreement.</td></tr>
<tr><td>3.</td><td>CL Product Agreement: Services</td><td>As captured in the Role of CL Partner.</td></tr>
<tr><td>4.</td><td>Business Commitment (INR Crore) in the FY</td><td>To state the business commitment that the partner agrees to for a financial year or more or a specific period</td></tr>
<tr><td>5.</td><td>CL Product Agreement: Participation Ratio</td><td> To state that MCSL and CL Partner will lend to the underlying borrower in the ratio, called Participation Ratio.
 State that the proceeds of the underlying loan and Processing Fee and other income / charges shall be split between MCSL and CL Partner in the Participation Ratio or any other pre-determined basis.</td></tr>
<tr><td>6.</td><td>Credit Enhancement</td><td>• The documents should state that the CL Partner agrees to provide to MCSL, Credit Enhancement (CE) guaranteeing the performance of the underlying loan(s)
• That the CL Partner provides CE equal to “x%” of the highest AUM calculated at the end of the month over the previous 12 months.
• That the CE is maintained in the form of cash collateral / any other mode agreed between the parties, in favour of MCSL.
• The CE available is calculated on monthly basis as per the methodology that would be agreed.</td></tr>
<tr><td>7.</td><td>Credit Enhancement Utilisation</td><td>To state how the CE utilisation would take place:
An Example:<table><tr><th>CE Trigger</th><th>% of AUM utilized or CE utilized</th></tr><tr><td>Trigger 1: PAR 30 Threshold</td><td>5% or Nil</td></tr></table></td></tr>
</table>

		Trigger 2: PAR 60 Threshold	50% or [1 EMI]
		Trigger 3: PAR 90 Threshold	100% or [2 EMI]
		Trigger 4: PAR 120 Threshold	NA or 100%
8.	CE Reconciliation and Availability	Detailed process for the month end reconciliation of the CE balance needed.	
9.	Servicing Agreement	The document to cover the fact that MCSL appoints the Servicer to conduct the following services on its behalf: • Collections, including handling of Arbitration/Litigation • Any other activities as may be decided	
10.	Servicer Fee	That for the services provided by the Servicer, if the Servicer is different from the CL Partner, a fee as per the schedule is payable. If the CL Partner carries on the function of the Servicer, the same would be adjusted as a part of the Income split Service Tax + Cess implication, if any, will be borne by the MCSL as per the schedule.	
11.	Reporting	• That the details of the underlying borrowers along with the repayment schedules have to be provided to the Lender (MCSL) by the Servicer on specific days of each week and also at the end of every month, in addition to making them available real time through the MIS access.	
12.	Accounts reconciliation	• The frequency at which the accounts at MCSL end and the Partner's end would be reconciled and the action to be taken at the end of each reconciliation should be clearly specified.	

7. Risks And Mitigants

As the Co-Lending deals with MCSL, one or more partners and several customers, all risk would need to be identified and mitigants put in place to ensure that the risks are well covered.

8. Credit Risk

1. MCSL is subjected to the credit risk of the underlying customer not being able to repay as per the repayment schedule.
2. The risk of CL Partner failing in assessing the risk appropriately.
3. Moral hazard: CL Partner originating a non-starter loan(s).

Mitigants:

1. MCSL relies on CL Partner's ability to originate quality loans. MCSL should assess the ability of CL Partner at the selection stage and then product and process screening stage and confirm that the strength of CL Partner's origination is good.
2. MCSL to also evaluate the CL Partner for its ability to survive the loan tenor. MCSL to give weightage to the Partner's vintage of relation with itself to decide on whether to do the Co- Lending with the Partner.

3. The incentive alignment captured in CL Product to ensure that moral hazard is taken care of:
    a. Pari passu risk sharing on contract level
    b. FLCE at portfolio level
4. Further review framework that allows for continuous risk monitoring.

9. The exposure limit for Co-lending

	Parameter	Risk Limit
Credit Risk	Individual exposure under co lending – Per co lender	25% of the AUM of MCSL
	Total exposure with co lender (including all credit exposures) (per co lender)	25% of the AUM of MCSL
	60 DPD exposure of co- lending + all the Credit exposure (per co lender)	10% of Tier I capital of MCSL

10. Other Risks and Mitigants

Sl. No.	Risk	Mitigants
1.	Operating Risk	Internal controls at CL Partner and MCSL's end, aided by Technology to limit operating risk.
	Fraud by CL Partner's employees	Servicing Agreement to make Servicer / CL Partner responsible for such risk.
	Documentation / Document storage: Misplacement of key documents by CL Partner	Servicing Agreement to make Servicer / CL Partner responsible for such risk.
2.	Regulatory Risk	Compliance and legal sign off at MCSL and CL Partner's end prior to Product-Process launch.
	KYC Compliance	Each customer offered CL Product would be subjected to KYC compliance and proper storage process for the same. MCSL to rely on CL Partner for KYC document collection.
	Direct customer exposure	Systems required as per RBI are in place or will be put in place. Such systems include Customer Complaint / Grievance Cell, FPC, AML, KYC, communication on the product etc.
3.	Market Risk	All loans will be offered a fixed rate. Liabilities supporting the product offering would be on both, fixed as well as floating rate.
		Such risk would be taken care of by the Treasury team and ALCO by ensuring a mix of both fixed and floating interest rates.

4.	Reputation Risk	Customers are serviced by CL Partner which subjects MCSL to reputation risk. Frequent audits, monitoring, and customer complaint cell, will ensue that such risk is mitigated.
5.	Servicer risk: CL Partner defaulting or becoming insolvent	CL Product considers replaceability of the servicer. While this is different from product to product, ability to continue to service and collect from customers is evaluated. Also over a period of time, the overlap of MCSL 's operations would also be considered.

11. **Income**

- **Revenue Recognition:** Interest income to be accounted for, in accordance with the provisions of the Indian Accounting Standards (IND AS). Income to be recognised on accrual basis.

- Processing Fee income to be recorded upfront, based on the sharing arrangement. This accounted amount would be spread in line with what is permitted under IND AS.

- All financial accounting entries for net interest income, on-balance sheet assets and contingents are to be booked in accordance with IND AS.

- Proceeds from utilization of credit enhancement to be accounted as income in accordance with the provisions of the IND AS.

12. Expenses

- Servicer fee, if any, to be accounted as per the provisions of the IND AS. It is recognized as expense on accrual basis.

- Provisions against standard assets; provisions against substandard assets; provisions against doubtful assets will be as per the provisions policy.

13. Assets

- Assets originated under CL Programme will be accounted as Loans and Advances to individual borrower to the extent of participation by MCSL.

- Doubtful assets will be calculated net of credit enhancement available and required provisions will be made toward these doubtful assets (net of CE).

14. Liabilities

- Any liability arising out of CL Programme will be accounted as per the IND AS.

All regulatory requirements relating to the co-lending undertaken by the MCSL will be complied with by MCSL. They include:

1. **KYC norms:** CL Partners to provide the necessary KYC, Financial, CIBIL and other relevant data and documents by uploading the information on their portal. As MCSL's Loan Management System (LMS) will be synced with CL Partner's LMS, either directly or through the Technology Partner's server, auto-update will happen.

2. **Documentation:** Loan documentation should have MCSL as lender along with the CL partner. Digital copy of the documentation will be made accessible to MCSL during the period of the loan and post closure for a period of up to 3 years. Further, such documentation in digital form will be made available to MCSL at the time of sanction or disbursement or post disbursement within a maximum period of [45] days. MCSL should give a Power of Attorney to the Partner to sign the Loan agreement on its behalf.

3. **Storage:** CL Partner will be responsible for storage of all contract level documents for underlying borrowers under the CL arrangement. MCSL should have access to the documentation after the same is asked for, within [5] days of the request from MCSL.

4. **Legal Compliance:** The documentation will be the MCSL approved set of documentation.

5. FPC

6. NPA classification

7. KYC/AML reporting

8. It is also necessary to specify that in case of transactions akin to Direct Assignment, necessary compliance as required by the extant RBI Directions on the issue will be ensured.

   Co-Lending documentation:

   - **Service Level Agreement/Co-Lending agreement:** Definitive document capturing the terms and conditions.
   - **First Loan Default Guarantee (FLDG)/Deficiency Cover:** Capturing the risk protection available to the lending partner; FLDG on Principal Outstanding (POS) / Peak POS / Disbursement. This will be part of the Co-lending agreement / Service Level Agreement
   - Master Security Trustee agreement (in case of secured asset class).
   - Corporate Guarantee agreement.

9. **Disbursement, Repayment or Collection, Overdue and penalty details:** All information regarding the disbursement and collections will be made available regularly as per the reporting requirements and for audit purposes.

15. Default Management

CL Partner, if he is the Servicer also, will provide all collection services including rendering of legal service required for arbitration / litigation.

16. Servicer Failure / Termination of Partnership

The CL agreement will specifically mention that even if the arrangement is terminated, the CL partner will continue to service the outstanding portfolio till it fully runs down. In case the above arrangement fails and MCSL is faced with a servicer risk event, MCSL will have its own portfolio servicing mechanisms mentioned below:

1. **Regular collection:** The continuance of the mechanism in place will ensure transfer of funds as per agreed proportion mentioned in Escrow Agreement even after termination of the partnership. MCSL, in case of termination, should look at the option of taking fresh NACH mandates for collection in its name rather than the Escrow account. In case the CL Partner has multiple loan exposures to a borrower, and any of those exposures are funded by the CL partner, risk of diversion of funds to other accounts needs to be mitigated. Direct contact with customers, through agencies representing MCSL, would be essential to ensure continued servicing of the loan.

2. **Overdue collections / recovery from delinquent accounts:** MCSL reserves the right to appoint third-party servicer / collection agency who will conduct collection on behalf of MCSL.

3. **Legal Recovery (Section 138 / other remedies):** Borrowers who default should proceeded against legally for recovery of outstanding amounts. MCSL would need to appoint a third-party advocate for managing day to day administration of the litigation along with CL-RM.

Product feature	Characteristics
Loan Amount (Max - Min)	
Return on Investment (ROI)	
PF	
Tenor	
Geography	
Minimum client selection criteria (CIBIL, turnover, YIB, residential stability,)	
Credit filters (FOIR, LTV threshold, machine make)	
Collection	

17. Customer related issues

i) The Partner shall be the single point of interface for the customers and shall enter into a loan agreement with the borrower, which shall clearly contain the features of the arrangement and the roles and responsibilities of Partner and MCSL

ii) All the details of the arrangement shall be disclosed to the customers upfront and their explicit consent shall be taken.

iii) The ultimate borrower may be charged an all-inclusive interest rate as may be agreed upon by both the lenders conforming to the extant guidelines applicable to both

iv) The extant guidelines relating to customer service and fair practices code and the obligations enjoined therein shall be applicable mutatis mutandis in respect of loans given under the arrangement.

v) The NBFC should be able to generate a single unified statement of the customer, through appropriate information sharing arrangements.

vi) With regard to grievance redressal, suitable arrangement must be put in place by the co-lenders to resolve any complaint registered by a borrower with the NBFC within 30 days, failing which the borrower would have the option to escalate the same with the concerned Ombudsman for NBFCs or the Customer Education and Protection Cell (CEPC) in RBI.

18. Other Operational Aspects

i) All norms of Directions on Managing Risks and Code of Conduct in Outsourcing of Financial Services by NBFCs issued by RBI to be adhered to

ii) MCSL shall also be required to comply with the Master Directions - Know Your Customer (KYC) Direction, issued by RBI and updated from time to time, which already permit regulated entities, at their option, to rely on customer due diligence done by a third party, subject to specified conditions.

iii) The MCSL and Partner shall maintain each individual borrower's account for their respective exposures. However, all transactions (disbursements/ repayments) between the both relating to CLM shall be routed through an escrow account maintained with the MCSL, in order to avoid inter-mingling of funds. The Master Agreement shall clearly specify the manner of appropriation between the co-lenders.

iv) The Master Agreement may contain necessary clauses on representations and warranties which the originating NBFC shall be liable for in respect of the share of the loans taken into its books by the MCSL.

v) The co-lenders shall establish a framework for monitoring and recovery of the loan, as mutually agreed upon.

vi) The co-lenders shall arrange for creation of security and charge as per mutually agreeable terms.

vii) Each lender shall adhere to the asset classification and provisioning requirement, as per the respective regulatory guidelines applicable to each of them including reporting to Credit Information Companies, under the applicable regulations for its share of the loan account

viii) The loans under the CLM shall be included in the scope of internal/statutory audit within the NBFCs to ensure adherence to their respective internal guidelines, terms of the agreement and extant regulatory requirements.

ix) Any assignment of a loan by a co-lender to a third party can be done only with the consent of the other lender

x) Both the NBFCs shall implement a business continuity plan to ensure uninterrupted service to their borrowers till repayment of the loans under the co-lending agreement, in the event of termination of co-lending arrangement between the co-lenders.

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