

Policy for Co-lending of loans between Arka and Banks/NBFCs

Policy on 042 - Policy for Co-lending of loans between Arka and Banks/NBFCs

| Action | Entity | Signature |
|---------------------|---|-----------|
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Version History

| Version No. | Particulars | Details |
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| 1 | Original Policy approved by Board | |
| 2 | Updates in terms with the Internal policies and current practice | <ul style="list-style-type: none"> - Addition of reference to Outsourcing Policy, Default Loss Guarantee Policy and KYC Directions - Authorizing Credit Committee approving the risk & reward participation and partner selection in a co-lending transactions - Distinct policy guidelines for co-lending with banks and NBFCs wherever relevant. |

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Background

RBI, wide its circular no. RBI/2020-21/63 FIDD.CO.Plan.BC.No.8/04.09.01/2020-21 dated November 05, 2020 (“RBI Circular of 2020”) allowed co-origination of loans by banks and NBFCs for lending to priority sector. The arrangement entailed joint contribution of credit at the facility level by both the lenders as also sharing of risks and rewards.

This Policy for Co-lending of loans between Arka and Banks/NBFCs (“Policy”) covers the general principles and practices which will be followed by Arka Fincap Limited (“Arka”/”Company”) in co-lending with partner institutions being banks or other non-banking financial companies (NBFCs).

Co-Lending is an evolutionary business model of partnership that can combine Arka’s capital & growth appetite with partner’s strong origination expertise and reach. For Arka, co-lending with other NBFCs represents an alternate model of disbursements that is asset light and creates a sound revenue model for sustainable business. Also, it can help Arka to increase their reach to remote locations, acquire new & diverse customer base and loan products at a low cost. For self-employed and salaried customers, co-lending provides two key benefits: Simplicity of dealing with a single entity – for their financing, and convenient access to a blended cost-effective rate of interest.

Also, co-lending with banks improves the flow of credit to the unserved and underserved sector of the economy and make available funds to the ultimate beneficiary at an affordable cost, considering the lower cost of funds from banks and comparatively greater reach of Arka. In case of Co-lending with Banks to the Priority Sector, the guidelines as prescribed in the RBI Circular of 2020 shall also be complied with. This Policy shall stand auto corrected to the extent of amendments in the said RBI Circular of 2020 to the extent it is relevant.

This Policy shall be read in conjunction with the Outsourcing Policy and the Policy guidelines on Default Loss Guarantee in Digital Lending to the extent applicable.

Objective

The objective of this Policy is to lay down the principles for Arka to govern and manage the co-lending business. The Policy will help Arka to adhere to guidelines as defined by the RBI from time to time, to the extent applicable and will ensure consistent approach & transparency in the roles and responsibilities of key stakeholders.

Modus Operandi

Norms of Agreement between Arka Fincap Limited and the Co-Lender:

- A prior master agreement shall be entered into between Arka and the partner institutions which shall include terms and conditions of the arrangement, the criteria for selection of partner institutions, the specific product lines and areas of operation, along with provisions related to segregation of responsibilities as well as customer interface and protection issues.
- Arka and the co-lending partner shall have the flexibility of pricing their part of exposure in accordance with internal pricing strategies, however, the ultimate borrower shall be charged an all-inclusive interest rate as may be agreed upon by both the lenders conforming to the extant guidelines as may be applicable to both.
- Upon repayment, the interest shall be shared between Arka and the partner in proportion to their share of credit and interest. Treatment of part payments, charges etc. received will also be aligned according to the lending partner.
- In terms of credit norms, it will differ basis the product, customer segment and partner type. However, we will continue to conduct mandatory regulatory checks and any other additional checks mandated by risk team on case-to-case basis.
- Co-lending arrangements shall must comply with the extant guidelines outsourcing as issued by RBI and the Master Directions - Know Your Customer (KYC) Direction, 2016, as updated from time to time to the extent applicable.

Sharing of risk and rewards:

- The ratio of sharing risk and rewards with the co-lending partner shall be approved by the Credit Committee. In case of co-lending with banks to priority sector, Arka shall retain a minimum of 20 per cent share of the individual loans on their books.
- The master agreement may provide Arka / co-lending partner, as the case maybe, to:
 - a. mandatorily take its share of the individual loans originated by the other partner in its books as per the terms of the agreement; or
 - b. retain the discretion to reject certain loans after appraisal memo is shared by partner & independent assessment done on those cases.

In case of co-lending with bank to the priority sector, if the bank can exercise its discretion regarding taking into its books the loans originated by Arka as per the agreement, the arrangement will be akin to a direct assignment transaction. Accordingly, the taking over bank shall ensure compliance with all the requirements in terms of RBI directions on Transfer of Loan Exposures, as updated from time to time, with the exception of Minimum Holding Period (MHP) which shall not be applicable in such transactions undertaken in terms of this co-lending model. The MHP exemption shall be available only in cases where the prior agreement between the bank and Arka contains a back-to-back basis clause and complies with all other conditions stipulated in the guidelines for direct assignment.

Products

The products, which Arka would be targeting under this Policy, would be Term Loans, Working Capital Loans and other products aligned to Arka's focus area.

Partner Selection

Credit Committee will evaluate all the partnership proposals received to ensure rights of Arka are protected and fits its long-term plans.

Arka may engage with third parties to seek any specialized diligence expertise for shortlisting & finalizing co-lending partners. Arka will also seek inputs from its internal Risk, Legal, Compliance and Technology team, as required.

Contract Termination

Arka may choose to terminate the contract in the event of certain scenarios like –

- Unfair practices by partner
- Mistreatment, Mis-selling, or misinformation to the customers
- Breach of Arka's fair practices code
- Any other wilful or non-compliant process/event, as part of this agreement or outside it, which may impact the reputation of Arka and interests of its shareholders

Both lenders will layout a detailed process for the termination, keeping in view continuity of customer servicing and collection protocols for existing accounts.

Customer Service

- The sourcing 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 both partners.
- All the details of the arrangement shall be disclosed to the customers upfront and their explicit consent shall be taken.
- The extant guidelines relating to customer service and fair practices code and the obligations enjoined upon Arka and the lending partner shall be applicable mutatis mutandis in respect of loans given under the co-lending arrangements.

Other Aspects

- Arka Fincap limited, along with the co-lending partner, depending on terms of

agreement, shall arrange for creation of security and charge as per mutually agreeable terms.

- Arka shall adhere to the applicable asset classification and provisioning requirements including reporting to Credit Information Companies, under the applicable regulations for its share of the loan account.
- The framework for monitoring and recovery of the loan, shall be guided as per mutually agreed terms on case-to-case basis.
- The loans under the co-lending arrangements shall be included in the scope of internal/statutory audit to ensure adherence to our internal guidelines, terms of the agreement and extant regulatory requirements.
- Any assignment of a loan by Arka or the partner to a third party can be done only with the consent of the other lender. Both partners may retain the right to buy out each other's portfolio at mutually agreed terms subject to compliance with applicable regulatory requirements.
- Arka and the co-lending partner shall ensure uninterrupted service to their borrowers, on-boarded under the CLM, till repayment of the loans even in the event of termination of co-lending arrangement between the co-lenders.
- The co-lending partner and Arka shall maintain each individual borrower's account for their respective exposures. However, all transactions (disbursements/ repayments) between the partners relating to CLM shall be routed through an escrow account maintained with the banks, in order to avoid inter-mingling of funds. The Master Agreement shall clearly specify the manner of appropriation between the co-lenders for the funds received in mutually agreed escrow account.
- Arka shall implement a business continuity plan to ensure uninterrupted service to its borrowers till repayment of the loans under the co-lending agreement, in the event of termination of co-lending arrangement between the co-lenders.

Technological Changes

In order to smoothly onboard the customers under co-lending model, underwrite them, disburse the loan and handle the post-disbursement activities like servicing, repayment etc., existing systems will have to be enabled to accommodate CLM related use cases. Few changes are covered below –

- Seamless flow and functionality for sharing the documents and customer data with each other
- System functionality to underwrite complete customer requirement while disbursing a part of it depending on our share in the loan
- Ability to trigger and share the common credit, regulatory and fraud checks
- Compliant KYC process in case KYC verification is done by one of the partners

- Ability to automate the repayment schedule split between partners, disbursement, and collections tracking.
- Designated partner should have the ability to generate a single unified statement and loan view of the customer, through appropriate information sharing arrangements with other partner.
- Depending on the partnership agreement, Arka can be a majority or a minority partner. Also, there can be scenario where partners decide to share the risk/reward on case-to-case basis. Commercial arrangement and its ensuing reconciliation may defer from partner to partner.
- Settlement of overdue loans, first loan default guarantee (FLDG), processing fee, servicer fee split and other built-in adjustments that can be configured as per arrangement between both partners.
- A reporting module, not just for ease of compliance and operations related reporting, but also ensuring that both parties are in sync across the entire lending lifecycle.
- Portfolio monitoring tools, early warning signals, and loss estimation models for real time and dynamic risk assessment

We will evaluate the cost and efforts involved in developing these & other functionalities in existing systems, integration efforts etc. and decide, along with BSG & IT team, to either develop this internally or onboard a co-lending platform developed by external vendors.

Changes in the policy

Any regulatory changes with respect to co-lending mechanism will be updated in the Policy from time to time.

Any further policy changes can be approved by the CEO and the ratification will be taken from the RMC and the Board at the time of annual review.