Avanti Microfinance Private Limited

Policy on Asset Classification and Provisioning Norms

This document was:

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1. Introduction

Avanti Microfinance Private Limited (hereinafter referred to as "**the Company**") has framed the Policy on Asset Classification and Provisioning Norms (hereafter referred to as "**Asset Classification and Provisioning Norms Policy**" or "**the Policy**") to set out the guidelines, principles and approach to manage NPAs of the Company and put in place a framework to identify, assess, measure, monitor, control and containment of NPA at minimum level and ensuring that their impingement on financials are minimum.

2. Objectives of the Policy

This Policy on Asset Classification and Provisioning Norms is applicable to all lending activities of the Company.

The quality and performance of advances have a direct bearing on the profitability of the Company. Despite an efficient credit appraisal, disbursement and monitoring mechanism, problems can still arise due to various factors and give scope for Non-Performing Assets ("**NPA"**). These factors may be internal or external.

The objective of the Policy on Asset Classification and Provisioning Norms is to ensure that asset quality of the company remains sound on a sustained basis and adequate provision is made on non-performing assets.

3. Scope

The Policy on Asset Classification and Provisioning Norms attempts to analyse the common reasons for delinquency and suggests preventive measures for avoidance of default. The scope of the Policy would include the following:

3.1 Provide standards and guidance towards identification, classification and provisioning of NPAs.

3.2 Provide the roles and responsibilities for the activities relating to the recognition of non- performing assets ("**NPAs**") and provisioning on assets.

3.3 Provide process of review and control.

3.4 Provide reporting and disclosures relating to 'Special Mention Accounts' (SMA)/NPAs and provisioning.

3.5 Strengthen the management of NPAs and proactive initiatives to prevent generation of fresh NPAs.

4. Income Recognition

Income from Non-Performing Assets (NPA) is not recognised on accrual basis but is recognised as income only when it is actually received. Therefore, the Company should not charge and take to income account interest on any NPA.

Fees and commissions earned by the Company as a result of re-negotiations or rescheduling of outstanding debts should be recognised on an accrual basis over the period of time covered by the re-negotiated or rescheduled extension of credit.

4.1 Reversal of Income

For advances which become NPA, the entire accrued interest which has been credited to income account in the past periods, shall be reversed if the same is not realised.

Fees, commission and similar income that have accrued to NPAs shall cease to accrue in the current period and reversed with respect to past periods, if uncollected.

Passing of entries for reversal of interest is to be done only for those accounts, which have been identified as fresh NPAs.

4.2 Appropriation of recovery in NPAs

Interest realised on NPAs may be taken to income account if the credits in the accounts towards interest are not out of fresh/ additional credit facilities sanctioned to the borrower concerned.

In the absence of any specific agreement between the Company and the borrower, any recoveries in NPA shall be first adjusted towards the the unpaid principal and residual amount, if any, shall be adjusted towards unrealized interest/charges. This appropriation logic requires a change to the platform and hence will be effective only once the necessary changes are made on the platform. Until then, appropriation logic used will be as earlier - first adjust to unrealized interest / charges and then the residual amount, if any, will be adjusted to the principal.

4.3 Recoveries in Compromise Settlements

Recoveries in NPA accounts in which compromise is accepted and the compromise amount is less than or equivalent to the real account balance, shall be adjusted to the real account balance only.

For NPA accounts in which compromise is accepted and the compromise amount is more than the real account balance, recovery over and above the real account balance shall be credited to P&L interest on Loans. Company shall ensure that compromise settlement is accepted as a last resort for recovery. It shall not be encouraged as a common practice. Approval from designated authorities shall be reckoned for all such settlements.

5. Asset Classification

Non-Performing Assets

An asset becomes non-performing when it ceases to generate income for the Company. A "Non-performing Asset" (NPA) is a loan or an advance where, interest and/or instalment of principal remain overdue for a period of 90 days or more. The classification of borrower accounts as NPA shall be done as part of day-end process for the relevant date and the NPA classification date shall be the calendar date for which the day end process is run.

All accounts classified as Non-performing Assets are further classified into following three categories based on the period for which the asset has remained non-performing and the realisability of the dues:

(i) Sub-standard Assets

(ii) Doubtful Assets

(iii) Loss Assets

Sub-standard Assets

A Substandard asset would be one,

(i) which has remained NPA for a period less than or equal to 12 months. Such an asset will have well defined credit weaknesses that jeopardize the liquidation of the debt and are characterised by the distinct possibility that the Company will sustain some loss, if deficiencies are not corrected.
(ii) an asset where the terms of the agreement regarding interest and/ or principal have been renegotiated or rescheduled or restructured after commencement of operations, until the expiry of one year of satisfactory performance under the renegotiated or rescheduled or restructured terms.

Doubtful Assets

An asset would be classified as doubtful if it has remained in the Sub-standard category for a period more than 12 months. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as sub-standard, with the added characteristic that the weaknesses make collection or liquidation in full, – on the basis of currently known facts, conditions and values – highly questionable and improbable.

Loss Assets

A loss asset is one where loss has been identified by the Company or internal or external auditors or the RBI inspection, but the amount has not been written off wholly. In other words, such an asset is considered un-collectable and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

Loan accounts classified as NPAs may be upgraded as ‘standard’ asset only if entire arrears of interest and principal are paid by the borrower. In case of borrowers having more than one credit facility, loan accounts shall be upgraded from NPA to standard asset category only upon repayment of entire arrears of interest and principal pertaining to all the credit facilities.

6. Provisioning requirements

In conformity with the prudential norms, provisions should be made on the non-performing assets on the basis of classification of assets into prescribed categories. Taking into account the time lag between an account becoming doubtful of recovery and its recognition as such the Company should make provision against sub-standard assets, doubtful assets and loss assets as below:

6.1 Standard Assets

Company shall make a provision of 0.40% of the outstanding Standard Assets which shall not be reckoned for arriving at NPAs. The provision towards standard assets should not be netted from gross advances but shall be shown separately as ‘Contingent Provisions against Standard Assets’ in the balance sheet.

6.2 Sub-standard assets

Company shall make a general provision of 10% of total outstanding of these assets.

6.3 Doubtful Assets

Company shall make a provision of 100% of the extent to which the advance is not covered by the realisable value of the security to which the Company has a valid recourse, and the realisable value is estimated on a realistic basis.

6.4 Loss Asset

Loss asset should be written off. If the loss assets are permitted to remain in the books for any reason, 100% of the outstanding should be provided for.

Additional provisions may be taken for certain loan accounts on the recommendations of the collections team based on their assessment of the collectability of the loan account.

7. Write Offs

All possible means of recovery of due amounts should be made prior to recommendation to write off the amount from the books of the Company. Waiver of legal action can be recommended only for cases where the management is satisfied that the borrower has no tangible security or attachable assets, has no adequate income for repayment and no useful purpose will be served by resorting to legal recourse.

Guidelines for write off recommendation:

a) Cases beyond 180 DPD should be recommended for write-off unless there is a reasonable indication that recovery is possible from the loan account

b) Cases between 90 DPD and 180 DPD can also be recommended for write offs in cases where (i) there is adequate indication that there is very little possibility of recovery from the loan account or (ii) there is adequate loss guarantee available to be invoked against the loans which are between 90 and 180 DPD

c) In cases of death, account may be written off prior to 90 DPD

Approvals for all write offs other than the cases mentioned above should be taken as per the approval matrix laid out in the Credit Committee Terms of Reference of Avanti Finance Private Limited, the holding company.

Any recoveries from the written off loan will be entered in the system towards repayment of the borrower and the same shall be reduced from the written off amount

8. Reporting Requirement & Disclosures

The Company shall disclose in their Annual Financial Statement:

(i) NPAs and movement of NPAs
(ii) Provision for NPA
(iii) Product wise NPA
(iv) Concentration of NPA i.e. total exposure to top four NPA accounts.

The Company shall identify incipient stress in the account by creating a sub-asset category viz. 'Special Mention Accounts' (SMA) as outlined below:

(i) SMA-0: Principal or interest payment not overdue for more than 30 days but account showing signs of incipient stress
(ii) SMA-1: Principal or interest payment overdue between 31-60 days
(iii) SMA-2: Principal or interest payment overdue between 61-90 days

The classification of borrower accounts as SMA shall be done as part of day-end process for the relevant date and the SMA classification date shall be the calendar date for which the day end process is run.

The Company will report to the Central Repository of Information on Large Credits (CRILC) data on all borrowers' credit exposures including SMA categorized accounts having aggregate fund-based and non-fund based exposure of INR 50 million and above.

9. Regulatory Reference

This policy is framed as per the following regulatory references and in accordance with leading industry practice:
Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023.

10. Policy Review and Updates

The Policy shall be reviewed as and when required or at least once in a year, to suit the needs of the Company with the approval of the Board and to comply with revised guidelines issued by RBI from time to time.

This revised Policy comes into effect from date of approval of the Board.