Policy on Pricing of Credit Facilities

NORTHERN ARC

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Document Control

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01	October 28, 2024	Board of Directors	New Policy

1 Introduction

The Northern Arc Group (Northern Arc Capital Limited and its subsidiaries) (“Company”) has been following certain procedures and practices in the matter of pricing its Credit Facilities. Though Interest rates are not controlled by the Reserve Bank of India, the RBI has vide circular DNBS. CC.PD. No.266/03.10.01/2011-12 dated 26 March 2012 (Guidelines on Fair Practices Code for NBFCs) and thereby directed NBFCs to have a documented Credit Facility Pricing Policy / Model approved by the Board of Directors which would lay down internal principles and procedures in determining interest rates and other charges on the loan products offered by NBFCs.

The specific points *referred to* in the above referred in the RBI circular and extant regulations are:-

- Charging of excessive interest rates by NBFCs.
- The need for adoption of an interest rate model along with approach for gradations of risk & rationale for charging differential rates.
- Disclosure of rates of interest rates, changes thereof and publicity thereto.
- Adoption of annualized rates of interest while dealing with customers.

2 Objectives

The main objectives of this Policy is to:

- Ensure that interest rates are determined in a manner to ensure long term sustainability of business by taking into account the interests of all stakeholders.
- Develop and adopt a suitable model for calculation of a reference rate.
- Enable fixation of interest rates which are reasonable: both actual and perceived.
- Ensure that computation of interest is accurate, fair and transparent in line with regulatory expectations and market practices.
- Charge differential rates of interest linked to the risk factors as applicable.
- Facilitate transition to income recognition norms that may be stipulated by RBI in future and adoption of best practices

Till date the Company was following the Interest Rate Model forming part of the Board Approved Fair Practice Code of the Company. However, for administrative convenience, it has been resolved to adopt a Board approved Policy on Pricing of Credit Facilities.

3 Applicability

This Policy is applicable for all credit facilities offered by Northern Arc, including credit facilities offered directly or through online / offline channels.

4 Methodology for calculation of pricing of credit facilities

The methodology is designed with a view to adopt a transparent and fair approach to the customers. Pricing may comprise interest and/or fees. Fee may be payable upfront or may be linked to usage of the facility.

4.1 Pricing of credit facilities to be measured in terms of Annualised Percentage Rate (APR)

a) Pricing of credit facilities shall be measured in terms of effective APR. Pricing of credit facilities may comprise of the following components:
   - Interest
   - Any fees charged to the borrower by whatever name called, and
   - Cost of insurance linked to the credit facility charged to the borrower whether mandatory or voluntary

   All the above components shall be considered in calculating APR.

b) The following components shall not be included in calculating APR:
   - Foreclosure / prepayment charges
   - Penal charges
   - Cost of any optional services / products that are charged to the borrower along with the credit facility
   - Taxes on any component of APR

c) APR Calculation:

   APR is calculated on net disbursed amount using IRR approach and reducing balance method.

4.2 Approach to Pricing of Credit Facilities

Pricing of credit facilities is calculated using the approach described below:

Component	Ref.	Remarks
Marginal Borrowing rate (including fund raising costs, hedging costs and other adjustments to be specified)	(1)	Borrowing relevant to the product / segment shall be considered
Tenor Premium	(2)	Premium charged for the risk associated with lending for higher tenors
Negative carry	(3)	Cost associated with non-earning reserves maintained for this product / segment to be considered
Cost of Funds	**(4) = (1 + 2+ 3)**	

Component	Ref.	Remarks
Operating costs (incl. corporate costs)	(5)	
Cost of outsourced services	(6)	The cost of material outsourcing of processes including: - Loan Service Providers (LSPs) under any Digital Lending arrangement - Business Correspondents (BCs) - Co-lender under a co-lending arrangement Also refer Para 4.4 below.
Total Operating cost attributable to the credit facility	**(7) = (5 + 6)**	
Credit Risk Premium	(8)	Risk premium may be determined at a portfolio level or any segmentation of the portfolio, including at a borrower level.
Margin	(9)	May be derived based on expected return on equity, anticipated leverage including market benchmarks
Borrower pricing (excl. Insurance)	(10) = (4 + 7 + 8 + 9)	
Cost of insurance (incl. taxes)	(11)	
Borrower pricing (incl. Insurance)	(12) = (10 + 11)	

- The Company may fix differential pricing of credit facilities for any borrower or business segment of the lending portfolio based on a variety of factors. Identical products with identical tenor and availed during the same period may attract different interest rates for different customers. Pricing could vary depending upon consideration of all or combination of multiple factors including but not limited to the following:
    - Credit and default risk in the related business segment;
    - Historical performance of similar homogeneous customers;
    - Profile of the applicant;
    - Industry segment;
    - Repayment track record of the applicant;
    - Nature and value of collateral security;
    - Secured vs unsecured facility;
    - Seniority of the facility;

  - Ticket size of the facility;
  - Credit rating of the applicant and corporate guarantor, if any;
  - Tenor of the facility;
  - Location delinquency and collection performance (applicable for retail);
  - Other indebtedness of the applicant.

- Prevailing competition in the market, Company's strategy, operating environment, state of the economy and other related factors may also be suitably considered in determining pricing of credit facilities.
- Taxation regulations as applicable shall be complied with.
- The rates may be inclusive of taxes or exclusive of taxes as per the decision of ALCO based on the recommendations of the Business Heads.

4.3 Principles used in calculation of interest

- Interest to be calculated on daily balances

  Interest amount shall be calculated on the daily outstanding balance in the loan account at the applicable rate.

- Minimum period for which interest chargeable

  The minimum period for which interest is payable by the borrower shall be 1 day. Interest payable / receivable shall be calculated on the actual daily outstanding balance.

- Basis - number of days per year

  Interest may be calculated based on 360 days / Actual days / market convention as may be determined for each product. Dates of disbursement and closure of account shall both be included for computation of interest.

- Compounding

  Interest may be compounded or simple; this shall be specified in the loan agreement.

- Annualised rate of interest

  Interest rate quoted shall be on annualized basis only in all documents, internal instructions / communications and publicity materials (pamphlets, brochures, hoardings, etc).

- Fixed rate / Floating rate

  Credit Facilities may be offered to customers on Fixed as well as on Floating Rates, in compliance of the applicable RBI Directions and in line with the Fair Practice Code as approved by the Board of Directors.

4.4 Principles in charging Fee

Fees under one or more heads, such as processing fee, documentation charges etc., may be charged to the customer at the time of application or after the sanction of a credit facility. Such fees shall be determined based on the sourcing costs and other upfront costs attributable to the facility. The fee may vary depending upon the consideration of all or combination of multiple factors including sourcing channel, geographical location, applicant profile, costs of verification, legal & valuation, credit appraisal etc. Identical products with identical tenor and availed during the same period may attract different fees for different customers.

4.5 Approval and Review of Pricing

The Asset-Liability Management Committee (ALCO) of the Company shall be responsible for approving pricing of credit facilities in all products / segments.

The ALCO shall review the pricing for all products / segments at least on a quarterly basis, and more frequently, if required.

Any change in interest rates or other charges based on such review shall be applicable prospectively for new credit facilities sanctioned from the date of such change in case of fixed rate facilities.

5 Maximum/ Ceiling on Pricing of Credit Facilities

Keeping in view the regulatory (RBI) expectations from NBFCs and the Fair Practices Code, the final pricing shall also be subject to the ceilings described below:

1. For Microfinance loans:

   Pricing of microfinance loans shall be subject to a ceiling of 200 basis points above the pricing as determined under Para 4.1 above for any category/ segment of borrowers.

2. For all other loans:

   The rate of interest for credit facilities other than microfinance loans shall be subject to a ceiling of 36% p.a. during the normal loan tenure across all products / business segments.

3. Review of ceilings:

   The above-mentioned ceilings shall be reviewed as and when required, but at least quarterly, by the Board of Directors keeping in view regulatory guidelines / directives, intensity of competition in the market, net interest margin target, market rates etc.

4. <u>Exceptions to the ceilings:</u>

   In exceptional cases, higher pricing beyond the ceiling mentioned above may be allowed for any product, customer segment, geographical segment or any other segment of credit facilities, which shall be defined clearly, by the ALCO based on a recommendation from Head – Origination, Head – Credit & Chief Compliance Officer. The ALCO may approve the same, with or without conditions, after considering the sourcing cost, cost of delivery & customer servicing, credit assessment and underwriting, risk premium required and the reasonableness of the margin.

   The maximum portfolio subjected to such deviation shall be 10% of the retail portfolio.

6 Communication of pricing to borrowers

6.1 Communication at the time of sanction

Interest rates will be intimated to the customers at the time of sanction of the loan/ in the KFS and the interest and principal repayment schedule will be made available to the customer. Interest shall be charged only on the outstanding principal and only for such period such principal amount remains outstanding.

In case of loans disbursed by way of issuance of cheques, interest will be charged only from the date the cheque was handed over to the customer or to the nominee of the customer.

Changes in interest rates and charges shall be given effect only prospectively and a suitable condition to that shall be incorporated in the loan agreement. Any increase in credit limits shall be with the explicit consent of the customer.

Company shall not charge foreclosure charges/ pre-payment penalties on any floating rate term loan sanctioned for purposes other than business to individual customers, with or without co-obligor(s).

6.2 Notice to borrowers for changes in interest rates, charges etc.

Notice shall be sent to the borrowers in the vernacular language or a language as understood by the borrower of any changes in the terms and conditions including disbursement schedule, interest rates, service charges, prepayment charges etc. It shall be ensured that changes in interest rates and charges are affected only prospectively.

7 Disclosure of Indicative Ranges

Indicative range of pricing of credit facility for all products shall be disclosed on the Company's website and updated periodically.

8 Penal Charges

To inculcate a sense of credit discipline, as a deterrent against intentional delinquency, and to encourage prompt and timely repayment of the loan, the Company may charge penalty in the form of Penal Charges as determined by the credit approving authority in case of payment default(s) or non-compliance of material terms and conditions governing a loan by the customer.

- It is expressly clarified that penal interest that is added to the rate of interest charged on the credit facility shall not be levied for any non-compliance of any terms or conditions governing a loan by the customer.
- Penal Charges may be levied for payment defaults and non-compliance of any other material terms and conditions, as may be specified in the relevant credit facility documentation.
  - In case of payment default, penal charges, if levied, may be charged upto an amount equivalent to 36% p.a. of the amount under default.
  - In case of non-compliance with other terms and conditions, an amount not exceeding 5% of the principal outstanding.
- Penal Charges shall not be capitalized, and no interest shall be applied on such Penal Charges. However, it is clarified that compounding of interest is permissible.
- In deserving cases, such Penal Charges may be settled at lower amounts or waived by the Credit Committee or as may be delegated by the Credit Committee from time to time.
- Applicable Penal Charges shall be displayed on the website of the Company.

For the purpose of the foregoing, material terms and conditions in respect of a loan shall mean such terms and conditions governing a loan including timely payment of amounts due and payable the breach of which would render all outstanding amounts in relation to such loan due and payable immediately or at the discretion of the Company

The principles based on which Penal Charges may be levied by the credit approving authority shall be as outlined below.

- The quantum of Penal Charges shall be reasonable and commensurate with the non-compliance of material terms and conditions of the credit facility without being discriminatory within a particular loan / product category.
- The Penal Charges in case of loans sanctioned to ‘individual customers, for purposes other than business’, shall not be higher than the Penal Charges applicable to non-individual customers for similar non-compliance of material terms and conditions.
- Penal Charges can be charged only once for one period of default and therefore cannot be permitted to be capitalised.

The quantum and reason for Penal Charges shall be clearly disclosed to the customers in the loan agreement and most important terms & conditions / Key Fact Statement as applicable, in addition to being displayed on the website of the Company.

Whenever reminders for non-compliance of material terms and conditions of loan are sent to customers, the applicable penal charges shall be communicated. Further, any instance of levy of Penal Charges and the reason therefor shall also be communicated.

9 Reset of floating interest rate on equated periodical instalment based floating rate credit facilities.

At the time of sanction of equated periodical instalment based floating rate Loans, the customers shall be clearly communicated vide the sanction letter about the possible impact of change in benchmark interest rate on the loan leading to changes in equated instalments and/or tenor or both. Any increase in the equated instalments/ tenor or both on account of the change in the benchmark interest rate shall be communicated to the customer immediately in writing.

A one-time option shall be provided to the customers during the original term of the loan to switch over to a fixed rate at the time of reset of interest rates.

The customers shall also be given the choice to opt for (i) enhancement in equated instalment or elongation of tenor or for a combination of both options; and, (ii) to prepay, either in part or in full, at any point during the tenor of the loan. No foreclosure charges/ pre-payment penalties shall be levied on any floating rate term loan sanctioned for purposes other than business to individual customers, with or without co-obligant(s).

Charges, if any, for switching of loans from floating to fixed rate and any other service charges/ administrative costs incidental to the exercise of the above options shall be transparently disclosed in the sanction letter and any revision to such charges shall also be communicated to the customers at the time of revision.

It shall be ensured that the elongation of tenor in case of floating rate loan does not result in negative amortisation.

Company shall share / make accessible to the customers, through appropriate channels, a statement (that is simple and easily understood by the customer) at the end of each quarter which shall at the minimum, enumerate the principal and interest recovered till date, equated instalment amount, number of equated instalments left and annualized rate of interest / Annual Percentage Rate (APR) for the entire tenor of the loan

10 Disclosure requirements

The following disclosure requirements shall apply in case of pricing of credit facilities:

- Pricing range for products / segments shall be disclosed on the website
- Quantum and reason for penal charges shall be clearly disclosed in the loan agreement and most important terms & conditions (MITC) / Key Fact Statement (KFS) as applicable. All charges mentioned in the KFS shall be net of GST.

11 Other/ General conditions

- The agreement with the borrower shall contain clause to the effect that the Company shall have the right to levy appropriate charges in addition to interest in the event of any material default / non-compliance of terms and conditions of the sanction order / financing agreements.
- The penal charges shall not be capitalised to the principal or compounded.

12 Review

This policy shall be reviewed at least on an annual basis by the Audit Committee. The Audit Committee may recommend modifications required to the Board for its approval.