Interest Rate Policy

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Laxman Finance Interest Rate Policy

1. Introduction

Laxman Finance Private Limited ("LFPL" or "the Company") is registered as a Non-Banking Financial Company (NBFC) with the Reserve Bank of India (RBI) and operates as a non-deposit taking NBFC in the base layer in terms of the Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023. ("SBR")

This Interest Rate Policy (the "Policy") has been adopted by the Board of Directors of LFPL (the "Board") in accordance with the SBR.

LFPL's objective is to become a credible and leading financier/NBFC within its chosen business segments while adhering to high ethical standards, regulatory compliance, and best industry practices. Any contravention of applicable laws and regulations will not be tolerated under any circumstances.

2. Objectives

- To provide a framework for an appropriate interest rate model to determine the interest rates to be charged for loans & advances.
- To provide transparency to its borrowers and provide an overview of the method and factors used for calculating the interest rates charged on various financial products of the Company.
- To adopt a uniform and consistent approach for determining the interest rates charged to different types of borrowers.
- To lay down broad principles of charging penalties.
- To ensure compliance with regulatory requirements.
- To maintain transparency and fairness in lending practices.
- To protect the interests of borrowers and other stakeholders.

3. Scope and Application

This Policy applies to all loans and advances extended by LFPL. It includes term loans, working capital loans, and any other credit facilities provided by the Company.

4. Interest Rate Model: Determination of Interest Rates

4.1. Factors Influencing Interest Rates:

- **Weighted average cost of funds:** The Company's aggregated short-term and long-term borrowings to reach the weighted average cost of raising funds through debt or equity.
- **Risk Premium:** Premium required to cover business-related risks and credit-risk of the borrowers (such as Expected credit losses and Non-Performing Assets [NPAs'], etc.).
- **Product/ Customer specific factors:** Loan type, collateral valuation, tenure, customer risk type, geographical factors, etc.
- **Market Conditions:** Prevailing economic and market conditions including inflation, market liquidity, industry trends, market volatility, competitive landscape, etc.
- **Operational Costs:** This includes employee expenses, branch-related fixed and variable costs, operations cost, sales and marketing expenses, administrative and overhead expenses incurred by LFPL.
- **Minimum Profit Margin:** The minimum return expected by the Company on its products.

4.2. LFPL's Framework for Determining Interest Rates

LFPL adopts a structured approach to determine interest rates, ensuring they are fair, competitive, and reflective of both market and borrower-specific factors. Below is an explanation of the primary factors influencing interest rates:

4.2.1. Cost of Funds

- **Definition:** The cost LFPL incurs to raise funds, whether through equity, debt instruments, or other financing methods, forms the baseline for setting interest rates.
- **Components:** Includes interest paid on borrowings, issuance costs for debt instruments, and any associated financing charges.
- **Impact on Rates:** Higher costs of funds lead to higher interest rates to maintain financial sustainability.

4.2.2. Risk Premium

- **Definition:** An additional margin added to the interest rate to account for the business-related risks and credit risk of the borrower.
- **Determination:** Risk premium varies based on factors such as:
  - Risk assessment of the borrower to determine their creditworthiness and repayment capacity.
  - Financial history and existing obligations.
  - Products specific losses based on the Company's historical experience of the product.
- **Impact on Rates:** Products with higher expected losses and borrowers with higher credit risk are charged a higher risk premium and vice-versa.

4.2.3. Product/ Customer specific factors

- **Definition:** Factors of products and customers which directly affect the risk assessment and interest rates offered.
- **Components:** Loan type, collateral valuation, tenure, customer risk type, geographical factors, etc. which involve higher risks will result in higher interest rates.

  Internal Factors:

  - Nature of lending (type of loan, frequency of repayment, tenor of loan, secured/unsecured, etc.).
  - Nature of security/collateral in relation to the loan.
  - Any other factors considered relevant by the Company from time to time.

  External Factors:

  - Inherent credit and default risk in similar business or category of borrowers.
- Any other factors considered relevant by the Risk Management Committee from time to time

4.2.4. Market Conditions

- **Definition:** Prevailing economic and financial conditions, such as inflation, Gross Domestic Product ('GDP') growth, and monetary policy, influence interest rate decisions.

- **Factors Considered:** Inflation, market liquidity, industry trends, market volatility, competitive landscape, changes to legal and regulatory landscape, demand and supply trends, etc.
- **Impact on Rates:** LFPL adjusts its rates to remain competitive while aligning with broader market trends.

4.2.5. Operational Costs

- **Definition:** The expenses incurred in managing loans, including but not limited to administrative overheads, staff costs, technology infrastructure, loan processing, service charges, documentation charges, borrower care, registration, handling charges etc.
- **Impact on Rates:** Higher operational costs necessitate slightly higher interest rates to cover these expenses and ensure profitability.

5. Product-specific considerations

5.1. Loans to Micro, Small, and Medium Enterprises (MSMEs):

- LFPL's MSME lending primarily includes Supply Chain Financing (SCF), targeting businesses with transaction sizes aligned to LFPL's operational limits.
- **Interest Rate Determination:**
    - Interest rates for MSMEs will be set after evaluating the benefits of Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) and other government-backed credit guarantee schemes, where applicable.
    - LFPL will ensure compliance with RBI guidelines for any subsidized rates, sector-specific incentives, or government schemes to promote MSME growth.

5.2. **Fixed vs. Floating Rates for Retail Loans and MSME Loans**:

In the case of fixed interest rates, the spread would be computed based on product specific and customer specific parameters. However, unlike floating interest rates that shall be reset at the prescribed intervals, fixed interest rates shall not be reset and remain fixed.

- **Retail Products (Consumer Durable Finance, Payday Loans, Personal Loans):**
    - Borrowers of retail loans will typically be offered fixed interest rates, providing predictability in repayment schedules, given the smaller ticket sizes (₹10,000 to ₹5,00,000).

  - Floating rates may be introduced selectively for personal loans or larger-ticket consumer durable financing, linked to external benchmarks such as the RBI repo rate.

- **MSME Loans (SCF):**

Borrowers will be given the option of fixed or floating rates.

  - **Fixed Rates:** Offer stability, particularly for short-term SCF arrangements where the borrowing duration is predictable.
  - **Floating Rates:** Will be linked to external benchmarks like the RBI's repo rate, ensuring alignment with broader market trends.

- **Transparency in Rate Adjustments:** LFPL will ensure borrowers are informed about the mechanism for rate changes in floating rate products, including triggers for adjustments and frequency of rate resets.

5.3. Exemptions:

- **Exemptions for Employee Loans:**
  - Loans provided to LFPL employees (e.g., personal loans against deposits or special schemes) may be exempt from Base Rate guidelines.
- **Compliance with Regulatory Provisions:**
  - LFPL will ensure that any exemptions adhere to RBI regulations and are limited to permitted categories to prevent misuse or inconsistencies.

5.4. Microfinance Loans:

The meaning of microfinance loans ('Microfinance Loans') and other terms used hereinafter shall have the same meaning as provided under the Master Direction – Reserve Bank of India (Regulatory Framework for Microfinance Loans) Directions, 2022 ('Microfinance Directions'), as amended from time to time.

- Interest Rate: The Company shall ensure that interest rates and other charges/fees on microfinance loans shall not be usurious. The interest rate shall vary on a case-to-case basis, depending on the borrowers' circumstances and such other factors like cost of funds, margin, risk premium, etc. Any change in interest rate or any other charge shall be informed to the borrower well in advance and these changes shall be effective only prospectively. A suitable condition in this regard must be incorporated in the loan agreement.

- Prepayment Penalty: There shall be no prepayment penalty on Microfinance Loans. Penalty, if any, for delayed payment shall be applied on the overdue amount and not on the entire loan amount.
- Disclosure: The Company shall prominently display the minimum, maximum and average interest rates charged on microfinance loans in all its offices, in the literature (information booklets/ pamphlets) issued by it and details on its website.

6. Penal Charge:

Penal charges may be charged to encourage timely repayment, discourage defaults, delinquency, non-compliance with loan covenants, delayed submission of financial documents or as and when circumstances warrant.

6.1. Penalties & Other Charges

Besides interest, other financial charges like processing fees, origination fees, cheque bouncing charges, late payment charges, pre-payment / foreclosure charges, charges for issue of statement account etc., may be levied by the Company wherever considered necessary. Besides these charges, stamp duty, service tax and other cess would be collected at applicable rates from time to time. Any revision in these charges would be effective only prospectively. A suitable condition in this regard must be incorporated in the loan agreement.

Penal charges serve as a deterrent against defaults and non-compliance of material terms and conditions of loan contracts while ensuring borrowers meet their contractual obligations. LFPL's approach to penal charge is transparent, fair, and aligned with regulatory requirements.

Penal Charges may be applied in the following situations:

- **Defaults in Repayment:** When borrowers fail to make timely repayments of principal, interest, or any other related charge. 'penal charge' will be charged on the overdue amount for the overdue period.
- **Non-Compliance with Loan Contracts:** Borrowers who breach agreed-upon material terms and conditions, such as usage of funds for unauthorized purposes, may incur penal charges.
- **Delayed Submission of Financial Documents:** When borrowers are required to submit financial statements, audit reports, or other critical documents and fail to do so within stipulated timelines, penal charges may be imposed.
- Any other instances which constitute sufficient grounds for the imposition of penal charges.

6.2. General requirements for penal charges

- The quantum and reason for penal charges shall be clearly disclosed by LFPL to the customers in the loan agreement and most important terms & conditions/Key Fact Statement (KFS) as, in addition to being displayed on the websites of LFPL under Interest rates and Service Charges.
- Penal charges (if levied, with quantum and reasons thereof) shall also be disclosed in reminders for non-compliance of material terms and conditions of loan sent to borrowers.
- Penal charges will be highlighted in **bold** and communicated clearly in loan agreements, ensuring borrowers are aware of potential consequences for non-compliance.
- Borrowers are informed promptly of the circumstances warranting the levy of penal interest, along with details of the overdue amounts and the basis for its calculation.
- LFPL adheres to regulatory guidelines to ensure that penal charge is reasonable, non-exploitative, and consistent across similar cases.
- There shall be no capitalization of penal charges i.e., no further interest computed on such charges.
- The quantum of penal charges shall be reasonable and commensurate with the non-compliance of material terms and conditions of loan contract without being discriminatory within a particular loan/product category

7. Transparency and Disclosure

- Publish the Base Rate and other interest rate details on its website and in all branches.
- Communicate changes in interest rates to borrowers promptly.
- Ensure that loan agreements transparently specify all charges, fees, and interest rate terms.
- The Company shall convey in writing to the borrower in the vernacular language as understood by the borrower by means of sanction letter or otherwise, the amount of loan sanctioned along with the terms and conditions including annualised rate of interest and method of application thereof and keep the acceptance of these terms and conditions by the borrower on its record.
- The Company shall inform the borrower in the vernacular language or a language as understood by the borrower of any change in the terms and conditions

including disbursement schedule, interest rates, service charges, prepayment charges etc. LFPL shall also ensure that changes in interest rates and charges are affected only prospectively. A suitable condition in this regard must be incorporated in the loan agreement.

- There shall be appropriate disclosures on the approach for gradation of risk and rationale for charging different rates of interest to different categories of borrowers in the application form and communicated in the sanction letter.
- The rates of interest and the approach for gradation of risks shall also be made available on the website of LFPL or published in the relevant newspapers. The information published on the website or otherwise published shall be updated whenever there is a change in the rates of interest.
- The Company shall provide a Key Facts Statement (KFS) covering interest rate, applicable charges, terms & conditions, etc. to all prospective borrowers to help them make an informed view before executing the loan contract, as per the standardized format prescribed in the Circular on ‘Key Facts Statement (KFS) for Loans & Advances’ issued by the RBI dated 15 April 2024.
- The Company shall share/make accessible to the borrowers, through appropriate channels, a statement at the end of each quarter which shall at the minimum, enumerate the principal and interest recovered till date, EMI amount, number of EMIs left and annualized rate of interest/Annual Percentage Rate (APR) for the entire tenor of the loan.

<u>For Equated Monthly Instalments (‘EMI’) based personal loans</u>

- The Company shall clearly communicate to the borrowers about the possible impact of change in the benchmark interest rate on the loan, leading to changes in EMI and/or tenor or both. Subsequently, any increase in the EMI/ tenor or both on account of the above shall be communicated to the borrower immediately through appropriate channels.
- The borrowers have the option to switch over to a fixed rate from floating interest rate up to 10 times.

8. Risk-Based Pricing

Risk-based pricing is a fundamental component of LFPL's interest rate determination framework. This approach ensures that interest rates are aligned with the credit risk profile of each borrower, offering fairness to customers while safeguarding LFPL's financial health. The following enhancements incorporate industry-standard metrics, weightages, and scoring models to reflect LFPL’s loan portfolio, which includes retail (consumer durable finance, payday loans, personal loans) and MSME (Supply Chain Financing).

Key Components of Risk-Based Pricing

1. **Risk Metrics and Models**
   - **Industry-Standard Metrics:** LFPL uses a well-defined risk assessment model that incorporates measurable factors such as:
     - **Creditworthiness Metric (Weightage: 40%):** Based on borrower credit history, credit score, and repayment behavior.
     - **Collateral Strength Metric (Weightage: 30%):** Evaluates the quality, type, and liquidity of collateral provided.
     - **Market and Industry Risk Metric (Weightage: 20%):** Assesses external factors like market volatility, sector performance, and macroeconomic conditions.
     - **Loan Tenure Risk Metric (Weightage: 10%):** Considers the repayment period and its impact on risk exposure.
   - **Risk Premium:** These metrics collectively yield a quantified **Risk Premium**, which is added to the Base Rate to determine the final interest rate for each borrower.
2. **Retail and MSME Grading and Parameters**
   - **Retail Loans (Consumer Durable Finance, Payday Loans, Personal Loans):**
     - **Grading Parameters:** Credit score, employment stability, income-to-loan ratio, and existing liabilities.
     - **Scoring Model:** Borrowers are graded into risk bands (e.g., A - Low Risk, B - Moderate Risk, C - High Risk).
     - **No-Go Cases:** Retail borrowers with credit scores below a defined threshold (e.g., 600) or unsatisfactory income documentation are considered no-go cases.
   - **MSME Loans (Supply Chain Financing):**
     - **Grading Parameters:** Business credit score, financial statements, operational history, and industry outlook.
     - **Scoring Model:** Borrowers are graded similarly into risk bands (e.g., A - Low Risk, B - Moderate Risk, C - High Risk).

- **No-Go Cases:** MSMEs with poor financial health (e.g., significant losses, unresolved defaults) or operations in high-risk sectors are classified as no-go cases.

3. **Borrower Evaluation Process**
    - **Credit History and Repayment Capacity:** A borrower's ability to meet repayment obligations is assessed using credit bureau scores, income stability, and past repayment patterns.
    - **Collateral Assessment:** The type, quality, and liquidity of collateral provided are factored into the risk grading. For unsecured loans like payday loans, additional weight is placed on creditworthiness.
    - **Market and Industry Risks:** External risks specific to the borrower's sector or the economic environment are accounted for, with higher-risk sectors incurring a higher risk premium.

Implementation and Transparency

1. **Standardized Rating Model:**
    - LFPL adopts a transparent and consistent rating model to evaluate borrowers, with weightages for each metric and clearly defined thresholds for risk premiums.
2. **Regular Reviews:**
    - The risk-based pricing model is reviewed periodically to align with industry standards and changing market dynamics.
3. **Borrower Communication:**
    - Borrowers are informed of their risk rating and how it impacts their interest rate, ensuring transparency and fostering trust.

9. Monitoring and Compliance

LFPL has robust monitoring mechanisms to ensure compliance with this Policy:

- Internal audits to verify adherence to interest rate guidelines.
- Reporting to the Board on interest rate practices and deviations.
- Timely compliance with regulatory reporting requirements.

10. Governance and Review

The Board of Directors oversees the governance and implementation of this policy. All interest rate structures and changes are subject to Board approval.

The Board of Directors of the Company will review this Policy at least once annually or as and when required to ensure compliance with regulatory updates, market conditions and operational need. The Board of Directors will approve all modifications made to this Policy.

The updated Policy shall be communicated to all the relevant internal and external stakeholders of the Company and communicated to the borrowers and updated to the Company website.

Annexures

Schedule of Interest rate:

Product	Rate of interest
Consumer Durable	**Weighted average cost of capital(WACC) + Business Security Spread(BSS) + Credit Risk Premium(CRP)**
Payday Loans	**Weighted average cost of capital(WACC) + Business Security Spread(BSS) + Credit Risk Premium(CRP)**
Personal Loans	**Weighted average cost of capital(WACC) + Business Security Spread(BSS) + Credit Risk Premium(CRP)**
MSME Loans	**Weighted average cost of capital(WACC) + Business Security Spread(BSS) + Credit Risk Premium(CRP)**
Microfinance loans	**Weighted average cost of capital(WACC) + Business Security Spread(BSS) + Credit Risk Premium(CRP)**