



RISK MANAGEMENT POLICY

STAR HFL

CREDIT TEAM
VERSION 1.0

Risk Management Policy

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Risk Management Policy

RISK MANAGEMENT -

NEED - Risk Management is the process of assessing risk, taking steps to reduce risk to an acceptable level and maintaining that level of risk. A risk can be defined as an unplanned event with financial consequences resulting in loss or reduced earnings. Under the purview of Risk Management Aspects, company has decided to set up a "Risk MANAGEMENT committee at centrally to ensure that it understands, measures and monitors the various operational risks that arise during the home loans processes.

The role of Risk management committee in STAR is broadly categorized into Internal control function and action on suspect transactions.

In the context of STAR being an HFC, the essential components of risk management system are -

- Risk Identification i.e the naming and defining of each type of risk associated with a transaction or type of product or service;
 - Risk Measurement i.e. the estimation of the size ,probability and timing of potential loss under various scenarios;
 - Risk Control/containment-i.e. the framing of policies and guidelines that define the risk limits not only at the individual level but also for particular transaction
- Measurement of risk is a very important step in risk management process.

TYPES OF RISKS : As regards to the operations of Housing finance, there are various types of major risks i.e. market, potential, customer's segment, quality of assets, credit risk, Legal risk and technical risk etc.

1. **MARKET RISK** - As per the market study, the size of the market including affordable housing and rural housing segments, is very vast and it can support to any number of new players on a long term basis. As regards to charging high ROIs and competition perspective, the scope of business is huge in affordable housing segment and competitors are offering high ROIs.
2. **CUSTOMER'S SEGMENTATION** - Affordable housing segment carries lower income profile customers and low cost properties. Lower income group people do not always having documented income proof and thus require proper income assessment methodology. Almost in all the states local government has made compulsory to have 15-25 % EWS/LIG units in any private and government colonies. Government has also launched EWS/LIG projects though HOUSING BOARD and development authorities therefore there is huge scope of funding to lower income group customers for buying low cost properties. Similarly the rural market is also having huge potential for home loan business.

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3. **CREDIT RISK** - In our lending operations, we are principally exposed to credit risk. Credit risk is the risk of loss that may occur from the failure of any party to abide by the terms and conditions of any financial contract with us, principally the failure to make required payments on loans due to us.

We currently measure, monitor and manage credit risk for each borrower and also at the portfolio level. We have a structured and standardized credit approval process, which includes a well-established procedure of comprehensive credit appraisal. Credit Risk is the risk of non-recovery of loan or the risk of reduction in the value of asset. The credit risk also includes the pre-payment risk resulting in loss of opportunity to the bank to earn higher interest income. Credit Risk also arises due excess exposure to a single borrower, industry or a geographical area.

CREDIT RISK MITIGATION -

1. VERIFICATION OF DOCUMENTS -

- **KYC DOCUMENTS** - Address and identity proof documents (applicable to all log in files) to be checked (on line) by RCU agency/In-house team. Reports to be submitted on prescribed format.
- **INCOME DOCUMENTS** - ITR, salary certificate/slip, Form No 16 to be checked and verified by RCU agency/In-house team. Reports to be submitted on prescribed format. Applicable to all log in files.
- **BANK STATEMENT** - Bank statements of applicant to be checked by RCU agency/In-house team. Reports to be submitted on prescribed format. Applicable to all log in files.
- **SIGNATURES ON DOCUMENTS** - Signature matching and verification (loan documents, PDCS and ACHs) - Applicants Signatures should be matched (with the document taken for signature verification) on all the documents executed. Reports to be submitted on prescribed format. Applicable to all log in files.
- **MISCELLANEOUS DOCUMENTS** - Other loan related documents such as License of shop & Establishment act, Gumashata (business license of Nagar Nigam/Palika), Mutation, tax receipts, UN-registered Patta etc also needs to be checked and verified. State credit head can obtain verification reports from the RCU agency if required.

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2. CONTACT POINT VERIFICATION -

- **RESIDENCE VERIFICATION** - RCU agency/team needs to conduct Residence address verification activity to confirm applicant existence at given address. Agency person needs to gathered information (As per the prescribed format). Applicable to all log in files.
- **BUSINESS/EMPLOYMENT VERIFICATION** - RCU agency/team needs to conduct Business/employer address verification activity to confirm applicant business/employment at given address. Agency person needs to gathered information (As per the prescribed format). Applicable to all log in files.

3. REFERENCE CHECK

TVR to be conducted and findings to be captured (as per the prescribed format). Applicable to all log in files.

4. LEGAL RISK -

The uncertainty of the enforceability of the securities for recovery of debts creates legal risk. Company seeks to minimize legal risk by using stringent legal documentation, employing procedures designed to ensure that transactions are properly authorized and consulting internal and external legal advisors.

LEGAL RISK MITIGATION -

- **SEARCH OF PROPERTIES** - search has been conducted in the office of sub registrar to find out transaction of proposed property and mortgage if created. Empanelled advocates are assigned the responsibility of conducting search of proposed mortgage properties. In order to cross check the reports, state credit head can obtain the search of properties (5 % of fresh log ins files) from any other advocate who has not submitted LSR for the case.
- **TITLE INVESTIGATION** - It is necessary to scrutinize the title deeds/documents that create a security for repayment of a loan. Such scrutiny is being done by an outside expert legal professional who are on panel of the company. In order to cross check the title reports, state credit head can obtain the title reports of the properties (2-5 % of fresh log ins files and disbursed loans) from any other advocate who has not submitted LSR for the particular cases.

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- **VETTING OF TITLE DEEDS** - vetting of title documents has been done by the panel advocate before the disbursement of loans. In order to get cross-confirmation of vetting reports, state credit head can obtain the vetting reports of the properties (2% to 5% of fresh log ins) from any other advocate who has not submitted LSR & vetting reports for the particular cases.
- **LOAN DOCUMENTATION** - As the existing practice operation department has been assigned to check the loan documentations. In order to cross check the vapidity and genuineness of execution of loan documents, state credit head can hand over some cases to the RCU agency.

4. **TECHNICAL (PROPERTY) RISKS** - Since properties serve as the underlying asset on which financing is given, the amount of loan advanced depends upon the value of the collateral offered. The value of the collateral ensures that the lender is secured and has covered itself from the risk of default. Hence, correct and realistic valuation of properties or fixed assets becomes necessary at the time of advancement of loan.

5. TECHNICAL RISK MITIGATION-

- **IDENTIFICATION OF PROPERTY** - As per the existing practice company's appointed technical valuer is conducting property visit and providing TSR. In affordable housing segment due to non-availability of approved building plan and colony lay our plan some times its difficult to identify the property proposed for mortgage. In such type of cases state credit head needs to take further opinion from other technical valuer to confirm the identification.
- **VALIDITY OF CONSTRUCTION** - This parameter is being established by having availability of approved map. In case where in approved map not available, technical valuer needs to give valuation of permissible area only. In such type of cases state credit head needs to take further opinion from other technical valuer to confirm the valuation of permissible area.
- **VALUATION OF PROPERTY-** Panel technical vendor responsibility is to ensuring that exact valuation of the property to be financed is done in such a way that there would be overvaluation scenario in normal market conditions. As regards to technical aspects of mortgage, valuation of property is the most important part of lending and there are more chances of frauds in respect to the valuation. In order to get cross- confirmation of valuation of the property, state credit head can obtain the valuation reports of the properties (2-5 % of fresh log ins) from any other advocate who has not submitted TSR for the particular property.

FUNCTIONS OF RISK MANAGEMENT COMMITTEE -

LOAN REVIEW MECHANISM (LRM) - LRM is an effective tool for constantly evaluating the quality of loan book and to bring about qualitative improvements in credit administration. Thus the company is intended to put in place effective Loan Review Mechanism for large value accounts with responsibilities assigned in various areas such as, evaluating the effectiveness of loan administration, maintaining the integrity of credit grading process, assessing the loan loss provision, portfolio quality, etc. Accurate and timely credit grading is one of the basic components of an effective LRM. Credit grading involves assessment of credit quality, identification of problem loans, and assignment of risk ratings. A proper Credit Grading System should support evaluating the portfolio quality and establishing loan loss provisions. Given the importance and subjective nature of credit rating, the credit ratings awarded by Credit Administration Department should be subjected to review by Loan Review Officers who are independent of loan administration. The main objectives of LRM is :-

- to identify promptly loans which develop credit weaknesses and initiate timely corrective action;
- to evaluate portfolio quality and isolate potential problem areas;
- to provide information for determining adequacy of loan loss provision;
- to assess the adequacy of and adherence to, loan policies and procedures, and to monitor compliance with relevant laws and regulations; and
- to provide top management with information on credit administration, including credit sanction process, risk evaluation and post-sanction follow-up.

Depth of Reviews - The loan reviews process would be focus on:

- Approval process;
- Accuracy and timeliness of credit ratings assigned by loan officers;
- Adherence to internal policies and procedures, and applicable laws / regulations;
- Compliance with loan covenants;
- Post-sanction follow-up;
- Sufficiency of loan documentation;
- Portfolio quality; and
- Recommendations for improving portfolio quality

**RISK MITIGATION THROUGH LEARNING BY EXPERIENCE-
(WHERE WE MAY GO WRONG)**

Risks can come from various sources including uncertainty in financial markets, impact on earnings after demonetization, credit, legal and technical assessment failures, circumstantial and natural causes and disasters etc. Credit underwriting team needs to go through the learning experiences of industry as to avoid the risks.

CREDIT RISKS

1. HIGH EXPOSURE ON UN- DOCUMENTED INCOME SEGMENT CASES -

There is high risk of credit assessment (Loan eligibility aspects) of Un- Documented income segment cases. If assessment is wrong, it would result to give high exposure of loan amount to the customer and resulting to irregularity/ delay of repayments. While taking loan customer always code higher loan amount as he/she thinks that lender would reduce the loan amount. It has been also noted that customer wants full amount of construction estimate/purchase value and avoid to invest own contribution.

MITIGATES/SOLUTION -

- **EXISTING UNDERWRITING TEAM** - Sharpen the credit skill in respect to the income assessment of the field credit team. It can be done by regular on the job training and sharing experiences and case studies. Credit managers need to understand the key factors of various business activities.
 - **LOAN EXPOSURE** - credit team needs to assess the proper income and fix the loan exposure basis on profile of the customers if income is not documented.
 - **CROSS CHECK OF INCOME** - it is essential to get cross verification of the income assessed by any other external agencies (LIP agent or RCU).
 - **HIGHER LOAN TICKET SIZE CASES (15 LACS PLUS)** - For income assessment of higher volume we should have preliminary assessment by credit officer and secondary by any senior officials (Cluster credit head or sales head). RCU verification will be additional comfort.
- 2. HABIT TO REPAY** - (Traditionally we appraise intention to pay and repayment ability) - Repayment track record not available or if available customer not served the EMI amount of proposed home loan to be availed from us. High risk of regular repayment of EMIs.

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MITIGATE/ SOLUTION - As the tradition goes we appraise intention to repay and ability to repay but in affordable segment habit to repay is also an important factor while calculating the eligibility. While doing such cases we should keep our exposure of loan lower side. In addition to intention and repayment capacity we should now add new parameter habit of repayment.

3. **END USE OF LOAN** - In case if End Use is for investment and not for self occupying the property, there is high risk of regular repayment.

MITIGATE/ SOLUTION - We need to understand End use of the proposed property to be constructed /purchased. Credit staff needs to categorically ask to the customers for the End use and justify it while recommending the loan cases. Sanctimony authority to carefully check this aspect.

4. **PROFILE FUNDING**- For the purpose of raising the funds/liquidity, some of the mischievous builders/colonizers are using profile of customers. Sometimes seller and buyer also collaborated to raise the funds. Since the customers are not concerned with the property and if property cost is equal to loan amount borrowers do not pay EMIs.

MITIGATES/SOLUTION - END USE to be established. OCR from the bank account of the customers. LTV to be maintained.

5. **INTERNAL TRANSFERS** - This is also one of the way to raise the funds/liquidity. If transfer is not genuine and for actual need and loan amount equal to the property cost, borrower would not pay EMIs.

MITIGATES/SOLUTION - END USE to be established. OCR from the bank account of the customers. LTV to be maintained.

6. **OWN CONTRIBUTION** - if we got failed to verify and utilize OCR, High risk of repayment.

MITIGATE/SOLUTION- Credit team to understand this parameter and ensure that the customer is having OCR from his own sources. If OCR to be paid in future, it would affect to repayments. Sometimes builder is also funding OCR and it is also very dangerous so need to keep our eyes open.

7. **FINANCIAL CRUNCH (SALARIED CUSTOMER- JOB LOST)** - We are dealing in un-documented and EWS segment and thus chances of job lost are more.

MITIGATE /SOLUTION - Credit team to establish the continuity of job and alternative job scope at the same income. Experience, Qualification and skill would be the essential factor to established this parameter.

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8. **FINANCIAL CRUNCH (SELF EMPLOYED SMALL BUSINESS- LOSS IN BUSINESS OR BUSINESS CHANGED)** - Loss in business also regular phenomena.

MITIGATE/SOLUTION - Credit team to establish the vintage of business, scope and growth of business, future impact of taxes and other affects,

9. **SPECIAL OFFER BY BUILDER** - Sometimes Builders are offering payment of PEMI/EMI till possession. If project delayed we face the repayment issue.

MITIGATE/SOLUTION - Credit team to understand the deal/scheme offered by the Builder. Customer must be educated that repayment is his/her responsibility. Only reputed Builders to be entertained. Past completion of projects and reputation of builder would matter to mitigate this risk.

10. **WRONG COMMITMENTS OF BUILDERS** - Builders give wrong commitments to the customers especially for completion and specifications, resulted dispute.

MITIGATE/SOLUTION - Customer must be educated that repayment is his/her responsibility in any case whether is delay in possession or dispute. Past completion of projects and reputation of builder would matter to mitigate this risk. Before handing over our loan cheques to the builder, discuss with the customer and clear about the repayment of PEMI till completion and EMI after possession.

11. **BUILDERS RAN AWAY AND PROPERTIES ARE INCOMPLETE** - This is happening in affordable segment. Small and new builders are running away without completion of properties.

MITIGATE/SOLUTION - Credit team needs to understand the reputation and past history of the projects. LTV to be maintained at every stage of disbursement. TPA offer with selected builders only.

12. **REPAYMENT CULTURE OF AREAS** - Some pockets are treated as negative areas and disbursements in such areas may lead to default.

MITIGATE/SOLUTION - Credit team needs to collect information of such pockets and declare as negative areas.

13. **MARKET DEFAULTERS** - sometimes we cannot trace the market defaulters through CIBIL/High mark reports.

MITIGATE/SOLUTION - Credit team needs to take additional information from references and do neighbour check.

14. **GEO LIMITS** - It should be within control. If hub location is not having capacity to provide services and control repayments, situation will be out of control.

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MITIGATE/SOLUTION - Spokes location must be approved by the state head with consultation with cluster head/Credit manager. We should have RR where we are having 25 plus cases.

15. VERIFICATION OF POSSESSION OF PROPERTY BT CASES - if the customer has actually not bought the property and not in possession.

MITIGATION - credit to check the possession of the customer on already mortgaged the property with any other lender. While doing BT cases new lender generally not focuses on verifying the possession of the property.

16. VERIFICATION OF POSSESSION OF PROPERTY RESALE-PURCHASE CASES - in cases where in POA holder has sold out the property it is found that possession not handed over to the buyer as actually property not sold out.

MITIGATION - credit to check that principal/ owner of the property actually executed the POA and knowing about the sale of the property. Credit to take care that the amount of sale value to be credited in owner's bank account. If POA contains that holder can receive the payment, credit needs to get it confirmed from the property owner and obtain confirmation letter from property owner before handing over loan cheque to POA holder.

TECHNICAL APPRAISAL RISK

1. LOAN TO VALUE RATIO TO BE MAINTAINED - LTV is the most important factor and wherever LTV is burst, customer started delaying instalments or if property cost is lower than the sale value, customer will not pay and surrender the mortgaged property.

MITIGATES/SOLUTION -

- Our team should be well aware about the property rates of areas where we are doing loans.
- Technical vendor must be informed that in case of incorrect or over valuation they would be individually held the responsible and accountable to indemnify/compensate the losses.
- Cross check of property valuation by internal staff.
- There are some of the pockets/areas where government guideline of the property is more than the market value/sale value hence technical vendor needs to justify the MV of the property in such areas. Credit team must have data of such pockets.
- While assessing the property value of old readymade houses/flats (constructed more than 10 years back), MV cannot be considered in line of Government guidelines.

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- In case if proposed property is part of new colonies (under development) the MV/sale value cannot be considered in line of Government guidelines/circle rates because colonies are not fully developed.

2. **PROPERTY VALUATION** - builders/sellers are usually coding cost of the property higher side which resulted higher exposure of loan amount.

MITIGATE/SOLUTION - Property cost must be properly evaluated. It has been found that technical valuers got also failed in evaluating cost of the property. In-house team must cross verify the cost by taking feedback of nearby occupants/residents and property brokers. Credit/BM needs to validate the technical reports particularly on property valuation aspect.

3. **CONSTRUCTION STAGES FOR DISBURSEMENT**- For maintaining LTV , stage of construction is an important parameter. If stage is wrongly reported LTV will be burst.

MITIGATE/SOLUTION - Credit/BM needs to validate the construction stage reported by technical valuer.

4. **IDENTIFICATION OF PROPERTY**- This is an important assignment of technical team. If seller/builder has shown other property, customer would certainly default.

MITIGATE/SOLUTION - Our team must be trained to identify the property. Technical report to be validated.

5. **VALIDITY OF CONSTRUCTION** - If LTV has not been maintained on valid part of constructions and in case if violated parts at risk of demolition, loan case will be in default.

MITIGATE/SOLUTION - in-house team to be trained to calculate valuation of permissible built up area. External technical vendor to be also informed for this aspect.

6. **REAL ESTATE SLAG/DEMONITIZATION EFFECT ON PROPERTY COST**- In some of the state's real estate is facing drastic slag and also after GST and demonetization property cost drastically reduced as buyers are not available.

MITIGATE/SOLUTION - Distress value aspect to be kept in mind while assessing the cost of property. Resale scope of particular area also to be considered while deciding LTV.

LEGAL APPRAISAL RISK

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1. **SECURITY CREATION** - According to TP Act and SARFAESI Act, we need to create valid mortgage (EM or simple mortgage. If we are not secured creditor we cannot enforce security.

MITIGATE/SOLUTION - Legal scrutiny report must be checked with this angle and aspect. In house team should be trained on legal aspects of home loans.

2. **DEFECTIVE TITLE** - If borrower's is not having title to mortgage the property, security is defective and cannot be enforced.

MITIGATE/SOLUTION - Legal scrutiny report must be checked with this angle and aspect. In house team should be trained on legal aspects of home loans.

3. **ENCUMBRANCES ON PROPERTY/MULTIPLE MORTGAGES** - If property is already encumbered, security aspects would be badly affected.

MITIGATE/SOLUTION - Searches of property must be properly conducted. In house team should be trained on legal aspects of home loans.

4. **ENFORCEMENT OF SECURITY ASPECTS** - According to the provisions of SARFAESI and as per the processes and practices of local department of district magistrate for obtaining DM order under section 14 of SARFAESI act we should have proper documents.

MITIGATE/SOLUTION - Our loan documentation needs to include the contents and practices. In house team should be trained on legal aspects of SARFAESI.

OPERATIONAL PROCESS RISK

1. **CUSTOMER RELATIONSHIP SERVICE** - An unhappy/dissatisfied customer will delayed repayments.

MITIGATE/SOLUTION -

- OUR team needs to handle customer properly.
- We should never do any wrong commitments.
- Desired/expected services should not be delayed.
- We need to fulfil our commitments fully and timely.
- Disbursement booking should be with consent of the customers.
- We need to be transparent and fair for expenses and documentations.
- ACH/PDCS presentation should be on time and after informing the customers.
- In case if ACH/PDCs got bounced we should timely inform to the customers.
- Avoid cash collections. If collected provide receipt and make sure that the deposit entry must be on same of cash collections.

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2. **MANPOWER INTEGRITY ISSUE** - Involvement of staff for irregularities/manipulation while processing loan cases.

MITIGATES/SOLUTIONS -

- Hiring of staff from known sources/references
- Cultivation of values of the organization.
- Development of Sense of belongings and attachment.
- Clear career path and timely reorganization and rewards.
- Effective motivational plans.
- Congenial working atmosphere.
- Honest and able team leader.
- Property quality check of loan files at the stage of log-in
- Verification of residence, employment and proposed property by credit & BM.
- Property cost to be ascertained by in house team.

LOAN DOCUMENTATION & EXECUTION - our security is based on the loan documents and its proper execution.

MITIGATE/SOLUTION -

- We should have proper and complete set of Loan documents.
- Execution of loan documents as per policy.
- Ops team to train for proper and effective execution of loan documentations.
- Stamp duty must be paid fully and timely.

HOW TO MITIGATE RISK OF INCOME ASSESMENT - IT'S AN IMPORTANT PARAMETER OF CREDIT APPRAISAL.

UNDOCUMENTED INCOME ASSESSMENT WHERE BUSINESS SET UP IS PERMANENT - Income assessment carried out by BCM/SCH/BM to be re-evaluated by the recommending and sanctioning authorities- It has been observed that credit team have done mistake in assessment of income and it has effected on regular repayments of EMIs. At recommending level HO credit staff needs to perform the role of underwriter rather than compliance of procedures and policies. Basis on the information provided by the credit officer of branch and documents available on records recommending authority needs to re-evaluate the income assessment of the customers. Involvement of credit cluster Manger/Area sales head in recommending the cases mitigate the risk of assessment because they are in the field and aware about the business and income inflow.

DOCUMENTED SALARIED CASES - Cross check of banking is compulsory either by credit or FCU agency. Employment verification by personal visit is also compulsory either by credit or UM.

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CASH SALARIED CASES - Branch Credit needs to check that whether employer can pay the amount shown in the salary certificate and also salary amount must be relevant to the skill, experience and qualification of the customer. And HO credit needs to re-evaluate the amount of salary shown in the certificate basis on the experience. Involvement of cluster manager is mitigating the risk of assessment because they are in the field and aware about the business of employers and income inflow.

LOAN EXPOSURE CAP FOR TEMPORARY BUSINESS SET UP - In business class cases where business is running with temporary set up credit manager can have lower exposure of loan amount.

LOAN EXPOSURE CAP FOR CUSTOER'S PROFILE - Credit Manager can have lower exposure of loan amount basis on the profile of customer.

CHECKS AND CROSS VERIFICATION - CREDIT ASPECTS -

BUSINESS CLASS CASES -

- Verification/checking of documents (Business license, ITR and bank pass book)- Cross verification by FCU agency is compulsory for all the business class cases.
- Cross check of business activities and ownership- as to mitigate risk of misrepresentation of ownership of shop credit officer/UM need to cross check it by contacting nearby shop keepers/neighbour check.

SALARIED CASES -

- Verification/checking of documents (Salary slip/ Salary certificate and bank pass book) - Cross verification by FCU agency /UM/Credit is compulsory for all the salaried class cases.