PALMA DEVELOPMENT FINANCE PRIVATE LIMITED

INTEREST RATE POLICY

This policy was reviewed and approved by Board of Directors of Palma Development Finance Private Limited in their meeting held on 20th July 2024.

I. Introduction

The Company has some internal policies to regulate and control interest charges on microfinance loans (assets), Subordinated debts and Non-Convertible Debentures (liabilities). The Reserve Bank of India had vide its Directives/guidelines directed the NBF's to adopt an interest rate model taking into account relevant factors such as, cost of funds, margin and risk premium, etc, determine the rate of interest to be charged for loans and advances and internal principles and procedures for the same. As per the circular and applicable directives issued by RBI-

i. Though interest rates are not regulated by RBI, rates beyond a certain level may be excessive, non-sustainable and non-conforming to normal financial practice.
ii. Appropriate internal principles and procedures in determining interest rate and processing charges need to be laid out by NBFC.
iii. There should be disclosure of interest rates, changes in rates/ charges to customers/ public.
iv. Annualized rates of interest shall be used in dealing with customers.

In line with the RBI directives and in the interests of the stakeholders associated with the Company, the Company herewith sets out the major points relating to our interest rate model-

II. Resources (Liabilities)

a. Subordinated Debt

Subordinated Debt is an instrument that constitute direct unsecured and subordinated obligations of the Company, subordinate to the claims of all other creditors and also depositors of the Company, present and future, as regards repayment of principal and payment of interest by the Company from out its own funds. The Company can offer subordinated debt in accordance with the applicable norms of RBI. The Company at present offer two types of subordinated debt-

i. Subordinated debt @ 12.50% p.a., 13% p.a.
ii. Subordinated debt doubling on maturity (14.87% cumulated p.a.)

Interest shall be paid to the debt holder on monthly/ Annual rate at the option of the customer.

The Company repays the debtholder from its returns especially the income generated (interest, overdue interest by company from loans offered to customers. The Company maintains adequate asset liability combination to ensure assured returns to the debtholders. The Company management believes the Company will always have adequate cash inflows to service the debt it owes to the creditors, and subordinate debtholders.

b. Non-Convertible Debentures (NCD)

The Company may issue Secured Non-Convertible Debentures as a "security" under the Companies Act 2013 and rules framed thereunder and also RBI norms, as may be applicable from time to time, subject to necessary approvals. The Company management may decide upon such interest rates which would be serviceable out of cash inflows/ earnings of the Company.

III. Loans Offered by the Company (Assets)

RBI has not stipulated any specific requirement for NBFC MFIs for computation of lending rate Accordingly the Company proposed to compute the Benchmark Lending Rate (BLR) based on the following parameters

Maximum Interest Rate on Loans or / Ceiling on Loans:

In adherence to regulatory directives from the Reserve Bank of India (RBI) governing Non-Banking Financial Companies (NBFCs), and in alignment with management decision, the maximum interest rate chargeable shall not exceed 36% per annum during the standard loan tenure across all states and regions. Penal charges and other borrower expenses shall be exclusive of the aforementioned ceilings.

These ceilings will be subject to periodic review, conducted quarterly or more frequently as necessary, by the Board of Directors or Committee authorised to do so. Such reviews will consider regulatory guidelines, market competition, targeted net interest margins, prevailing market rates, and other relevant factors.

Within the established ceiling, the actual interest rates for Microfinance Institution (MFI) loans and other loans will be determined based on the following parameters:

1. Cost of Funds: Determine the weighted average cost of funds (WACOF), including interest paid on borrowings and other sources of funds. This can be calculated by assigning weights to each funding source based on their respective proportions in the total fund portfolio.
2. Risk Premium: Assess the credit risk associated with lending to microfinance borrowers. Segment borrowers into risk categories based on objective parameters such as credit score, repayment history, etc. Apply risk-adjusted interest rates to each risk category to compensate for default risk.
3. Operational Expenses: Factor in all direct and indirect operational expenses incurred in administering microfinance loans.
4. Monitoring and Other Costs: Include costs associated with monitoring borrower performance, compliance with regulatory requirements, and provision for loan loss reserves. Allocate these costs to each loan disbursed to ensure adequate coverage.

Processing Charges – Processing fee of 2%.

The computed rates, as outlined above, are provided in **Annexure 1**. These rates will undergo review and potential adjustments by management, with considerations presented during Pricing Committee meetings.

Revisions to the rates will be implemented prospectively from a date determined by management.

Risk-Based Interest Rates:

Interest rates may vary for different borrower categories based on factors such as customer profile, repayment history, market segment, credit risk, collateral value, and more. Rates are determined on a case-by-case basis, with each loan product priced according to the Asset Based Lending Rate (ABLR) after considering credit risk premiums, including portfolio behavior, Probability of Default (PD), Loss Given Default (LGD), and borrower credit scores.

Micro finance loans pricing:

Interest Rate Benchmarking: Given the nature of microfinance loans, pricing will be determined based on the Benchmark Lending Rate (BLR).

Rebate Consideration: Rebate options will be evaluated on a case-by-case basis during full settlement, subject to approval from the Managing Director/ Wholetime Director/ authorised Director.

Interest Servicing Due Date: Interest accrues from the disbursement date until the account is closed, with payment due starting from the disbursement date.

Overdue Interest: Any overdue amount not fully serviced incurs additional interest, not exceeding 3% per month (contracted rate plus 300 basis points), on the outstanding amount.

Competitive rate:

To remain competitive and promote our products, Palma will offer interest rates below the BLR. The Managing Director/ Wholetime Director/ authorised Director is authorized to approve rates below the BLR, considering the company's overall profitability, competitive landscape, business priorities, and risk exposure.

Change in rate:

The pricing Committee will periodically set the actual rates within the specified limits under each category and review them at least every six months. Additionally, the pricing committee is authorized to introduce any other reasonable or justifiable charges, including adjustments for changes in taxation regulations.

Pricing Committee:

The pricing committee shall hold meetings as and when required. Review of interest rates shall be taken up by the pricing committee within the overall stipulations of the Interest Rate Policy approved by the Board of Directors.

The pricing committee shall consist of the under mentioned functionaries

• Managing Director/ Wholetime Director/ authorised Director- Chairperson

• Finance Department (i/c)- Member

• Credit Department (i/c)- Member

• Other Officers appointed by Chairperson from time to time- Invitees

Other guidelines:

1. Interest rate re-setting: Sanctioning Authorities are empowered to prescribe the reset frequency for interest rates, whether quarterly, half-yearly, annually, or every 2-3 years. Interest reset clauses will be included in sanction letters and loan agreements for floating interest rates.

2. Processing Fees: Fees will either be deducted from the disbursed amount or collected in advance.

3. Appropriation of charges and interest: Remittances for loan repayment will first cover regular interest, with any remaining balance applied to principal, other charges, and overdue interest according to specified terms.

4. Internal Rate of Return (IRR): Expected IRR will be calculated based on net disbursements (loan amount minus processing charges) and EMIs over the loan tenure.

5. Penal Charges: Overdue balances will incur penal charges upon realization.

6. Advance Payments: Borrowers' advance payments won't reduce the principal for interest computation unless approved by Palma for schedule modifications.

7. Differential Interest Rates: Interest rates for the same product and tenure may vary among customers, considering factors such as credit risk, liquidity risk, and tenor.

8. Borrower Communication: Palma will communicate loan details, including amount, annualized interest rate, interest application frequency, tenure, and daily/ weekly/ monthly instalment amount, at the loan sanction stage.

9. Change in Terms: If there is any change in interest rates or charges, we will notify the borrowers, and the changes will take effect prospectively.

10. Flexible Payment Schemes: Palma offers variable and equated daily/weekly/monthly instalment schemes to borrowers. Palma provide flexibility to the borrower with regard to repayment periodicity.

IV. Complementary effect

This policy shall be read along with other policies of the Company.

V. Overriding effect

Where due to any amendment in applicable laws/regulations/rules, any clauses of this policy become inconsistent with law, then the amended law shall apply to such clauses or such portion of the policy to make the policy legally valid.

VI. Revision/Amendments

Any amendments to this policy shall be made by decision of Board of Directors on recommendation made by any committee of Board or by KMP or loan department or to bring the policy in line with any future amendment in applicable laws.

For **Palma Development Finance Private Limited**

Sd/-

Director

PALMA DEVELOPMENT FINANCE PRIVATE LIMITED

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Annexure 1

Methodology for interest calculation:

1. Cost of Funds: Determine the weighted average cost of funds (WACOF), including interest paid on borrowings, and other sources of funds. This can be calculated by assigning weights to each funding source based on their respective proportions in the total fund portfolio.

2. Risk Premium: Assess the credit risk associated with lending to microfinance borrowers. Segment borrowers into risk categories based on objective parameters such as credit score, repayment history, etc. Apply risk-adjusted interest rates to each risk category to compensate for default risk.

3. Operational Expenses: Factor in all direct and indirect operational expenses incurred in administering microfinance loans.

4. Monitoring and Other Costs: Include costs associated with monitoring borrower performance, compliance with regulatory requirements, and provision for loan loss reserves. Allocate these costs to each loan disbursed to ensure adequate coverage.

Calculation:

1. Cost of Funds:

Weighted average cost of funds (WACOF)= (Cost of Funds1 * Weight1) + (Cost of Funds2 * Weight2)

Since there is only equity capital as fund, cost of equity has been taken into consideration as cost of fund.

Cost of equity= Risk Free Rate + β * (Market Risk Premium)

The rate of return on a risk-free investment represented by the yield on 5-year government bond for the month March, 2024, is taken as 7%. Since the shares of the company are unlisted β is taken as 1. Market Risk Premium has been calculated based on an expected return on market portfolio as 16%.

Cost of equity= 7+1(16-7) = 16%

Hence the Cost of Funds is 16%

2. Risk Premium:

Normally, Company is giving unsecured loan to the customers and hence the risk factor is very high. Considering this Risk Premium is revised and calculated at 8% or 10.5% on case-to-case basis. However, customers having proven good credit relationship with the Company and other factors may be given reduced risk premium based on the decision of Wholetime Director/

Director in charge as special cases I&II. In that case Risk Premium will be 6.5% & 8% respectively.

3. Operational Expenses:

After evaluating various operational factors, it has been determined that an 8% charge will be included in the interest rate to cover operational expenses.

4. Monitoring and Other Costs:

Upon thorough evaluation of monitoring and other associated costs, it has been decided to include a fixed charge of 1.5% within the interest rate framework. This measure aims to adequately address the expenses associated with monitoring and other operational requirements, ensuring efficient operations.

Range of spread of each component:

1. Cost of Fund: 13.5% -16%

2. Risk Premium: 6.5%- 10.5%

3. Operational Expenses: 6%-8%

4. Monitoring and other costs: 1%-1.5%

Therefore, the proposed interest rate is as follows-

Interest Rate = Cost of Funds + Risk Premium + Operational Expenses + Monitoring and Other Costs

Interest rate for normal cases I:	16% + 8% + 8% + 1.5% = **33.5%**
II:	16% + 10.5% + 8% + 1.5% = **36%**
Interest rate for special cases I:	16% + 6.5% + 8% + 1.5% = **32%**
II:	16% + 8% + 8% + 1.5% = **33.5%**

Minimum, Maximum and Average range of interest rate:

Minimum interest rate: 32%

Maximum interest rate: 36%

Average interest rate: 33.83%

Sd/-

Chairperson
Pricing Committee